Final Report: Strategic Review - Outcome of the Consultation Process and Proposed Next Steps

2010 Pensions Working Group

14th March 2012

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Abbreviations

AWG	Ageing Working Group
CA	Children's Allowance
COLA	Cost of Living Adjustment
DSS	Department for Social Security
EC	European Commission
EPC	Economic Policy Committee
EPD	Economic Policy Department
ETC	Employment and Training Corporation
EU	European Union
FES	Foundation for Educational Services
GNMP	Guaranteed National Minimum Pension
GPD	Gross Domestic Product
HLE	Health Life Expectancy
IRD	Inland Revenue Department
KNPD	National Council for Persons with Disability
KSU	Kunsill Studenti Universitarji
IMF	International Monetary Fund
LE	Life Expectancy
MCESD	Malta Council for Economic and Social Development
MEDE	Ministry of Education, Youth and Employment
MFEI	Ministry of Finance, the Economy and Investment
MFSA	Malta Financial Services Authority
MHEC	Ministry of Health, the Elderly and Community Care
MITA	Malta Information Technology Agency
MJDF	Ministry for Justice, Dialogue and the Family
MPI	Maximum Pensionable Income
MS	Member States
NEST	National Employment Savings Trust
NDC	Notional Defined Contribution
NSO	National Statistics Office
ONS	Office for National Statistics, UK
OECD	Organisation for Economic Cooperation and Development
PAYG	Pay-As-You-Go
PSU	Pensions Strategy Unit
PWG 2004	The 2004 Pensions Working Group which was responsible for the White Paper titled 'Pensions: Adequate and Sustainable' dated November 2004
PWG 2010	The 2010 Pension Working Group which is responsible for the Report titled 'Strategic Review on Adequacy, Sustainability and Social Solidarity of the Pensions System' dated December 2010
RPA	Retirement Pensions Act
RPI	Retail Price Index
SABS	ICT System for the Administration of Social Benefits

SFA	Special Funds (Regulations) Act, 2002
SILC	Survey on Income and Living Conditions
SSA	Social Security Act
TFP	Total Factor Productivity
UK	United Kingdom
US	United States
WHO	World Health Organisation

Glossary

Term	As Applied in this Report
Anomaly	A consequence or impact which deviates from the standard or expected behaviour and is an irregularity which may be difficult to explain using existing rules of the pension system.
Average Pension Replacement Rate	The value of the average pension relative to the national average wage. .
Annuity	A financial services product purchased by means of a single premium or periodic payment to provide a regular income for a specified number of years or for a remaining lifetime.
Contribution	A payment made to a pension plan by a plan sponsor or member for the purpose of providing a pension to the contributor. The term is used with regards to a First, Second or Third Pension respectively.
Default Fund	The default fund option is a combination of the pension fund and risk management mechanism that a person chooses to invest in or is automatically enrolled in the event that he or she does not indicate an investment choice for whatever reason. A person selects a default fund when he or she is not ready or willing to be engaged in financial decisions. Decisions are, therefore, taken for them about their risk profile on the basis of an appropriate conservative balance between risk and return for the likely membership profile and a charging structure that reflects this balance.
Defined Benefit PAYG Pension	Refers to the Two-Thirds pension system in Malta which provides on earnings based guaranteed pension income value that is based on two-thirds of a maximum pensionable income ceiling.
Life Cycle Investment Principles	Life cycle investment principles are an approach to investment that automatically switches a member's investments from riskier to safer assets as retirement approaches. Life cycle funds start to migrate investments a number of years before retirement from 'growth' assets such as equities, which should provide long-term growth but include an element of short-term risk, to safer investments such as government bonds and cash, which offer more short-term security.
Mandatory Second Pension	A defined contribution funded pension that can be grafted onto a First Pension or established as a separate pension mechanism where-in employers and employees are mandated to contribute a % of salary or earnings. In the context of this report an 'automatic' enrolment pension with a voluntary opt out or a pension scheme which the law mandates an employer to set up but where the employee's membership is on a voluntary basis is considered to be a mandatory Second Pension. A Second Pension that is voluntary to both an employer and an employee for the purpose of this report is not defined to be a Second Pension but to be a pension instrument under a Third Pension framework.
Notional Defined Contribution PAYG Pension	A Pay-As-You-Go pension system that aims to mimic the structure of a defined contribution system while maintaining fiscal stability by

	using an internally consistent rate of return rather than a market based rate of return.
Pay As You Go (PAYG) Pension	A pension system, such as that of Malta, where the pension received by a pensioner today is paid through the contributions made by a worker and employer in the labour market today. A PAYG scheme is an unfunded pension scheme, meaning that the scheme accepts responsibility to provide retirement benefits to participants but does not set aside money today to meet future obligations.
Third Pension	Is a savings instrument which is long term and 'locks' the savings made by the said person until he or she retires – where-in only a small part of the savings can be taken as a lump sum upon maturity with the remaining large part of the income to be received as a monthly annuity or a programmed annual / monthly drop down income or any other form of income withdrawal as established by the regulatory framework.

Following the tabling at the House of Representatives on 14th December 2010 of the document titled 'Strategic Review on the Adequacy, Sustainability and Social Solidarity of the Pensions Systems' the then Minister for Education, Employment and the Family launched on 15th March 2011 the official consultation process at the Malta Council for Social and Economic Development (MCSED).

During the consultation process, the 2010 Pensions Working Group (PWG 2010) carried out an extensive and embracing national discussion process which included:

Formal meetings with constituted bodies and stakeholders
Formal meetings with individual persons
Participation in TV and radio programmes
Presentation of lectures and workshops.

The document titled 'Synthesis of the Formal Consultation Feedback: Strategic Review – Outcome of the Consultation Process and Proposed Next Steps' which is presented in this report provides a synthesis of the salient aspects presented in the formal feedback received from each constituted bodies and other stakeholders who participated in the consultation process. Copies of the full reports submitted to the PWG 2010 can be viewed online or downloaded from the Pensions Reform website (https://secure2.gov.mt/socialpolicy/SocProt/social_benefits/pensions_reform/strat_rev_pensions.aspx).

It is to be noted, that unlike the consultation sessions held when the White Paper titled 'Pensions: Adequate and Sustainable' was issued in November 2004, the debate that took place either through the media or through the holding of public seminars et al, on the pensions issue generally and on the findings and recommendations of the Strategic Review specifically, was significantly muted.

The reasons of why the report and the proposed recommendations failed to trigger a broad and comprehensive national consultation can be various – current foreign affairs that had a direct impact on Malta, the continued global and European financial and economic turmoil, as well the fact that to persons who are young and / or still active in the labour market behavioural issues such as inertia, myopia, habits et al influence the way persons look towards future personal matters vis-a-vis on going day-to-day concerns.

It is the view of the PWG 2010 that the feedback received during the consultation process shows a convergence of opinion on the need for continued reform as well as on the majority of key principles proposed in the Strategic Review such as the need to complement the PAYG Pension (alternatively referred to as the First Pension in this report) by a complementary pension mechanism. Concerns, however, were raised by a host of stakeholders with regards to:

(a) That no measure should be adopted in the near and immediate future, given the uncertainties arising from the continued economic and financial turmoil, that either increases the cost of competitivity on industry or enterprise; or decreases a person's standard of living by deferring income (and hence consumption) into savings for future consumption for when the person retires.

(b) Any further reforms to the pension system cannot be designed outside of the current realities of today's social and economic challenges.

The participation of youths in the consultation process – particularly those between the age of 18 years to 28 years who would primarily be affected by the implementation (or otherwise) of the recommendations proposed in the Strategic Review was marked by its absence. Whilst this is consistent with behavioural economics given that concerns relating to pensions and retirement are distant in the minds of the young, the fact remains that as *the cohort* that has a strong stake in shaping the pensions policy debate that undoubtedly plays a major influence on its future, they abdicated the policy design process to other vocal and vociferous stakeholders.

The PWG 2010 expresses its concern that the quasi complete absence of youths from the pensions consultation process – other than through a limited number of sessions held with the Kunsill Studenti Universitarji (KSU) and attempts by the Parliamentary Secretary for Youth to muster organised fora – is clear evidence of the absence of a national structured and sustained platform that seeks to inculcate financial literacy within Malta's polity (not necessarily restricted to youths): the absence of which results in a person's poor preparation with regards to knowledge in personal finance generally and pensions and retirement specifically.

The following presents, in the opinion of the PWG 2010, the key critique arising from the consultation process:

Theme	Feedback
Mechanistic Approach to Macro-economic Assumptions	The report is criticised because it limited its model to only one macro-economic framework of assumptions. Additionally, it is argued that the macro-economic assumptions – which were based on the Aging Working Group (AWG) assumptions – portrayed a negative outlook of Malta's economic growth, labour participation, women participation, et al – which, it is stated, not surprisingly deflate the performance of the Pay As You Go (PAYG) pension system given that these are all important determinants with regards to its adequacy and sustainability. The point was emphasised by a number of constituted bodies and the Partit Laburista that the sustainability of the pension system lies in economic growth: where-in economic growth depends on the country's competiveness as well as the increase of the value of output of its human resource capital. Whilst the PWG 2010 believes that it was correct in modelling future behaviour of the pension system on the AWG macro-economic assumption framework for reasons it articulated in the Strategic Review report and explains in further detail in Chapter 02 of this report, it notes and accepts the critique that the undertaking of different scenario models that look at the performance of the PAYG under different economic growth scenarios would have helped the ensuing debate during the consultation process.
A First Pension with a Funded Component	There was agreement amongst a broad range of constituted bodies and stakeholders that the reform of the pensions system should not evolve in a separate First Pension and mandatory Second Pension but in a First Pension that is complemented with a funded pension component that is grafted onto it. Various variants were proposed with regards to how a First Pension with a funded pension component should be designed: - The Investment Principles of the funded pension component will be set and managed by Government, Employers and Employees whilst the actual investment of the funded pension component is managed by the financial services market within the established Investment Principles; - That the contribution from the First Pension and its funded component should be ring fenced in an ad hoc pension fund; - That the funded aspect of the First Pension should be separated from the contribution of the traditional PAYG First Pension and ring fenced, etc.

	One other variant proposed with regards to a First Pension with a funded pension component was a reformed pension system that would be designed on the basis of a Notional Defined Contribution (NDC) pension system with a funded pension component grafted onto it.
At Risk-of-Poverty	The Strategic Review report was criticised as it made light reference to the at risk-of-poverty and that it applied a universal Average Pension Replacement Rate (APRR) rather than a stratified one that allows for a far more realistic assessment of how persons outside of the APRR would be exposed to poverty. A further critique presented was that the issue of at-risk–of-poverty should also be studied from a gender perspective to determine the implications of a woman's lower retirement age, the inter-relationship between benefits, saved income and the longevity of a woman who on current longevity rates outlives her husband or spouse and the arising at-risk-of-poverty in old age. Additionally, it was stated that the Strategic Review should have been complemented by the following studies: - Determination of what constitutes 'adequate' and the establishment of such a yardstick as the minimum acceptable income to be received by a person (and studied on the basis of gender) in retirement. - Analysis of non-contributory benefits provided by the State to different cohorts of pensioners to determine how such non-contributory benefits complement the pension income. - Determination of pensionable income received by different types of pensioners and not a single APRR – which should subsequently be correlated to at-risk-of-poverty and modelling simulated accordingly.
Linking Retirement Age to Longevity	The response to this recommendation was mixed. The position presented by those who rejected this recommendation was that whilst the official retirement age should not be extended, there should be an aggressive stance to policy design and implementation directed to render it attractive to the extent possible for people to continue in employment beyond their respective official retirement age. Particular incentives proposed during the consultation process include a more flexible pension system that would result in a higher pension value to a person who 'draws down' the pension later than the official retirement age; a more attractive tax rate; the introduction of job sharing work practices; etc.
Mandatory Second Pension	Where constituted bodies and stakeholders opted for a mandatory Second Pension outside of a reform that grafts a First Pension with a funded pension component, a number of critiques or conditions were presented - which included: - The Strategic Review did not, unlike the Final Report presented by the PWG 2004 in June 2005, present details on the constitutional framework of a mandatory Secondary Pension that would allow for the identification of potential impacts on the cost of labour to business. - In determining contributions to be paid into a mandatory Second

	Pension a holistic approach with regards to the determination of the contribution rates to be invested in a mandatory Second Pension is taken that takes into account other social policy measures such as free health, the COLA adjustment mechanism, and non contributory benefits such as the energy benefit. - A mandatory Second Pension needs to be designed in a manner that, on the one hand, does not create shocks to industry and enterprise through the increase of the cost of ownership and the reduction in competitivity, and, on the other hand, reducing the quality of life of a person today through mandating onerous conditions for such a person to save today for his or her future retirement. - It was expressed that Malta lost a unique opportunity between 2004 and 2007 to introduce a mandatory Second Pension. The timing of the implementation of a mandatory Second Pension is seen as a sensitive and critical issue. The general reaction is that unless there is stability in the global economy generally and in Europe specifically, the decision to implement a mandatory Second Pension should be suspended as this would create uncertainty that would prove detrimental to local industry and enterprise. - There was general agreement that the concept of a default fund and a more stringent investment guideline framework than that applicable to private pensions under the International Organisation of Pension Supervisors (IOPS) good practices as well as current EU Directives should be applied with regards to a mandatory Second Pension given that this pension instrument, unlike a Third Pension, is effectively an extension of the social security pension system. - A series of issues relating to taxation matters were raised in this regard.
Third Pension	There is unanimous agreement that a Third Pension should be one major outcome of the Strategic Review. Indeed, the general response is that a Third Pension should precede a First Pension (with a partial pension funding component or a mandatory Second Pension) as this will allow Malta to accrue knowledge with regards to a regulatory framework for private pensions, design of pension funds for the local market; uptake and response to a Third Pension, etc. In support of this, there was agreement that a Third Pension should be designed in a manner that would allow for this to be seamlessly converted into a mandatory Second Pension should such a mechanism be introduced in the future. Constituted bodies and stakeholders expressed their disappointment that despite that the Government had issued the Final Report of the 2004 PWG in June of 2005, Malta has yet to introduce a Third Pension - and that the enactment of the Retirement Pensions Act (RPA) in August 2011 is a welcomed development. There also was general agreement that the Government should complement the introduction of a Third Pension with a tax incentive framework that should be designed on the basis of Exempt on contributions paid into the pension fund; Exempt on maturity of the pension fund; and Taxable on pensionable income paid monthly from the said pension fund (EET). Additionally, there was general agreement that the Government should

introduce a fiscal instrument to incentivise persons who have today invested in financial services products to lock a considerable part of the resulting surrender value of such products on their maturity into a Third Pension.

Financial service providers expressed concern with regards to the introduction of a Third Pension that is annuity based stating that Malta is far too small for the design and maintenance of such a complex financial services product. The concern was stated that should there be an insistence for Third Pension based annuity products, the likely outcome of such a condition would be that the costs of administration to develop and launch such a product would be so high that they would fritter away the return on investment from the said product.

A number of stakeholders rejected the proposal with regards to the introduction of a Child Pension Account instrument where parents would be provided with the choice to **voluntary** lock part of the Children Allowance (CA) into such an instrument. It was argued that the introduction of such a third pillar instrument would result in social stigmatisation amongst those families who would not be in a position to enrol their child in such an instrument.

The reaction to the introduction of a home equity release as a third pillar instrument was mixed and primarily negative. Reasons put forward of why such an instrument is not applicable to Malta were diverse:

- local culture where parents want to ensure that their children inherit the parents' property;

- that such a scheme would create social stigmatisation as not all owned property would be attractive to investors;

- the risk of concentrating property ownership in a small number of investors;

- potentially encouraging further investment in housing stock when the generally held view is that there is far too much investment in the property market already;

- the danger of home owners getting caught in a negative housing equity trap.

Gender

Whilst it was recognised that the Strategic Review was more gender sensitive than previous reports it still was believed that the recommendations presented in the said report did not go far enough in this regard.

A number of issues were raised. Although the PWG 2010 in the Strategic Review sought to correct a policy measure introduced in the 2007 reforms that rendered it far harder for a female worker to obtain a full pension given that the contributory period was increased from 30 to 40 years, the fact that increased child credits are now linked to fertility still render the contributory history that needs to be achieved sufficiently high. The recommendations presented, therefore, fail to take into account the difficulties that a woman faces to carry out an ‘uninterrupted’ work career.

Furthermore, although new work design such as job sharing, reduced hours, part time work etc, allow a woman to return in the labour market

	particularly if they are raising a family, such employment results in a reduced pension entitlement to a woman (the gender cohort that primarily carries out such atypical employment) due to lower contributions paid as a result of the lower income earned. It is argued that the minimum contributions limit for a woman to qualify for a pension should be reviewed as this creates a barrier that, primarily, prevents a woman to obtain a pension that reflects her contributory history given that she may have made the choice of exiting the labour market after 10 years in order to raise a family - and, therefore, fail to qualify for a pension entitlement. The recommendation to replace the 5/6 pension entitlement to a woman successor by a full pension was well received. Be that as it may, it was argued that this measure did not go far enough and that a woman who would have worked and accrued her pension due to her direct activity in the labour market should continue to receive her full pension as well as the pension of her husband in the event of the death of the latter. It was emphasised that the current state of play not only discriminates against a woman who would have actively participated in the labour market but disincentives a woman to enter the labour market at the first instance. It is argued that this is the case given that, under current pension rules and given Malta's traditional work orientation where the male continues to be perceived as the family's sole bread winner, the pensionable income of the male spouse or partner is higher than that of the female spouse or partner. The pensionable income, therefore, selected by the surviving female spouse or partner on the death of the male partner would be that of the male - which means that a woman would have to forgo the pension which she would have directly contributed to.
Disability	The issue with regards to the minimum contribution requirement was also raised with regards persons with disabilities. Whilst representative bodies of persons with disabilities want such persons to be actively participating in the labour market it was emphasised that the expectation that the majority of persons with certain disabilities would live to reach the minimum contribution requirement was not realistic.
Family	There was general consensus that the Government should commit itself in earnest to introduce pro-family measures not only to protect the role of the family in Malta's society but also to foster and incentivise a higher fertility rate. Additionally, the Strategic Review was perceived to have fallen short in failing to discuss the issue of pensions and separation of families and cohabitation.
Active Participation	There was general consensus that the low active participation rate is, in fact, an opportunity with regards to pension reform and a solution to the challenges faced by the pension system. The argument was presented by many a constituted body as well as the Partit Laburista that the sustainability of the First Pension can be considerably improved through a focused strategy directed towards increasing the active participation rate. Different recommendations were presented with regards to increasing employment with particular regards to women and elderly persons who would have reached their official retirement age.

	Additionally, it was underlined that Malta must ensure that all activity in this regard is synchronised with the outcomes and goals established for the EU 2020 strategy.
Immigration	Where reactions were presented there was general consensus that Malta's immigration policy should change to one that is linked to address skills gaps subject to the conditions that (i) such a measure should complement efforts directed to build indigenous human capital; and (ii) Maltese persons are not discriminated in their own country.
Financial Literacy	There was general consensus on the importance of financial literacy and on the need to set up a vehicle to inculcate, on a sustained basis, such a culture within Malta's polity.

02.1 Background

The pension projections presented in the Strategic Report reflect the modelling of pension experts from the World Bank. The World Bank visited Malta during the summer of 2010 and during that time discussions were held with the Department of Social Security (DSS), Economic Policy Department (EPD), Inland Revenue Division (IRD) and the Malta Information Technology Agency (MITA) with a view to deepen the understand of the pension system in Malta and features of the data.

Detailed discussions also took place with the PWG 2010 regarding the assumptions to be adopted for the baseline model. It is to be noted that the World Bank experts, adopted on the advice of the PWG 2010, the demographic and macro-economic assumptions of the Economic Policy Committee (EPC) AWG that served as the basis for the projections for Malta, as outlined in the Ageing Report 2009.[1]

The AWG[2] was set up in 1999 by the EPC with the purpose of preparing age-related expenditure projections. The first AWG common budgetary projections were prepared in 2001. Malta submitted the first set of budgetary projections in 2006, following the European Union (EU) accession in 2004. At the moment the AWG is working on the Ageing Report 2012, to be published later on in 2012, following adoption by the ECOFIN Council.

As an overview, the starting point for the exercise was the population projection EUROPOP2008, produced by Eurostat. Using this projection, 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. Projections of the Gross Domestic Product (GDP) were calculated combining these assumptions. The assumptions included in the report were made by the EPC-AWG by applying common methodologies uniformly to all EU Member States (MS). The projections were made sequentially whereby the approaches and assumptions used were the following:

- A convergence approach for the demographic projection.

- An assumption of unchanged structural unemployment rates combined with an assumed reduction to the EU15 average for those MS with initially high structural unemployment rates.

- A production function approach for the potential GDP projection.

- An assumption of a constant real interest rate.

The long-term projections that result from this exercise provide an indication of the timing and scale of economic changes that would result from an ageing population in a **'no-policy change'** scenario: that is, **reflecting only enacted legislation but not possible future policy change**. Consequently, the GDP assumptions adopted were more cautious than those adopted by the PWG in 2004 \ 05. This part of the post consultation report provides an analysis of the GDP and labour force participation projections and the methodology adopted by the EPC-AWG for these two important macro-economic indicators.

[1]For a detailed overview refer to www.ec.europa.eu/economy_finance/publications/publication13782_en.pdf
[2] Since its establishment over a decade ago, the AWG, whose principal output is the tri-annual Ageing Report has established itself as an authority in the area of pension projections in Europe and its work is considered as an important input in the research on pensions by leading institutions. The 2009 Ageing Report has served as an input in the *Pensions at a Glance* publication by the Organisation for Economic Co-operation and Development (OECD), research by the Fiscal Affairs Department of the International Monetary Fund, Standard and Poor's *Global Aging Report* and the *Pensions Sustainability Index* by Allianz Global Investors. In addition, the AWG benefits from the participation of researchers from the European Central Bank and has collaborated with the OECD and the IMF in developing the methodology underpinning the projections.

02.2 Conceptual Implications of Aging for Potential GDP Growth

According to the European Commission (EC) (2005)[3], ageing populations have both a direct and an indirect impact on the economy. The direct impact of an ageing population occurs on GDP growth and GDP per capita through (i) the labour force; (ii) the quality of labour; (iii) capital intensity; and (iv) total factor productivity (TFP) and innovation. On the other hand, the indirect impact arises as a consequence of the budgetary impact of ageing.

02.2.1 Ageing and the Labour Force

Ageing populations and the simultaneous decline in fertility rates are expected to adversely affect the supply of labour and its quality. The pessimistic view of the impact of demographic decline on economic growth can be traced back, at least, as far as Keynes. Keynes stressed, as far back as the 1930s, that falling fertility would harm the economy because of its adverse impact on the number of consumers available to support demand.

Ageing not only leads to an increase of the average age of the population, but also leads to a decline in the size of the working-age population as older generations are replaced by less numerous younger cohorts. As a result, it has an adverse impact on potential labour inputs. The effects of decline in the size of the working age population may be partly offset, at least for some time, by rising female participation rates resulting from a cohort effect. This increased working age population consequently saves for retirement, thus providing resources for further investment and leading to a boost to the economy. Changing cultural attitudes and social norms with respect to gender roles, therefore, may have a substantial influence on female employment and the overall size of the labour force.

Additionally, ageing might stimulate migration, which would increase labour supply and stimulate growth provided that the skills of the migrants broadly match the economic needs of the host country. According to Carone[4] European countries already rely on migrants to fill shortages for certain skilled and unskilled tasks, for example in the health sector. Therefore, as argued by Carone, immigration could be viewed as a positive factor in the labour market adjustment. It has also been argued that migration could sustain the financial sustainability of PAYG pension schemes.

For these benefits, however, to materialise fully, migrants must be employed in the formal economy and thus contributing to the tax and social security systems. In addition, pension schemes should also be broadly in actuarial balance given that otherwise migrants' contributions would be insufficient to cover their future pension entitlement, thus potentially leading to the funding of unsustainable pension systems.

Furthermore, the projected change in the age structure of the workforce could alter the composition of consumption and domestic demand, which might imply re-allocations between sectors, thus requiring a rise in job mobility.[5] It is, however, widely recognised that job mobility amongst older workers is an uncommon notion. In fact, it is to be noted that younger workers tend to change jobs and employers relatively frequently, while older workers tend to have stable relationships with their employers. Consequently, average rates of voluntary separations from jobs decline with age, while average tenure increases.

Dixon[6] stresses that a higher share of older workers in the workforce means that exit rates will fall and average tenure will increase, under *ceteris paribus* conditions. A contributing factor to the likely reasons for age differences in voluntary separations from jobs is that many employers, particularly in larger firms, operate remuneration systems that reward tenure or seniority as a means to fostering the development and retention of firm-specific skills and to reduce turnover costs.

Once workers have remained with an employer for a sufficient time to gain the benefits of tenure or seniority-based pay systems, they face higher costs of leaving. Additionally, older workers are more likely to have found a good job match, and also that job changes may require geographical mobility,

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[3] http://ec.europa.eu/economy_finance/publications/publication562_en.pdf
[4] Carone G. (2005), Long-term Labour Force Projections for the 25 EU Member States, A set of data for assessing the economic impact of ageing", European Commission Economic paper No. 235, November
[5] Borsch-Supan A. (2003), Labour Market Effects of Population Ageing, Labour, Vol. 17, Special issue
[6] Dixon S, (2003), Implications of Population Ageing for the Labour Market, Labour Market Trends

which is costly, and older workers have a shorter time span in which to recoup those costs through higher earnings or other job-related benefits. These factors contribute to lower job mobility among older workers and are likely to persist in future.[7]

Dixon[8], further adds that such decline in voluntary job mobility is likely to have both positive and negative consequences. Turnover costs to employers, including recruitment and initial training costs, would be reduced. This would have a favourable impact on overhead labour costs and profitability. Meanwhile, the labour market, as a whole, might become less flexible. Adjustments to changes in technology and changes in product markets require the movement of workers across firms and between geographical regions. Labour market mobility facilitates adjustment to technical change or shifts in labour demand.

Flowing from the fact that older workers are less mobile, however, a decline in voluntary attrition rates could force some employers to make greater use of redundancy to adjust the size of their workforces. As older workers come to make up a large share of the labour force, they may be forced to bear a larger share of the impact and costs of the redundancy.[9] Consequently, in the occurrence of such job loss, older workers may be at a greater risk of long-term unemployment. If re-employed, they will tend to experience significantly larger reductions in their average earnings than younger aged workers.

Although there are other factors that also influence the cost of job loss, the positive relationship between age, tenure and the magnitude of the earnings losses that are associated with displacement seems likely to persist in the future, with the result that older workers will continue to be harder hit by job losses.[10]

Additionally, it is important to highlight that that there is a downward trend characterising the activity rates of older men. The frequency of early retirement and early withdrawal from the labour force is highly dependent upon the improvements in pre-retirement savings levels and by the growth of occupational pension schemes that allow members to draw pensions before the State Pension Age. While increased longevity causes workers to wish to work longer, rising income causes them to wish to retire earlier. Both gains in life expectancy and gains in income per capita were impressive in the past decades.

This explains the tendency for earlier withdrawal from the labour force. Additionally, this tendency has been accentuated by the expansion of public and private old-age pension arrangements. Accordingly, Dixon[11] argues that reforms to occupational pension schemes and other social security programmes designed to reduce the opportunities and incentives for early retirement, are likely to prolong individuals' effective working lives and lead to higher participation rates in the future.

In sum, the phenomenon of ageing populations is expected to lead to a decline in the labour supply and to an overall older labour supply. The theoretical analysis, however, highlights that this impact is expected to be partly mitigated by higher activity rates of females and older workers and also in part by migration.

02.2.2 Ageing and the Quality of Labour

A priori, one expects that if an individual's productivity declines with age, then a rising share of older workers in the labour force would reduce overall labour productivity even though age-specific productivity remains constant over time. According to EC (2005), however, whether productivity is affected by age is a complex issue, since the identification of the age effect is blurred by cohort and selection effects.

According to Hellerstein et al [12] an additional measurement problem comes from the fact that the age-profile of productivity is calculated on the basis of hourly earnings, and there may be a divergence

[7] Groot, W., and Verberne M., (1997), Ageing, Job Mobility and Compensation, Oxford Economic Papers, 49, pp 380-403
[8] Dixon S, (2003), Implications of Population Ageing for the Labour Market, Labour Market Trends
[9] OECD (2004), Education at a Glance, OECD Indicators, Paris
[10] Dixon S, (2003), Implications of Population Ageing for the Labour Market, Labour Market Trends
[11] Ibid
[12] Hellerstein, J. K., David N. and K. R. Troske (1999), Wages, Productivity and Worker Characteristics: Evidence from Plant Level Production Function and Wage Equations, Journal of Labor Economics, No. 17, pp. 409-446

between wages and productivity in the older age brackets due to the payment of seniority wages. Dixon[13] argues that there is a positive relationship over the life-cycle between age and earnings. Employers' wage costs will tend to be pushed up by labour force ageing if current earnings differentials by age are maintained. The impact on unit labour costs will depend on whether average productivity rises in line with age. An older workforce may be more productive, given that older workers tend to have more years of prior work experience.

According to the EC (2005) a possible cause of these age-related productivity declines is the reduction in cognitive abilities over a person's life span. Some abilities, such as perception speed, show relatively large decreases from a young age, while others such as verbal abilities, show only small changes throughout a person's working life. Additionally, according to the EC (2005) the quality of labour will be affected by the rising level of education of the labour force resulting from a cohort effect, whereby younger cohorts are more educated than the older cohorts that are approaching retirement, with a particular emphasis for women.

The EC (2005), however, argues that while the average human capital should increase over time, this effect should flatten out when the low-education cohorts are completely replaced in the labour market by relatively more-educated cohorts.

Overall, the impact of ageing on productivity is uncertain, although the effect is suspected to be negative. The impact of ageing on the quality of labour is a complex issue and there may be a divergence between wages and productivity in the older age brackets due to the payment of senior wages. Additionally, the quality of labour input will also be affected by rising educational attainment levels.

02.2.3 Ageing and Capital Intensity

The EC (2005) argues that ageing has three principal effects on capital intensity: (i) the increasing marginal product of capital; (ii) the decline in the savings rate; and (iii) the international allocation of capital.

The EC (2005) adds that the decline in the labour resource will raise wages, leading to a substitution of capital for labour. The capital / labour ratio will rise and so will the level of labour productivity and GDP per capita. A second channel through which an ageing population can affect capital intensity is via saving behaviour. The life-cycle hypothesis of private saving behaviour, based on the seminal research by Ando and Modigliani (1963), assumes that individuals consume a constant percentage of the present value of their life income, so that the average propensity to consume is higher in young and old households, whose members are either borrowing against future income or drawing on accumulated savings, while prime-age people tend to have higher incomes with a lower propensity to consume and a higher propensity to save.

According to the modern life-cycle approach, the elderly also tend to save as a precautionary measure in the light of uncertainty about their life expectancy (EC, 2005). In other words, they are likely to consume less (and bequeath more, albeit involuntarily) than they might otherwise like because they worry about outliving their resources. Thus, one should not assume that population ageing will automatically lead to a large and progressive decline in total private savings: it is not clear how the share of income which the elderly save will evolve and what impact this will have on aggregate private saving in the context of an ageing society.

In considering the savings channel, it is important to look at aggregate savings, both public and private. Public savings are a matter of policy choice, but there is strong evidence that ageing populations will lead to increased pressure for additional public spending on pensions, health care and long-term care: if not offset by an increase in the tax burden or cuts in non-age-related expenditure, this would increase the risk of large underlying budget deficits emerging in future decades. The EC (2005) highlights several studies which argue that national savings, both government and private, will decline. A study by Rosevaere et al. (1996) estimated that (under the hypothesis of a partial Ricardian equivalence effect) an increase in the old-age dependency ratio in OECD countries of 20% in the next 30 years will reduce private savings by 6%.

[13] Dixon S, (2003), Implications of Population Ageing for the Labour Market, Labour Market Trends

Empirical evidence on the relationship between the dependency ratio and the saving ratio is very mixed, depending heavily upon the estimation method and type of data used. While micro-economic studies based on household data suggest that demographics have no effect on private saving patterns, most studies using either time-series or cross-sectional aggregate data conclude that changes in the old-age dependency ratio have a greater impact on the saving ratio than those in the youth dependency ratio, though there is no consensus on the scale of the effect.

Ageing is also expected to affect capital intensity through the international allocation of capital. International mobility of capital combined with financial integration will help achieve a better allocation of savings to investment-needs worldwide. McMorrow and Roger[14] by using a general equilibrium model, which is an international generational overlapping model, find that the decline in the labour force will lead to lesser investment needs, as the capital stock should broadly follow the development in GDP. The consequence is worldwide excess savings, despite the ageing-related decline in the saving rate. This would result in a fall in worldwide interest rates, entailing an increase in investment and higher capital intensity in the world. Savings and investment will be equalised worldwide through the movement in world interest rates.

The EC (2005) argues that overall, ageing should have a small positive impact on capital intensity, albeit only a temporary one. The EC further argues that while the theoretical relationship between the dependency ratio and the saving ratio is clear according to the life-cycle hypothesis, the overlapping generations models reach different conclusions. Miles[15] using simulations with an overlapping generations model, suggests that the positive effect of capital deepening on economic growth (due to a higher marginal return of capital and despite declining savings rate), will be fairly marginal compared with the projected drop in labour supply. Accordingly, an exogenous rise in total factor productivity would then be needed to compensate for the loss in output resulting from a fall in the working-age population.

02.2.4 Ageing and Total Factor Productivity

According to Barrel[16] in addition to lower 'labour quality', an ageing population could hamper innovation and weigh down TFP growth in the medium and long run. TFP is a variable which accounts for effects in total output not caused by inputs. Thus, growth in TFP represents output growth not accounted for by the growth in inputs. Barth et al[17] also show that despite their greater dedication at work, longer experience and better skills, older workers are considered by a panel of employers to be less flexible in accepting new assignments and less receptive to training, which may hamper innovation and the full exploitation of technical progress.

Skirbekk[18] argues that the knowledge and skills held by people in the workforce influence productivity levels and provide a basis for innovation and productivity improvements. An increasingly mature labour force will have higher average levels of work experience, whereby this level of experience could have positive effects on productivity. Workforce skills, however, also depend on the stock of the knowledge that is acquired before entry to the labour market, or in the early stages of individuals' careers.

Thus, as the average age of the participants in the workforce rises, there is a risk that the stock of skills that were achieved from the original education and training, will become outdated, leading to negative effects on innovation and productivity. Nonetheless, shifts in the age structure imply that the labour market becomes more reliant on mature and older workers in order to meet new and emerging skill needs.[19]

[14] Mc Morrow K. and W. Röger (2003), Economic and Financial Market Consequences of Ageing Populations, European Commission Economic paper No. 182, April
[15] Miles D. (1999), Modelling the Impact of Demographic Change upon the Economy, Economic Journal, Royal Economic Society, Vol. 109(452), pp.1-36
[16] Barrell R. (2005), "Productivity and Ageing", Presentation to the Ageing Working Group of the European Policy Committee of the European Union, Brussels, 19th September 2005
[17] Barth M.C., McNaught W. and P. Rizzi (1993), Corporations and the Ageing Workforce", John Wiley and Sons
[18] Skirbekk V. (2003), Age and Individual Productivity: A Literature Survey, MPIDR Working Paper WP 2003-028, August
[19] OECD (2001), Investment in Human Capital through Post-Compulsory Education and Training, OECD Economic Outlook 2001

Moreover, older workers face higher opportunity costs when they undertake education that requires time away from work, because the earnings they must forgo are higher. The shorter remaining length of the working life for older workers also reduces the period in which they can gain benefits in the form of higher wages or improved job opportunities and from having the additional qualifications. Accordingly, Dixon argues that given poor returns to investments in off-job education and training undertaken at older ages, on-the-job training and short courses are likely to become increasingly important means for maintaining and updating the skills of an older workforce.

02.3 Modelling of Projections in the Strategic Review Report

02.3.1 Methodology of Labour Force and GDP Projections

As stated above, pension projections are modelled on the basis of **the assumption of a no policy change scenario**. According to Bloom et al in discussing the economic growth implications of population ageing one needs also to take into consideration the behavioural effects associated with changes in the age structure of the population.

As an illustration, increased life-expectancy can change life-cycle behavior leading to a longer working life, higher savings and more investment in human capital. In particular, the policy environment plays a crucial role in determining the effect of ageing on economic growth. New policies will be needed if countries are to take account of those incentives that individuals face in order to enable them to adjust their behavior in responses to population ageing.

Such policies include more flexible old-age pension arrangements combined with increases in official retirement age (including efforts to combat age discrimination), life-long learning programmes, investment in health improvements, policies combating gender discrimination, and increased support for childcare to increase labour force participation more generally.[20]

Another important element is the role of immigration, in particular making the political case for immigration whilst making it more palatable for groups in society that might lose out. Ageing may also affect growth through the increase in taxation required to fund public pensions based on PAYG as well as health and long-term care. In this respect, pension policies aimed at reducing old age dependency could include adjusting premiums and benefits as well as a transition to a fully-funded or a system of private accounts.[21] Bloom et al conclude that if today's policy makers take prompt action to prepare for the effects of ageing, this development will cause less hardship than most anticipate.

Labour force projections are based on the cohort component methodology. The methodology follows a dynamic approach and takes into account implicitly that women belonging to any given cohort have their own specific level of participation, which is usually higher at all ages than the corresponding level of older generations. This participation gap between subsequent cohorts not only reflects socio-cultural factors, but also individual characteristics such as the number of children and level of education.

Thus, compared with a standard projection based on the invariance of activity rates, the cohort-based projection contains an autonomous increase of female participation – referred to as a 'cohort effect' – corresponding to the gradual replacement of currently older women, with relatively low participation rates, by younger women who have a much stronger attachment to the labour force. In the long-run, this effect leads to a homogenous female population with the same individual characteristics as women who entered the labour force in 2007. With regards to men there is a negative 'cohort effect' for men because their participation rates have tended to decrease across generations in a large majority of countries, contrary to what is observed for women.

The rationale for choosing a cohort-component methodology is to reflect the substantial changes in the labour market situation amongst different age and gender groups over the past years and

[20] Bloom, Canning and Fink (2011), Implications of Population Aging for Economic Growth http://www.hsph.harvard.edu/pgda/WorkingPapers/2011/PGDA_WP_64.pdf
[21] ibid

decades. In recent years, labour force participation has undergone substantial changes, especially for the young, women and the elderly.

As highlighted in the 2009 Ageing Report (European Economy, 2009) a variety of factors underlies these changes, in particular the following:

- Social factors, such as longer schooling or change in the role of women in households.

- Demographic factors, including the decline of fertility rates and modifications of the age structure.

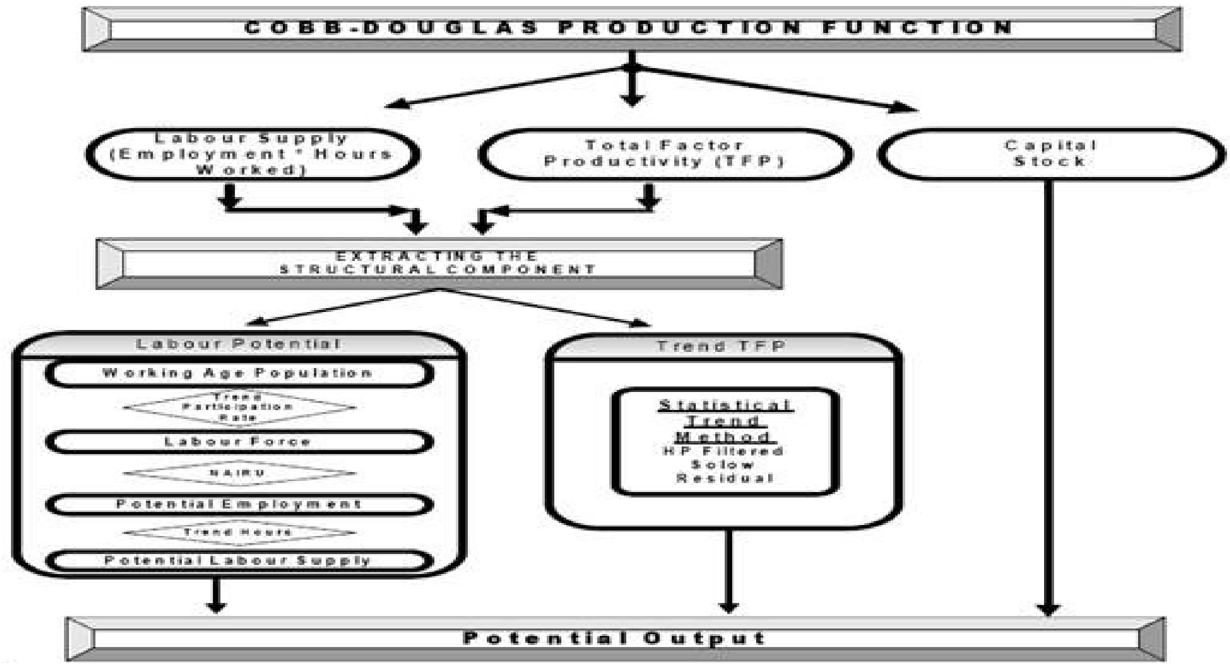
- Institutional factors, in particular early retirement schemes or changes in the age of retirement.

- Economic factors, such as the rate of unemployment, the average household income, the share of part-time employment or the share of the services sector in the economy.

Meanwhile, the production function approach has been used in the projections of output growth. It was also agreed to adopt total hours worked as labour input. By using a standard specification of the Cobb-Douglas production with constant returns to scale, potential GDP can be expressed formally as total output represented by a combination of factor inputs multiplied with TFP, which drives the technological level.

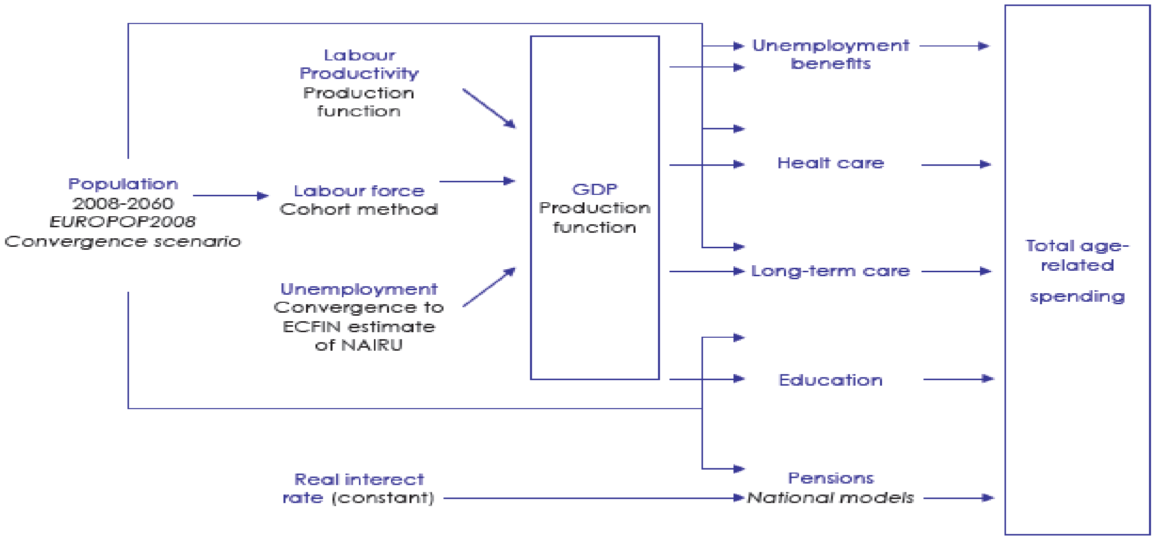
Thus, the projection of TFP growth and the growth in capital per hour worked (capital deepening), are the key drivers of projected labour productivity over the medium run.

Figure 01: Measuring Potential Output Using a Production Function Approach



In the long-run, according to the neo-classical growth model (Solow model), the economy should reach its equilibrium, the steady state or balanced growth path, where the ratio of capital stock to labour remains constant over time. As a result, the capital stock per hour worked grows at the same pace as labour augmenting technical progress. The methodology is illustrated in Figures 01 and 02 respectively.

Figure 02: **Overview of the 2009 Projection of Age Related Expenditure**



02.3.2 Projected GDP Growth Rates

According to the projections by the EPC-AWG, the annual average GDP growth rate for Malta is projected to decline from 2.6% in the period 2007 - 2011 to 2.5% in the period 2011 - 2030, to 1.2% between 2031 and 2050 and to 0.9% in the period 2051 - 2060.

These developments reflect changes in the sources of economic growth that are projected to alter significantly. Employment will make a positive contribution to growth up to 2030, but will turn significantly negative thereafter, while over time, labour productivity will be the dominant source of growth.

These developments reflect the acute ageing process that is expected to affect Malta's population over the period up to 2060. In fact as illustrated in Table 1, Malta's Old Age Dependency Ratio is projected to reach 59% by 2060, 6 p.p. higher than the average rate for the EU.

Table 01: **Old Age Dependency Ratio (Population 65+ as a % of Population 15 - 64 years)[22]**

Country	Ch. 07-60	2007	2010	2015	2020	2025	2030	2035	2040	2045	2050	2055	2060
BE	20	26	26	28	31	34	38	40	42	43	44	45	46
BG	39	25	25	28	31	34	36	39	44	50	55	61	64
CZ	41	20	22	26	31	34	36	38	43	50	55	59	61
DK	19	23	25	29	32	34	38	41	43	43	41	41	43
DE	29	30	31	32	35	40	46	53	55	55	56	58	59
EE	30	25	25	27	29	32	34	36	39	42	47	54	56
IE	27	16	17	18	20	22	25	27	31	35	40	43	44
EL	29	28	28	31	33	35	38	43	48	53	57	58	57
ES	35	24	24	26	27	30	34	40	46	54	59	60	59
FR	20	25	26	29	33	36	39	42	44	44	45	45	45
IT	29	30	31	34	35	38	42	48	54	58	59	59	59
CY	27	18	18	20	22	25	27	29	31	33	38	41	44
LV	40	25	25	26	28	31	35	37	41	45	51	60	64
LT	43	23	23	24	26	30	35	39	43	46	51	59	66
LU	18	21	21	22	24	27	31	34	36	37	38	38	39
HU	34	23	24	26	30	33	34	36	40	47	51	54	58
MT	40	19	21	27	31	36	39	40	42	45	50	54	59
NL	26	21	23	27	31	35	40	45	47	46	46	46	47
AT	26	25	26	27	29	33	38	43	46	47	48	49	51
PL	50	19	19	22	27	33	36	38	41	47	56	63	69
PT	29	26	27	29	31	33	37	40	45	49	53	54	55
RO	44	21	21	23	26	29	30	35	41	48	54	63	65
SI	40	23	24	26	31	36	41	45	49	55	59	62	62
SK	52	16	17	19	24	28	32	35	40	48	55	63	68
FI	25	25	26	32	37	41	44	46	45	46	47	48	49
SE	20	26	28	32	34	35	37	40	41	41	42	44	47
UK	18	24	25	27	29	30	33	36	37	37	38	40	42
NO	22	22	23	26	28	31	34	38	40	41	41	42	44
EU27	28	25	26	28	31	34	38	42	45	48	50	52	53
EA16	27	27	28	30	32	36	40	45	48	51	53	54	54
EU15	25	26	27	30	32	35	39	43	46	48	50	51	51
EU12	44	21	21	23	28	32	34	37	41	48	54	61	65
EU25	28	25	26	29	31	34	38	42	46	48	50	52	53
EA12	27	27	28	30	33	36	40	45	49	51	53	54	54
EU10	45	20	21	23	28	32	35	38	41	47	54	60	65

[22] pg 280, Aging Report: Economic and Budgetary Projections for the EU-27 Member States (2008-2060), European Economy, 2/2009, Directorate General for Economic and Financial Affairs, European Commission

The outcome of the projections for potential growth rates up to 2060 for the EU MS is shown in Table 02. The annual average potential GDP growth rate in the EU is projected to decline sharply, from 2.4% in the period 2007 - 2020, to 1.7% in the period 2021-30 and then being reduced to 1.3% in the period 2041 - 2060.

Over the whole period 2007 - 2060, output growth rates in the Euro Zone are very close to those in the EU 27, as the former represents more than 2/3 of the EU 27 total output. It is also to be noted that as highlighted by the EC, these figures reflect projections on a pre-financial crisis baseline and therefore might be slightly optimistic.

Table 02: Project Potential Growth Rates (Annual Average Growth Rates)[23]

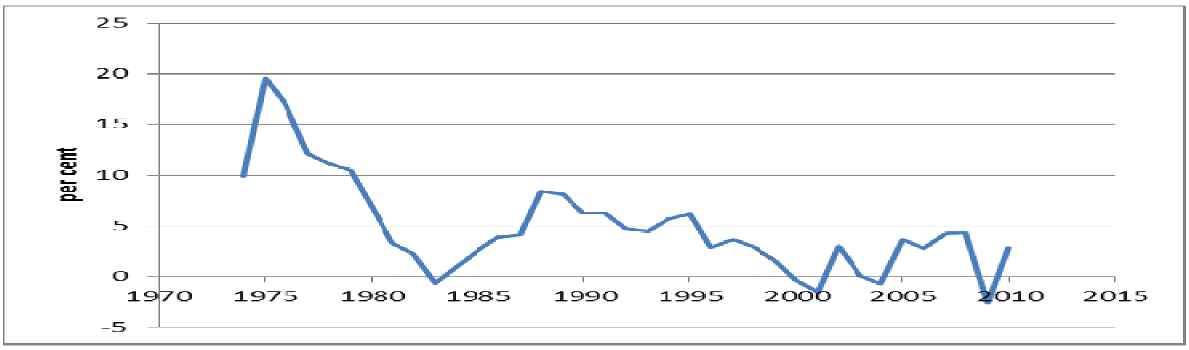
	2007-2020	2021-2030	2031-2040	2041-2050	2051-2060	2007-2060
EU27	2.4	1.7	1.4	1.3	1.3	1.7
BE	2.3	1.6	1.7	1.7	1.7	1.8
BG	4.4	2.0	1.5	0.7	0.6	1.9
CZ	4.0	1.7	1.1	0.8	0.9	1.8
DK	1.8	1.7	1.7	1.9	1.7	1.7
DE	1.7	1.0	1.0	1.1	1.0	1.2
EE	5.0	2.3	1.4	0.7	0.9	2.1
IE	3.8	2.6	2.1	1.6	1.8	2.4
EL	3.1	1.8	1.1	1.1	1.3	1.8
ES	3.1	2.4	1.3	0.9	1.4	1.9
FR	2.0	1.8	1.8	1.8	1.8	1.8
IT	1.6	1.6	1.1	1.2	1.4	1.4
CY	3.7	3.2	2.6	2.0	1.8	2.8
LV	5.0	1.9	1.0	0.2	0.5	1.8
LT	5.0	1.8	0.9	0.4	0.3	1.8
LU	4.2	2.3	2.2	2.2	2.0	2.7
HU	2.9	2.1	1.5	0.9	0.9	1.7
MT	2.6	2.1	1.4	1.0	0.9	1.7
NL	1.9	1.3	1.4	1.5	1.4	1.5
AT	2.1	1.6	1.6	1.5	1.5	1.7
PL	4.3	2.3	1.0	0.3	0.4	1.7
PT	1.8	2.1	2.2	1.5	1.3	1.8
RO	4.9	2.1	1.6	0.6	0.4	2.0
SI	3.7	1.4	0.8	0.7	1.0	1.6
SK	5.3	2.3	0.9	0.3	0.4	2.0
FI	2.6	1.5	1.6	1.5	1.4	1.7
SE	2.5	1.8	1.8	1.8	1.6	1.9
UK	2.4	2.0	2.1	2.1	1.8	2.1
NO	2.6	1.8	1.8	1.9	1.8	2.0

02.3.3 Trend Developments in GDP Growth and Labour Market Activity

Figure 03 below shows the real GDP growth rate for Malta during 1974 - 2010.[24] As shown in this figure, there is a declining trend in the overall rate of real GDP growth during this period. This is consistent with the experience of a country that is advancing in its developmental path. GDP growth averaged around 6% over the period 1986 - 1990, slowed slightly to 5.3% during the period 1991 - 1995 and to 3.2% over the period 1996 - 2000. Focusing on the past ten years, GDP growth rate over the period 2001 - 2010 stood, on average, around 1.6%.

This mainly reflects the sluggish performance over the period 2001 - 2005 with an average growth rate of 0.9%, in reflection of cyclical developments and adjustment associated with economic modernisation in view of Malta's entry in the EU. On the other hand, GDP growth was stronger over the period 2006 - 2010 and stood, on average, at 2.3%.

Figure 03: Real GDP Growth Rate[25]



23 Ageing Report 2009 pg.165 http://ec.europa.eu/economy_finance/publications/publication14992_en.pdf

24 Figures prior to 2001 reflect SNA methodology.

25 NSO

Thus, although Malta’s GDP growth performance over the past decade was slightly better than the EU average which stood at 1.4%, it certainly compares less favourably with the performance of some of the other MS that acceded the EU in 2004 and, later as can be noted from Figure 04 below.

Figure 04: **Average GDP Growth 2001 - 2010[26]**

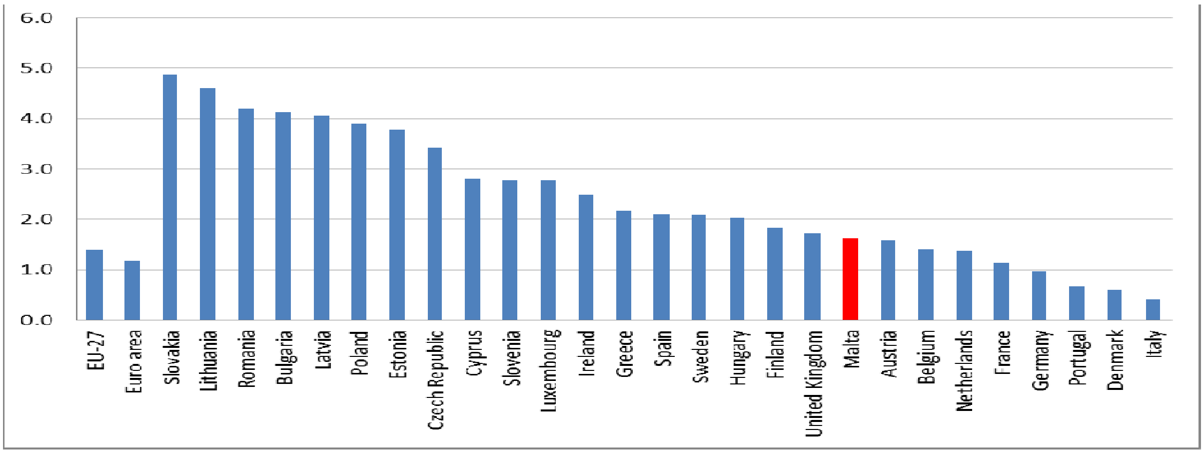


Table 03 below shows the activity rates (15 - 64 years) for the EU MS. During the period, the total activity rate for Malta increased by 2.2 p.p. to 60.3%, while the overall activity rate for the EU stood at 71.0% in 2010, up to 2.4 p.p. over 2001.

Table 03: **Activity Rates: 15 - 64 years (%)[27]**

Country	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
EU-27	68.6	68.6	68.9	69.3	69.7	70.2	70.4	70.8	70.9	71.0
Belgium	64.2	64.8	64.9	65.9	66.7	66.5	67.1	67.1	66.9	67.7
Bulgaria	62.5	61.9	60.9	61.8	62.1	64.5	66.3	67.8	67.2	66.5
Czech Republic	70.8	70.6	70.2	70.0	70.4	70.3	69.9	69.7	70.1	70.2
Denmark	79.9	79.6	79.5	80.1	79.8	80.6	80.2	80.7	80.7	79.5
Germany	71.5	71.7	72.1	72.6	73.8	74.9	75.6	75.9	76.3	76.6
Estonia	70.0	69.3	70.1	70.0	70.1	72.4	72.9	74.0	74.0	73.8
Ireland	68.6	68.6	68.8	69.5	70.8	71.9	72.5	72.0	70.2	69.5
Greece	63.3	64.2	65.2	66.5	66.8	67.0	67.0	67.1	67.8	68.2
Spain	64.7	66.2	67.6	68.7	69.7	70.8	71.6	72.6	73.0	73.4
France	68.7	69.1	69.9	70.0	69.9	69.8	69.9	70.0	70.5	70.5
Italy	60.6	61.1	61.5	62.7	62.5	62.7	62.5	63.0	62.4	62.2
Cyprus	70.6	71.2	72.4	72.6	72.4	73.0	73.9	73.6	74.0	74.4
Latvia	67.7	68.8	69.2	69.7	69.6	71.3	72.8	74.4	73.9	73.2
Lithuania	69.7	69.6	69.9	69.1	68.4	67.4	67.9	68.4	69.8	70.5
Luxembourg	64.4	65.2	64.6	65.8	66.6	66.7	66.9	66.8	68.7	68.2
Hungary	59.6	59.7	60.6	60.5	61.3	62.0	61.9	61.5	61.6	62.4
Malta	58.1	58.5	58.6	58.2	58.1	57.6	58.4	58.9	59.1	60.3
Netherlands	75.8	76.5	76.5	76.6	76.9	77.4	78.5	79.3	79.7	78.2
Austria	71.0	71.6	72.0	71.3	72.4	73.7	74.7	75.0	75.3	75.1
Poland	65.5	64.6	63.9	64.0	64.4	63.4	63.2	63.8	64.7	65.6
Portugal	72.1	72.7	72.9	73.0	73.4	73.9	74.1	74.2	73.7	74.0
Romania	67.3	63.4	62.2	63.0	62.3	63.6	63.0	62.9	63.1	63.6
Slovenia	68.1	67.8	67.1	69.8	70.7	70.9	71.3	71.8	71.8	71.5
Slovakia	70.4	69.9	70.0	69.7	68.9	68.6	68.3	68.8	68.4	68.7
Finland	75.0	74.9	74.5	74.2	74.7	75.2	75.6	76.0	75.0	74.5
Sweden	77.9	77.6	77.3	77.2	78.7	78.8	79.1	79.3	78.9	79.5
United Kingdom	75.3	75.3	75.3	75.3	75.4	75.7	75.5	75.8	75.7	75.5
Iceland	:	:	86.2	84.9	86.0	87.1	87.1	86.2	84.6	84.7
Norway	80.0	79.9	78.7	78.4	78.3	78.0	78.8	80.0	78.9	78.1
Switzerland	81.2	81.3	81.3	81.0	80.9	81.2	81.6	82.3	82.5	82.4
Croatia	:	62.9	62.4	63.7	63.3	62.8	63.4	63.2	62.4	61.5

As shown in Table 04, these developments were underpinned by an increase in the female activity rate, which increased by 6.5 p.p. to 42.3% in 2010; which, in turn, was countered by a drop in the male activity rate of 2.6 p.p. to 77.7%.

Table 04: **Activity Rates (%): 15 - 64 years[28]**

[26] Eurostat
[27] Eurostat

	Total	Males	Females
2000	58.2	80.3	35.8
2001	58.9	82.1	35.6
2002	59.1	80.7	37.4
2003	59.1	80.8	37.1
2004	57.6	80.7	34.5
2005	58.1	79.1	36.9
2006	57.6	78.1	36.5
2007	58.4	77.6	38.6
2008	58.9	76.9	40.2
2009	59.1	76.7	40.8
2010	60.3	77.7	42.3

02.4 Sensitivity Analysis on Base-line Pensions Projections Presented in the Strategic Report

One of the critiques directed towards the PWG 2010 with regards to the Strategic Review report, as mentioned in Chapter 01, was that it did not carry out, apart from the base line model adopted in the Report, sensitivity analysis that simulates the behaviour of the pension system under different behaviour assumptions with regards to the key drivers that affect the performance of the pension system.

Table 05: Sensitivity Analysis on the following Pension Drivers with regards to Base-line Model Assumptions

Active Participation Rate
Elderly Active Participation Rate
Female Active Participation
Labour Productivity Rate.

The PWG 2010, in the preparation of this report, has carried out modelling and further analysis as discussed hereunder.

02.4.1 Securing an Adequacy Level that is 55% of the Average Pension Replacement Rate

The modelling carried out by the PWG 2010 in the Strategic Review was based on the reforms carried out, the latest data available at the time, and as discussed in this Chapter, the macro-economic assumptions as established by the AWG.

The modelling projected an APRR of 45%[29] with a budget deficit of (5.8%) of the pension system balance to GDP. The PWG 2010 identified that the projected APRR for persons who will draw their pension in 2060 was lower by, approximately, 10% when compared to the APRR of current pensioners: which was projected to stand at 54.7% as at 2010[30].

The PWG 2010 proposed that the minimum APRR threshold that should be set for the First Pension should be 50% - though ideally this should not be less than 55% - an APRR that, as a minimum, renders parity to that enjoyed by current pensioners today.[31]

[28] Eurostat
[29] Pg 67, Strategic Review on the Adequacy, Sustainability and Social Solidarity of the Pension Systems, 2010 Pensions Working Group, Final Report, December 2010
[30] Pg 51, Ibid
[31] Pg 67, Ibid

Modelling carried out by the PWG 2010 projects that for persons in 2060 to receive a 55% APRR that is equivalent to that enjoyed by current pensioners today, the projected pension system balance deficit to GDP of (5.8%) would worsen by a further (2.4%) - always relative to the 2060 baseline.

02.4.2 Sensitivity Analysis of Pension System Drivers

The Table below presents the impact of different shocks on public pension expenditure as a percentage of GDP, the pension system PAYG system balance, and the APRR under each sensitivity scenario.

Table 06: Financial Impact of Sensitivity Scenarios

	Change in % points Relative to Base-line					
	2010	**2020**	**2030**	**2040**	**2050**	**2060**
PAYG System Balances (as a % of GDP)						
Higher 1% Employment Rate	0.0%	0.1%	0.1%	0.1%	0.1%	0.1%
Higher 5% Older Employment Rate	0.0%	0.2%	0.1%	0.1%	0.1%	0.1%
Higher Labour Productivity	0.0%	0.1%	0.1%	0.2%	0.2%	0.3%
PAYG Expenditure (as a % of GDP)						
Higher 1% Employment Rate	0.0%	-0.1%	-01.%	-0.1%	-0.1%	0.0%
Higher 5% Older Employment Rate	0.0%	-0.1%	-0.1%	-0.1%	-0.1%	-0.1%
Higher Labour Productivity	0.0%	-0.1%	-0.2%	-0.2%	-0.3%	-0.5%
PAYG Revenue (as a % of GDP)						
Higher 1% Employment Rate	0.0%	0.1%	0.0%	0.0%	0.0%	0.0%
Higher 5% Older Employment Rate	0.0%	0.1%	0.0%	0.0%	0.0%	0.0%
Higher Labour Productivity	0.0%	0.0%	0.0%	-0.1%	-0.1%	-0.2%

The Sensitivity Analysis tests and the interpretation of the results are discussed hereunder:

Higher Employment	The sensitivity test of a 1% **higher employment rate** than under the baseline scenario is achieved by introducing this increase linearly over the period 2010 - 2020 and remains 1 p.p. higher thereafter. The higher employment rate is assumed to be achieved by lowering the rate of structural unemployment (the NAIRU). Meanwhile, the 5% increase in the **older employment rate** (55 - 64 year) is introduced linearly over the period 2010 - 2020 and remains 5 p.p. higher than the baseline scenario thereafter. The higher employment rate of this group of workers is assumed to be achieved through a reduction of the inactive population. The scenarios modelling 'higher employment rate' (+1%) and 'higher employment rate of older workers' (+5%) result in marginal decreases in pension expenditure of around 0.1 percentage points over the long-term, while the revenue ratio is unaffected. Consequently this gives rise to an improvement in the PAYG balance (as a % of GDP) by 0.1 p.p. by 2060. This result is the net effect of higher pension expenditure in line with the increase in the number of contributors and higher GDP, with the increase in the latter resulting in a marginal decline relative to the baseline case.

Higher Labour Productivity	Under this Sensitivity Analysis model, **labour productivity growth** is assumed to converge to a productivity growth rate that is 0.25 p.p. higher than under the baseline scenario. This increase is introduced linearly during the period 2010 - 2020 and remains 0.25 p.p. above the baseline scenario thereafter. Under this scenario, PAYG expenditure is projected to be 0.5 p.p. of GDP lower than under the baseline scenario by 2060, while the revenue ratio is also projected to decline by 0.2 p.p of GDP by the end of the projection period. Consequently, the PAYG balance is expected to improve by 0.3 p.p. of GDP in 2060 over the baseline scenario. This result reflects the fact that higher labour productivity results in a higher outlay on pensions and higher revenue in reflection of the partial indexation of benefit formula parameters to wages but also higher GDP with the latter effect outweighing the former.

The Table below shows the developments in the APRR for the Sensitivity tests modelled.

Table 07: Sensitivity Analysis Results: Changes in % Points Relative to Base-line

	Change in % points Relative to Base-line						
	2009	**2010**	**2020**	**2030**	**2040**	**2050**	**2060**
Higher 1% Employment Rate	0.0%	0.0%	0.0%	-0.1%	-0.1	-0.1%	-0.2%
Higher 5% Older Employment Rate	0.0%	0.0%	-0.1%	-0.1%	-0.2	-0.2%	-0.2%
Higher Labour Productivity	0.0%	0.0%	-0.5%	-1.0%	-1.2	-1.4%	-1.6%

The scenarios modelling 'higher employment rate' (+1%) and 'higher employment rate of older workers' (+5%) result in a marginal decline in the APRR by 2060, leaving the APRR practically unchanged relative to the baseline.

Meanwhile, under the higher labour productivity scenario, the APRR declines by 1.6 p.p. relative to baseline by 2060. This reflects the fact that pensions are only partially indexed to wages, thus stronger wage growth under the higher labour productivity results in a relatively slower rate of growth in average pensions relative to pensions.

02.4.3 Sensitivity Analysis of Assumption that Malta Meets Sweden's Female Active Labour Participation Rate

As explained earlier, the baseline model has adopted the assumptions of the AWG which are based on rigorous modelling of developments in potential GDP over the long term. This scenario simulates the effect of strong increases in the female labour force participation rate - brought about by future reforms and changes in society – on the pension system in Malta. This scenario is **optimistic** – given that it assumes that over the projection period, Malta's age-specific employment rates for females will catch up with Sweden's, which is one of the top performers in the EU.

As shown in the Table below, the current employment rates in Malta demonstrate an element of gender stratification in terms of participation. In fact, while the employment rate for males aged 15 - 64 is the highest in the EU at 72.4%, the employment rate for females, in the same age bracket, is the lowest at 39.3%.

As regards, older workers (55 - 64 years), the same patterns are noted with the employment rate for females being the lowest in the EU at 13%. This is indicative of the potential for catching up in both female employment rate and also in the employment rate of older workers.

Table 08: **Employment Rates in Europe**[32]

	Total		Males		Females	
	15-64	55-64	15-64	55-64	15-64	55-64
GEO/TIME	2010	2010	2010	2010	2010	2010
European Union (27 countries)	64.1	46.3	70.1	54.6	58.2	38.6
Euro area (17 countries)	64.1	45.8	70.4	53.8	57.9	38.1
Belgium	62.0	37.3	67.4	45.6	56.5	29.2
Bulgaria	59.7	43.5	63.0	50.3	56.4	37.7
Czech Republic	65.0	46.5	73.5	58.4	56.3	35.5
Denmark	73.4	57.6	75.8	62.7	71.1	52.5
Germany	71.1	57.7	76.0	65.0	66.1	50.5
Estonia	61.0	53.8	61.5	52.2	60.6	54.9
Ireland	60.0	50.0	63.9	58.1	56.0	42.0
Greece	59.6	42.3	70.9	56.5	48.1	28.9
Spain	58.6	43.6	64.7	54.7	52.3	33.2
France	63.8	39.7	68.1	42.1	59.7	37.4
Italy	56.9	36.6	67.7	47.6	46.1	26.2
Cyprus	69.7	56.8	76.6	71.2	63.0	43.0
Latvia	59.3	48.2	59.2	47.6	59.4	48.7
Lithuania	57.8	48.6	56.8	52.3	58.7	45.8
Luxembourg	65.2	39.6	73.1	47.7	57.2	31.3
Hungary	55.4	34.4	60.4	39.6	50.6	30.1
Malta	**56.1**	**30.2**	**72.4**	**47.9**	**39.3**	**13.0**
Netherlands	74.7	53.7	80.0	64.5	69.3	42.8
Austria	71.7	42.4	77.1	51.6	66.4	33.7
Poland	59.3	34.0	65.6	45.3	53.0	24.2
Portugal	65.6	49.2	70.1	55.7	61.1	43.5
Romania	58.8	41.1	65.7	50.3	52.0	33.0
Slovenia	66.2	35.0	69.6	45.5	62.6	24.5
Slovakia	58.8	40.5	65.2	54.0	52.3	28.7
Finland	68.1	56.2	69.4	55.6	66.9	56.9
Sweden	72.7	70.5	75.1	74.2	70.3	66.7
United Kingdom	69.5	57.1	74.5	65.0	64.6	49.5

An analysis of current trends in employment rate in Malta by age and sex shows that there is an increasing trend amongst females while the opposite is the case for males.

This scenario retains the employment rate projections for males of the AWG unchanged, but models strong increases in female employment rate. In particular, it is assumed that the employment rate for the various age groups would increase in line with the current trends up to the 2010 level of the employment rate in Sweden. In cases where, on account of current trends, convergence was projected to take place after 2060, it was decided to impose convergence by 2060 to the 2010 levels of the respective employment rates in Sweden.

The AWG framework was, subsequently, used to estimate the impact of the higher employment on potential GDP, keeping labour productivity growth and hours worked per employee unchanged. The results are illustrated in Table 09.

After adopting the 2010 age-specific employment rates for Sweden, the employment rate for the female 15 - 64 age group in Malta is projected to reach 72.5% by 2060. In light of the increases in employment (both males but mostly females), potential GDP is projected to increase by 0.4 p.p. on average per annum to 2.1% over the period 2007 - 2010.

[32] Eurostat

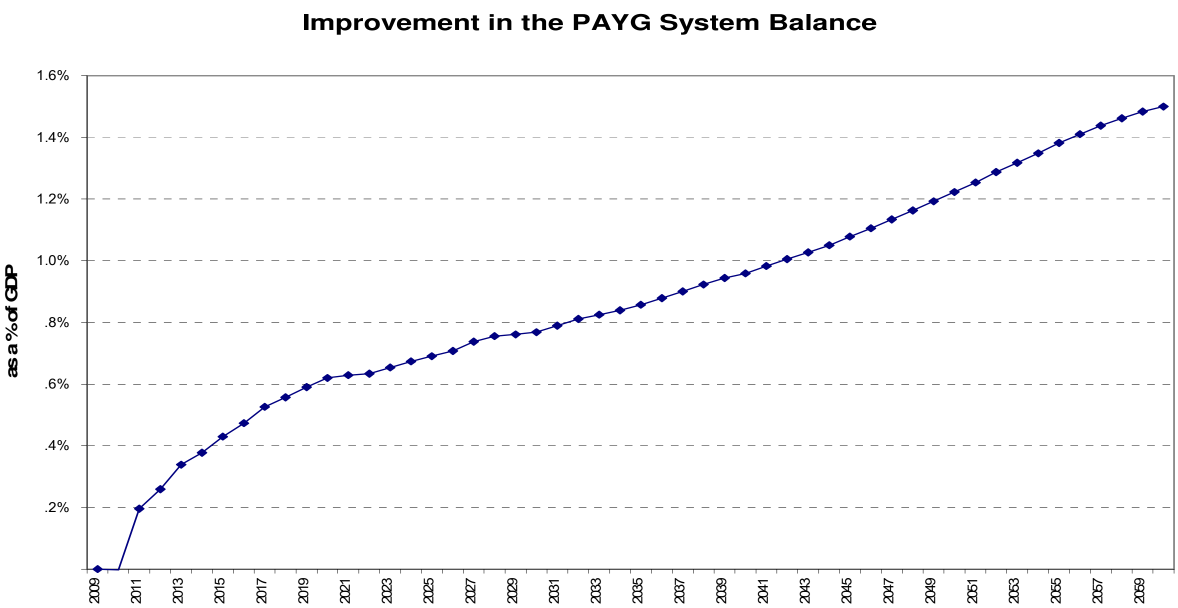
Table 09: Impact of Assumption that Malta Meets Sweden's Female Active Labour Participation Rates

	Employment Rates in 2010 (15-64)		Employment Rates in 2060 (15 - 64) on Malta Meets Sweden's Female Active Labour Participation Rates		Average Potential GDP Growth	
	Males	Females	Males	Females	AWG	Assumption on Swedish Active Female Participation Rates
Malta	72%	39%	78.7%	72.5%	1.7%	2.1%

Thus, in terms of financial results, it is projected that a higher female employment will result in a permanent improvement in the pension system deficit with an improvement of 1.5 percentage points (p.p.) of GDP relative to the baseline by 2060 as shown in Figure 05 below.

Nevertheless, it is to be noted that the pension system balance is projected to be (4.3%) of GDP in deficit by 2060.[33]

Figure 05: Improvement in the PAYG System: Assumption that Malta Meets the Swedish Active Female Participation Rate



This improvement, mainly, reflects a drop in the expenditure ratio, since the rate of increase in nominal GDP growth offsets the rate of increase in PAYG expenditure, relative to baseline. It is to be noted that as a result of the new assumption there would be an increase of approximately 15,000 female pensioners in retirement by 2060, relative to baseline, since the longer attachment to the labour market results in an increase in the number of persons eligible to pensions. In addition, it should be noted that there would be an increase of 0.5. p.p in the average replacement rate for all existing female retirees by 2060.

[33] The figure quoted is inclusive of the State contribution to the social security contribution, which in reality is a paper transaction.

The assumption adopted results in a permanent improvement in the financial indicators (+1.5 p.p. of GDP by 2060), an increase in the number of female retirees (+15,000 by 2060), and an increase in the replacement rate for females (+ 0.5 p.p. by 2060).

Be that as it may, it is pertinent to underline that despite the fact that this scenario - that the age-specific employment rates in Malta converge with best-performing Sweden by 2060 - reflects a **optimistic** view on how the labour market in Malta might evolve over the medium to long-term, the average GDP growth is estimated to increase **by only 0.4 p.p. to 2.1%** over the period 2007 - 2060, under the potential GDPframework and assumptions outlined above: leaving the pension system balance with a heavy deficit of (4.3%) of GDP for a First Pension APRR threshold of 45%.

The projection of these scenarios leads the PWG 2010 to conclude that there is a need **for realism** with regards to the overall impact that a high female active participation rate will have on the sustainability of the pension system as well as what represents a plausible rate of long-term potential GDP growth for Malta.

Indeed, it is to be noted that the system is projected to remain heavily in deficit, dispelling any optimistic perceptions that major improvement in the labour market behavior adopted and the consequent rate of GDP growth might address the problem of financial sustainability.

The PWG 2010:

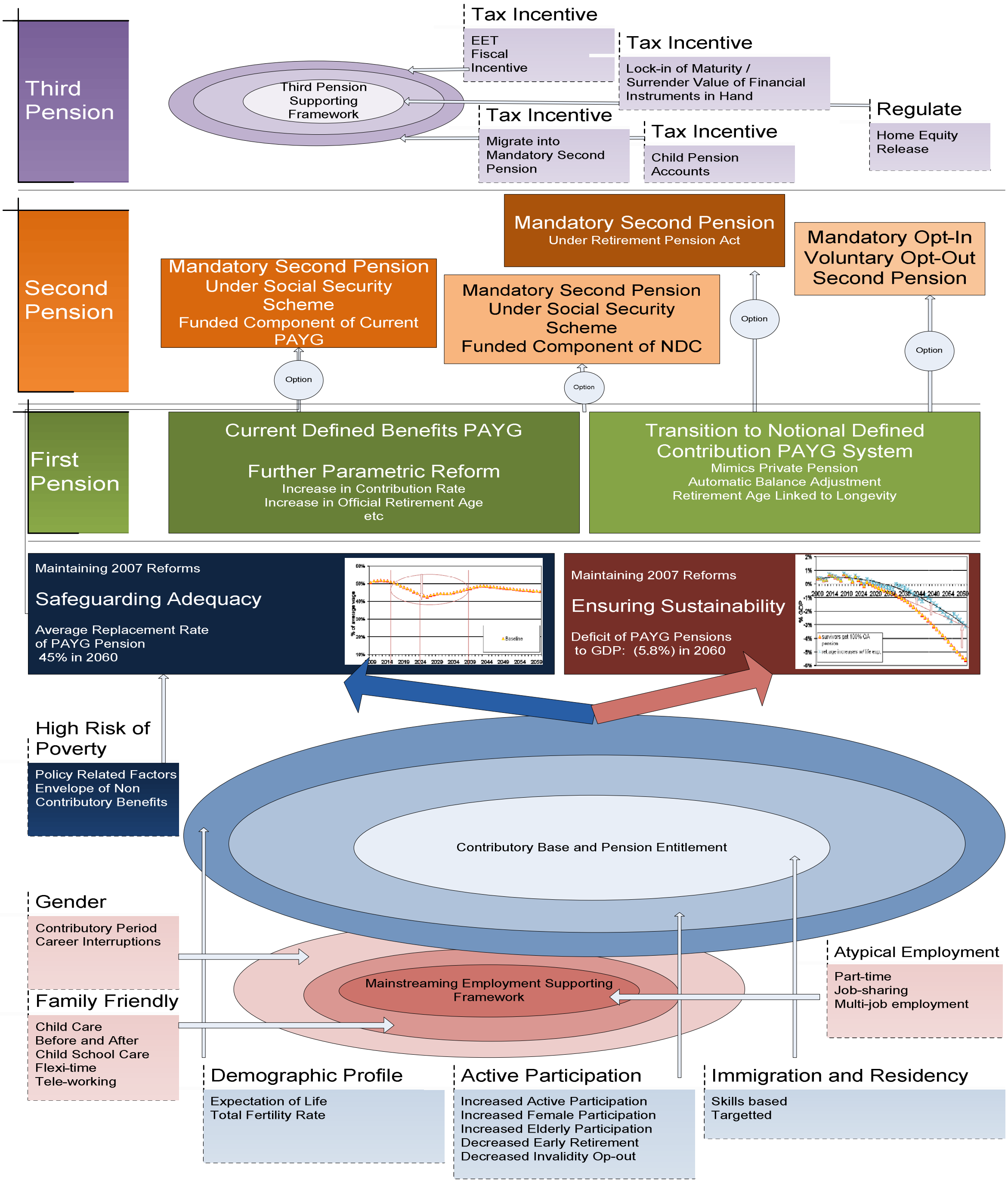
Strategic Review	Post Consultation Recommendation
Recommendation 01: Whilst the 2010 Pensions Working Group is recognisant of the fact that maintaining the macro-economic assumptions adopted by Aging Working Group with regards to Malta for the period 2010-2060 leads to results that are far more negative 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.	**Re-affirms Recommendation 01**. The developments in these macro-economic indicators over the past decade call for a cautious approach to be adopted with regards to the plausible assumptions upon which the baseline projections for long-term pension expenditure is to be modelled given that: (a) Modelling that assumes a higher GDP rate as a result of more optimistic active employment rates; migrant rates; labour productivity; total factor productivity et al will deliver a far more optimistic behaviour of the pension system over a 50 year period than that stimulated by the AWG macro-economic framework upon which the PWG 2010 based its modelling in the Strategic Review. Nevertheless, the adoption of such assumptions **are nor expected to,** as the sensitivity analysis carried out in this report shows, change the assessment regarding the financial sustainability of the pension system. The adoption of a more positive macro-economic assumptions framework, therefore, which is not supported by a strong and robust methodological framework that explains and demonstrates the validity of why more positive assumptions are selected may discredit Malta's pensions reform programme - and its cascading impact on other macro-economic sectors - in the eyes of the European Commision, International Monetary Fund and rating agencies. (b) The supporting macro-economic assumptions framework cannot be independent of the continued impact of the economic and financial uncertainty on the EU generally and more specifically on Malta as a Euro Zone Member States specifically. Economic and political developments in the EU are

	increasingly showing the need for fundamental structural reforms for the Euro Zone - which reforms are increasingly likely to lead in the fiscal consolidation of national budget and debt management at an EU Zone coordinated level as well as the entrenchment of the Fiscal Compact in Malta's constitution.

03.1 Introduction

As discussed in the previous Chapter of this report, an approach to pensions reform requires a structured and sustained approach across the various policy measures that together will result in an adequate and sustained pension system.

Figure 06: Core Pension Problem and Policy Considerations



The modelling carried out, based on the macro-economic framework discussed in the previous Chapter, during the Strategic Review reflected the approved 2007 reforms (that is they are restricted to the parametric changes to the First Pension only and ***do not*** simulate a mandatory Second Pension and a Third Pension given that recommendations presented by the PWG 2004 were not embraced by Government) show that the reforms are estimated to result in an APRR of 45% as at 2060 with an estimated negative impact of the pensions system balance on GDP of (5.8%).

The Strategic Review concludes that whilst the parametric changes to the First Pension introduced in 2007 were deemed to have fulfilled their role as they braked what otherwise would have been an accelerated degeneration of the APRR and thus stemmed the pension system from collapse (the projected APRR by the PWG 2004 in the case of no pre 2007 reform was estimated to fall to 18% by 2050) the parametric reforms:

> "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."[34]

Figure 06 shows the policy considerations that the Strategic Review assessed with regards to the continued reform necessary to safeguard adequacy, ensure sustainability and secure solidarity. In presenting the post consultation report, the 2010 PWG assessed and analysed the consultation feedback;, and further developed its work with regards to the underlying policy considerations as well as on the basis of results of further modelling it carried out.

03.2 Incremental Approach to Pensions Reform (Chapter 03 - Section 03.4 of the Strategic Review)

The PWG 2010 re-affirms its original recommendation to Government that the most appropriate approach to the reform of the pension system is an incremental approach carried out between one strategic review and the other as mandated by the Article of 64 B of the Social Security Act (SSA) titled 'Five Yearly Review'.

Be that as it may, the PWG 2010 is strongly of the opinion that for such an approach to be successful the Government must, build within the DSS the appropriate strategy, policy development and implementation capacity to provide for the necessary sustained critical mass to maintain momentum with regards to such reform.

Furthermore, the PWG 2010 continues to be of the considered opinion that an incremental approach to pensions reform is not an abdication of reform but rather the best strategic approach to reform: it allows continuous review of assumptions made, allows for the assessment of behaviour of reforms introduced and for the undertaking of calibrations as and where appropriate within five year intervals - realistic period of time to introduce incremental adjustments as and where appropriate.

An incremental approach to reform is a ***managed*** process of reform: it avoids big bang reform that too often is necessary in the event that required change is deferred or ignored until such time when external and internal pressures leave no leeway but to embark on dramatic and fundamental changes that society may subsequently find difficult to absorb - resulting in social and political upheaval.

The PWG 2010 re-affirms this position, however, on the **pre-supposition** that between one Strategic Review and the other, the Government will assess the recommendations presented to it, undertake national consultation and assess and review the resulting feedback, and decide on the incremental change required - and, as importantly, that it will implement such decisions reached.

The PWG 2010:

Strategic Review	Post Consultation Recommendation
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	**Re-affirms Recommendation 02**.

[34] Pg (i), Strategic Review on the Adequacy, Sustainability and Social Solidarity of the Pension Systems, 2010 Pensions Working Group, Final Report, December 2010

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.	
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.	**Re-affirms Recommendation 03**.

03.3 Changes to the Demographic Profile (Chapter 04 - Section 04.1 of the Strategic Review)

03.3.1 Increasing the Fertility Rate (Section 04.1.1 of the Strategic Review)

The PWG 2010 recognise that its recommendation to re-calibrate the Child Rearing Credit introduced as a result of the 2007 reforms is directed, in part, to neutralise the 10 year additional increase in the new 40 year employment contribution history which has rendered it far more difficult for an average woman employee to meet the full contributory history to receive a full a pension.

The PWG 2010 recognises that the 40 year contributory parametric reform introduced in 2007 may have worked against women as the reforms mandate that a full pension entitlement reflects a model that rewards a person who works uninterruptedly for a period of 40 years – (re-inforcing the traditional social model that it is assumed that it is male who works, and in doing so works uninterruptedly). The PWG 2010 further recognises that the child rearing credits that it introduced in the pension system were neutralised by the 10 year increase in the contribution period.

In calibrating the 2007 reform measure, the PWG 2010 tied the maximum Child Rearing contribution credit of 10 years to a pro-fertility increase incentive: where-in a parent would qualify for the maximum pension credit following the birth of a third child.

In the consultation process, appropriate stakeholders whilst acknowledging that the 2010 PWG was gender sensitive in its recommendations, stated that it still was not bold enough in designing a pension system that rendered it more realistic for a woman employee to be sufficiently incentivised to remain or return back to formal employment knowing that she is able secure a full pension at the end of her career.

The 2010 PWG re-affirms the principle that the provision of child rearing credits towards pension contributions is a mechanism that compensates, in today's society, parents (in Malta the primary beneficiary is invariably a women worker) for the time a parent would have spent outside his or her working career to bring up a child by allowing for the accumulation of a parent's pension entitlements during that said period.

In this sense, the PWG 2010 underlines that the introduction of a child rearing credit in the pensions systems represent a step forward for gender equality in three distinct ways.

Firstly, in so far as child rearing credits recognise the existence of differentiated life courses for the purpose of pension accumulation, child rearing credits are consistent with the application of substantive gender equality. This is a significant departure from gender equalisation efforts that often result in a ‘downward’ equalisation for women’s entitlements, a loss, in other words, of additional rights that women had in recognition of their differentiated contribution to society. Given the continuing differences between a typical male and female life, care and work patterns, a substantive perspective on gender equality is more likely to be beneficial for women in pension accumulation terms. [35]

Secondly, the idea of providing child rearing credits towards pension contributory history departs from the conventional link in European-level social policy between paid employment and the promotion of gender equality. This departure represents a forward step in that it is an important recognition that any policy strategy aimed at the further application of gender equality must also take men’s and women’s contribution in the private sphere into account.[36]

Considering the development to-date of gender equality strategies at the European level, the greater incorporation of private sphere activities in discussions of gender equality is a considerable change of direction, reflecting also the different ways that Malta chooses to combine employment and family policies.

Thirdly, child rearing credits also depart from the inherent link in traditional pension systems between pension accumulation and paid employment. The implications, and benefits, of this departure are particularly important for women in country contexts where the combination of work and care is more difficult, resulting in a higher child rearing penalty in terms of pension accumulation.

The value of child rearing credits, both symbolically and in financial terms, is also higher in contexts where female labour in the informal labour market is more prevalent and also more likely to go unnoticed for the purposes of social security.

For these reasons, the introduction of the child rearing credits in the pension system, undoubtedly, represent a step forward for families but also for individuals (male or female) who tend to follow less typical life courses that may not be rewarded through the traditional pension system structure.

The recognition of care as an activity that is worthy of valorisation within pension provision should also be regarded as a sign that social policy is more responsive to societal norms. In addition, and as long as women tend to perform the majority of (unpaid) child rearing within households, child rearing credits represent a step forward particularly for women.

In the EU various systems of childcare credits in pension systems are present. In certain countries credits for childcare are provided for parts or for the whole of the periods that maternity and / or parental benefits are received (for example Spain, Hungary and Poland). Other countries exhibit greater generosity by extending the covered period beyond such leave, for instance Austria and Sweden provide (up to) 4 years of contributions to a parent for every child, while France and Luxembourg provide 2 years for every child. In some countries the provision of care credits contributes to pro-natalist policies, as the number of contribution years per child increases with the number of children (for example Austria). [37]

For the countries that provide child rearing credits based on a pro-family approach relates to policy assumptions about the age at which a child is assumed to require less intense care and supervision, the point at which a child’s carer is presumed available and able to enter or re-enter the labour market. For example, Latvia provides credits for the period up to a child is 8 years old, Estonia until the child is 10 years old, Ireland and Cyprus until the child is 12 years old, while Switzerland takes into account the period of care up until a child is 16 years old.[38]

Thus, the 2010 PWG also re-affirms the principle that the introduction of a child rearing care benefit recognition in the pension system should also as a vehicle directed to engender a positive fertility policy.

[35] Pg 8, Vlachantoni, A; Care Credits in European Pension Systems, CRA Discussion Paper no. 801, CRA DP/0801, Centre for Research on Ageing, School of Science, University of Southampton, United Kingdom, November 2008
[36] Pg 9, Ibid
[37] Pg 6, Ibid
[38] Ibid

The difference in view, therefore, between the 2010 PWG and appropriate stakeholders is not in the introduction of a child rearing benefit in the pension systems as a measure to account for social realities *as well as* a positive pro-natal vehicle but whether the measure proposed goes far enough to meet the objectives sought: that is that the child rearing credits are sufficiently long to compensate against the bias that an uninterrupted career based pension entitlement favours male and not female employees.

In presenting its recommendation in this regard in the Strategic Review the PWG was careful that the policy instrument designed would not be too generous that would tilt it to become counter-productive: that is over compensating for child rearing to the extent that this would create financial sustainability issues.

The PWG 2010**:**

<table>
<tr><th>Strategic Review</th><th>Post Consultation Recommendation</th></tr>
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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: (i) 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; (ii) 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; (iii) 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.

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Reaffirms Recommendation 04.

On the basis of arising empirical data the Government should in subsequent Strategic Reviews assess the extent of the success of this policy measure vis-a-vis the goals set for it - to incentivise increased fertility as well as to secure an increased return to the labour market for parents who decide to raise a family - and should, thereafter, calibrate the child rearing credit mechanism as appropriate – which mechanism is proposed as follows with regards to persons in the Switchers Group:

Child	Credit	Condition
1st under six years	2 years	Return to employment for a period of 2 years
2nd under six years	Additional 3 years	Return to employment for a period of 3 years (including 2 years for the first child)
3rd under six years	Additional 5 years	Return to employment for a period of 5 years (including years for 1st and 2nd child)

In the event of a child who suffers from a serious disability the child rearing credit mechanism is propsed as follows:

Child	Credit	Condition
1st child with serious disability under 10 years of age	6 years	Return to employment for a period of 2 years
2nd child with serious disability under 10 years of age	8 years	Return to employment for a period of 3 years (including 2 years for 1st child)
3rd child with serious disability under 10 years of age	10 years	Return for employment for a period of 5 years (including years for 1st and 2nd child)

The PWG 2010 further proposes that this recommendation is introduced with effect from 2012.

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</table>

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: (i) a one (1) year pension credit for each child born under six years of age; or (ii) 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.	**Re-affirms Recommendation 05** and adds that the principle should be applied to the child rearing credit mechanism as newly proposed in Recommendation 04. The PWG 2010 further proposes that this recommendation is introduced with effect from 2012.
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.	Whilst the PWG 2010 **re-affirms recommendation 06** it proposes that a Task Force, constituted of a multi-disciplinary group of experts from within and outside of Government, is established by not later than April 2012 to present a report on a holistic pro-natal policy framework to the Minister for Justice, Dialogue and the Family as well as to the Standing Committee of the House of Representatives on Family Affairs by not later than October 2012. The PWG 2010 further recommends that the Terms of Reference for this Task Force should include, but not be limited, to the following: To identify the main social and economic challenges to Malta arising from the changes to the local population profile in the next 30 years. In the light of (a) above, to highlight those policy areas or programmes which will require further study in the pursuit of a comprehensive pro-natal policy framework. To recommend practical measures which may be taken in the short and medium term in order to pursue the principal objectives of a pro-natal policy framework. To recommend a suitable mechanism and to map out a time-table for developing and implementing a comprehensive pro-natal policy framework for Malta The PWG 2010 further recommends that the proposed Pensions Strategy Unit is represented on this Task Force.

03.3.2 Incentivising Active Participation in the Labour Market: Invalid and Disabled Persons (Section 4.1.2.1 of the Strategic Review)

Disability is defined as a physical, mental, or psychological condition that limits a person's activities. Up to recently, in Malta this has been interpreted according to a medical model - that is, disability is linked to various medical conditions, and is viewed as a problem residing solely in the affected individual. Furthermore, disability has traditionally been solely seen as the result of an individual's inability to function - with interventions usually limited to medical rehabilitation and the provision of social assistance.

It so follows that part of the exits from the labour market and entries into the realm of pensions occur via the disability pension system. Too often, once a person is granted an invalidity or disability pension, few return to work. The question then is whether it is possible to limit the flow into a permanent invalidity or disability pension? Or perhaps, whether it is possible to increase job opportunities for those who face health problems and reduced work ability?

This raises a second, perhaps more important question that is at the heart of working life: why do so many persons end their active years in sickness, poor work ability and disability? The question is also related to prevention, but the policy areas to be addressed become more manifold. To name some of the most important ones, policies with regards to the workplace, management practices, health services, occupational health system, rehabilitation and different income security schemes need to be scrutinised. These questions are not new, but they have, perhaps, become more urgent in ageing societies and at a time of economic turbulence.

To discuss invalidity and disability and employment at the same time does not go without controversy. After all, a starting point for welfare states has been that invalidity and disability, understood as incapacity to work, is, with particular regard to disability a legitimate reason to withdraw, stay, and remain outside employment. Further, from a social rights perspective, incapacity to work has been acknowledged as a justified reason for unconditional social protection. Thus, to consider employment issues among the invalid and the disabled may raise concerns regarding the principles of social protection. [39]

The thesis presented in the Strategic Review on this policy matter is that there are degrees of incapacity to work, and it is evident that attitudes and cultural factors, as well as work environments, together with supporting policies, will result in positive differences. The issue at stake is, thus, whether the potential work input of people with partial work capacity is addressed properly, and whether there exist opportunities to support the remaining work capacity in a more employment friendly way.

Comprehensive reforms in overseas jurisdictions in this regard exist. According to OECD experience, the Netherlands, Denmark and Sweden are countries that have implemented major reassessment of their policies and practices to increase employment of people with partial work capacity. They have reformed their sickness and disability benefit systems with similar goals in mind. Measures taken have included tightening the eligibility criteria, restricting benefit duration, focusing on the remaining work ability instead of on loss of work capacity, increasing regular assessment of work ability and increasing employer responsibility regarding the costs of sickness and disability benefits.[40]

Good-practice of policy measures in this regard include flex-job assessment (Denmark), work capacity assessment (several countries), treating people with partial capacity as unemployed (more recently also in Australia and Luxembourg), capacity assessment for unemployed with temporary work incapacity (Australia), partial sickness benefit (Nordic countries).[41]

The flex-job assessment mechanism introduced in Denmark, for example, is directed to ensure that everyone with an ability to work also has the opportunity to use this ability on the labour market, primarily in jobs on normal terms or, if this is not possible, in flex jobs. Thus, an individual cannot

[39] Pg 13, Kuatto, M., and Bach-Othman, J., Disability and Employment: Lessons from Reforms, Finnish Centre for Pensions, Reports 2010:4, Finland, 2010
[40] Pg 14, Ibid
[41] Pg 29, Ibid

receive an invalidity or disability pension if he or she can cope with a flex job. The basis for these efforts is the individual's ability to work, and focus is placed on the individual's resources rather than his or her limitations. In other words, the focus is directed at what the individual can do or can be helped to do, rather than at what he or she cannot do. Therefore, the individual's ability to work on the labour market always forms the basis for case processing.[42]

The concept of the ability to work in Denmark is now used in all case processing, and it ensures cohesive efforts and a full assessment of all resources so that, as far as possible, the individual can be helped back into the labour market. This also means that the medical assessment is only included in the decision as part of an overall assessment of the individual's total resources. Therefore, before granting an invalidity or disability pension today, the individual is subject to a more protracted process under which work trials and tests examine the possibilities of retaining the individual's attachment to the labour market. The point of departure is always the shortest possible route back to work.[43]

The PWG 2010 is aware that the Government in 2010 established an Inter-Ministerial Working Group constituted of the Employment Training Centre (ETC), the National Council for Persons with Disability (KNPD) and the DSS to review and propose recommendations with regards to reforming the invalidity and disability pensions framework to a system that targets an individual's ability to work, and where focus is placed on his or her resources rather than limitations.

It is pertinent to underline that the DSS has proposed reforms which Government will legislate in the SSA for the setting up of a multi-disciplinary panel for the purpose of advising the Director on the psycho-socio aspect of cases in which a claim for an invalidity pension is made which has not led to a conclusive determination of the work capacity of the applicant. The multi-disciplinary panel will be made of (i) a psychiatrist; (ii) a psychologist; (iii) an occupational therapist; and (iv) a social worker.

The PWG 2010**:**

Strategic Review	**Post Consultation Recommendation**
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.	R**e-affirms** recommendation 07.
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.	The PWG 2010 recommends that the Department of Social Security should continue to build on the positive work it has carried out with regards to orienting an individual's ability on his or her strengths rather than a person's limitations and that this principle is also extended with regards to the disability pension. The PWG 2010 adds that with regards to the extension of the principle to the disability pension, the existing Inter-Ministerial Committee concludes its work by October 2012.
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	R**e-affirms** recommendation 09.

[42] Pg 54, Ibid
[43] Ibid

person to continue to participate in the labour market to earn income as appropriate.

03.3.3 Incentivising Active Participation in the Labour Market: Females (Section 4.1.2.2 of the Strategic Review)

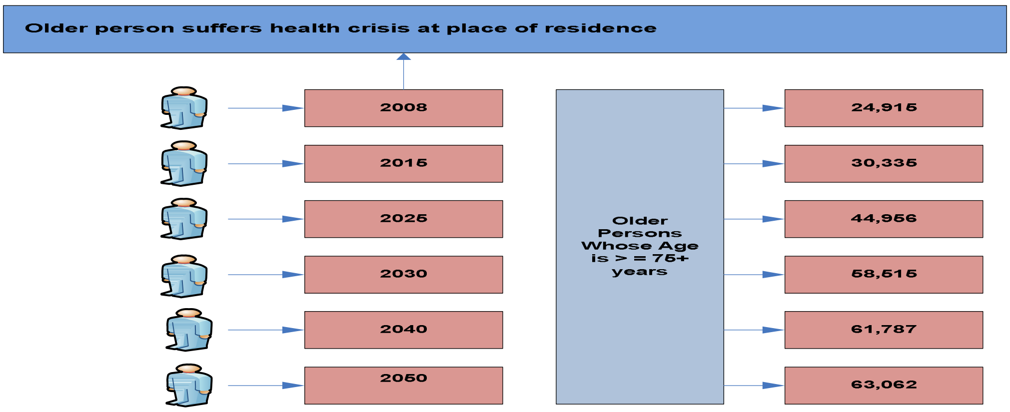
03.3.3.1 Females As Traditional Carers for Elderly Persons

A number of the stakeholders consulted underlined that one key reason of low female participation in Malta's labour market is that the female traditionally assumes the role of taking care of elderly relatives. A further concern, is families will increasingly decide on whether a member of the family assumes a carer's responsibility for a frail elderly person on the basis of the economic implications of such a decision to the said family.

In either circumstances, undue economic pressures are generated on the Maltese economy. The first will result in a continued low active female participation rate in the labour market given the increased incidence of aging in Malta's population over the next 20 years. In the event that Maltese women, on the other hand, will opt to actively engage in the labour market as against taking care of elderly relatives, the incidence of elderly persons that may require institutionalisation or a residential home care or who will require primary health care to remain integrated within the community, will increase.

During the consultation process stake holders argued that aging and its economic consequences constitutes the other 'side of the coin' of the pensions issue - and that both issues are intrinsically intertwined and that they cannot be reviewed independently.

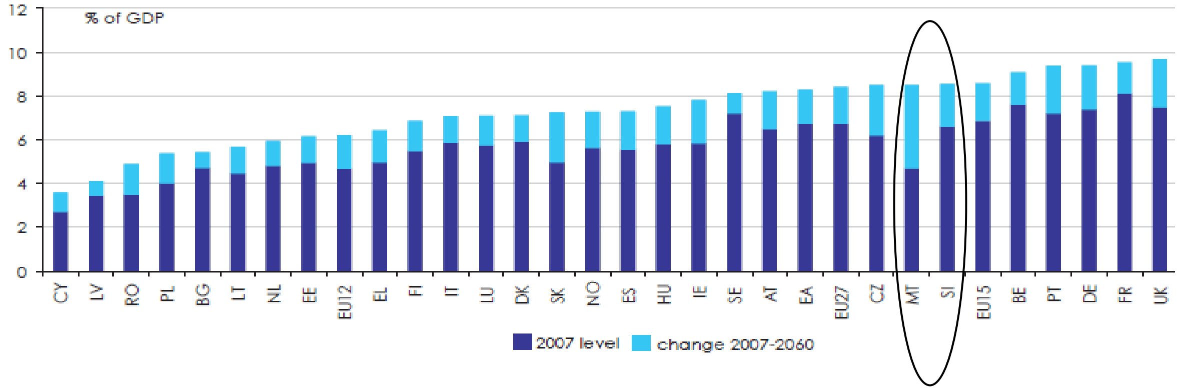
Figure 07: Increase of 75 Years+ of Elderly Patients: 2008 – 2050



As can be seen from the above Figure, the number of elderly persons who are 75+ years of age is projected to increase from 24,915 (2008) to 44,956 - an increase of 20,041 persons or 80.4% - by 2025: that is 13 years time. Within a further 5 years, that is in 2030 (or in 18 years time), on the 2025 figure, the number of elderly persons who are 75+ years of age is projected to increase by a further 13,559 persons. This constitutes an increase of 30.2% over the 2025 75+ population; and 134.9% over the 2008 75+ figures.

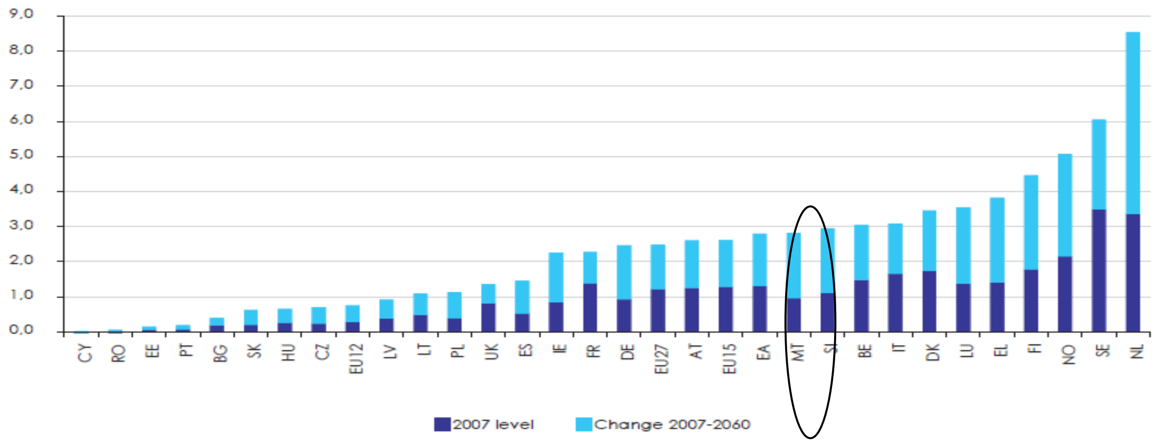
The financial and economic implications of aging with regards to health and long term care are projected to be significant - particularly given the fact that most persons will seek State support for residential or nursing or community care.

Figure 08: **2007 - 2060 Impact of Demographic Change on Public Expenditure on Health Care: % of GDP**[44]



As can be seen from Figure 08, the impact of demographic changes on health expenditure on GDP with regards to Malta for the period 2007 to 2060 is expected to be an additional increase of 3.8% of GDP - or in relative terms an increase of 80% on the 2007 baseline. Figure 09 below demonstrates the projected impact of demographic changes on long term care expenditure on GDP. As can be seen, the expenditure of long term care relative to GDP is expected to increase sharply from slightly lower than 1% to approximately 2.9% by 2060.

Figure 09: **2007 - 2060 Impact of Demographic Change on Public Expenditure on Long Term Care: % of GDP**[45]



A key recommendation arising from the consultation process is that the pension system, similar to the introduction of child rearing credits directed to compensate for pension accumulation for women who have interrupted work careers due to child bearing, should be leveraged as a vehicle for compensation for people who devote a considerable part of their life caring for dependents who are either elderly or long term sick.

It is pertinent to underline, that as part of the efforts to adjust to changing demographic, social and economic circumstances, pension reforms across the EU have increasingly included the provision of care credits towards the carer's pension contributions in the public pension system in recognition of their caring work. The provision of care credits is also an inherently gendered issue of social policy. This is because historically most of the care has been provided by female family members, and this has not changed even as more women have entered the labour market.[46]

[44] Pg 121, Aging Report: Economic and Budgetary Projections for the EU-27 Member States (2008-2060), European Economy, 2/2009, Directorate General for Economic and Financial Affairs, European Commission
[45] Ibid, Pg 135
[46] Pg 1, Vlachantoni, A; Care Credits in European Pension Systems, CRA Discussion Paper no. 801, CRA DP/0801, Centre for Research on Ageing, School of Science, University of Southampton, United Kingdom, November 2008

Consequently, unless labour markets are able to cater for care providers, and pension systems to compensate carers with alternative ways of building up pension entitlements, caring for elderly dependants indirectly contributes to gender inequalities in the accumulation of lifetime and retirement income.

Elderly care credits, therefore, serve to recognise the individual right to make choices throughout the life course for which individuals are not, directly or indirectly, penalised by the welfare state - where-in such recognition of diversity is particularly important for women whose care and employment patterns are often incompatible with eligibility advantages in social security systems.

Moreover, elderly care credits ensure the valorisation of unpaid care work in the context of social insurance, thereby attaching a symbolic value in policy terms to the act or caring for dependants. Furthermore, elderly care credits ensure the valorisation of unpaid care work not just in principle, but also in practice by attaching a temporal value to the credit contribution to the carer's record of employment.

Finally, care credits function as a vehicle for promoting greater gender equality in terms of pension accumulation, because across the developed world the majority of care work for the elderly family members still tends to be undertaken by women.

The following are pension systems in the EU that are leveraged as a policy instrument for recognising care of the elderly or the long term sick.

Table 10: Examples of Policy Instruments for Recognising Care of the Elderly or the Long Term Sick

Czech Republic	Periods caring for a close relative who is incapacitated
Finland	Periods for caring for dependents
Germany	Periods for caring for dependents
Luxembourg	Periods caring for a dependent
Slovakia	Period receiving the benefit for care for a sick relative
UK	Period caring for dependants (towards basic pension and for carers with 20 years of contributions).

Thus a decision to graft onto the pensions system a policy instrument that recognises care of the elderly or long term sick requires an economic analysis that assesses amongst others:

(i) The economic offset with regards to women taking up employment in the labour market (increased female labour participation) and, therefore, transferring the cost of care for elderly relatives, primarily, onto the State.

(ii) The economic offset with regards to women not taking up employment in the labour market to take care for elderly relatives and therefore reducing the economic impact of increased female labour participation.

(iii) The cost of a pension induced policy instrument that financially rewards a women for opting out of the formal market to take care of elderly relatives vis-a-vis the cost of the State assuming the burden for such care. Thus, the question is raised whether there is an economic argument in favour of introducing an economically attractive carer's pension (currently the highest rate of the Carer's Pension is €90.93 per week - €4,728.36 (Lm2,029)) when compared to the economic costs of long term and health care for the elderly? Dementia UK estimates that the total costs of dementia in 2007 amounted to an average of £25,472 per person with late onset dementia. The total annual cost per person with dementia in different settings is shown in the Table below.

Table 11: Cost of Dementia of Persons in Different Settings[47]

Person in the community with mild dementia - €17,390
Person in the community with moderate dementia - €24,347
Person in the community with severe dementia - €34,122
Person in care homes - € 37,395.

The total annual cost per person with Alzheimer's disease in different settings is estimated is shown in the Table below.

Table 12: Cost of Alzheimer of Persons in Different Settings[48]

Person in the community with mild Alzheimer - €14,033
Person in the community with moderate Alzheimer - €22,957
Person in the community with severe Alzheimer - €27,557
Person in care homes - €32,040.

The PWG 2010:

Strategic Review	Post Consultation Recommendation
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.	**Recommends** that an Inter-Ministerial Working Group is set up constituted of the Ministry for Health, Elderly and the Community, Ministry for Finance, Economy and Investment and Ministry for Justice, Dialogue and the Family to carry out a study directed to assess whether the pension system may be leveraged as a vehicle to offset the economic impact related to aging through the introduction of contributions to persons who take care of elderly or long term sick persons. The PWG 2010 underlines that the assessment to determine whether such a policy instrument is to be grafted onto the pension system should be based on a comprehensive review that determines the economic implications of aging as well as the appropriate balance of policy measures required to recognise care to the elderly by family members as an economic activity in its own right. The PWG 2010 further recommends that the Inter-Ministerial Working Group should be set up in April 2012 and mandated to deliver its report by October 2012. The Pensions Strategy Unit, upon its set up, is to be represented on the afore mentioned Inter-Ministerial Working Group.

[47] http://www.dementiauk.org/
[48] http://alzheimers.about.com/od/financialissues/a/Costs_Alzheimer.htm

03.3.3.2 Childcare Support Services and Females in the Labour Market

During the consultation process, appropriate stakeholders placed considerable emphasis that the number of families that utilise childcare services for children is low when compared to EU MS' that have a high employment rate of women in the labour market.

The use of formal childcare facilities is considered to be the most important indicator to monitor the provision of childcare facilities in different MS'. The percentage of families in Malta that do **not** make formal use of childcare services for children below 3 years has actually increased in 2009 on 2008 and 2007 figures: standing at 92%. This compares negatively both to the EU 15 - at 67% and the EU 27 - at 72% averages, respectively.

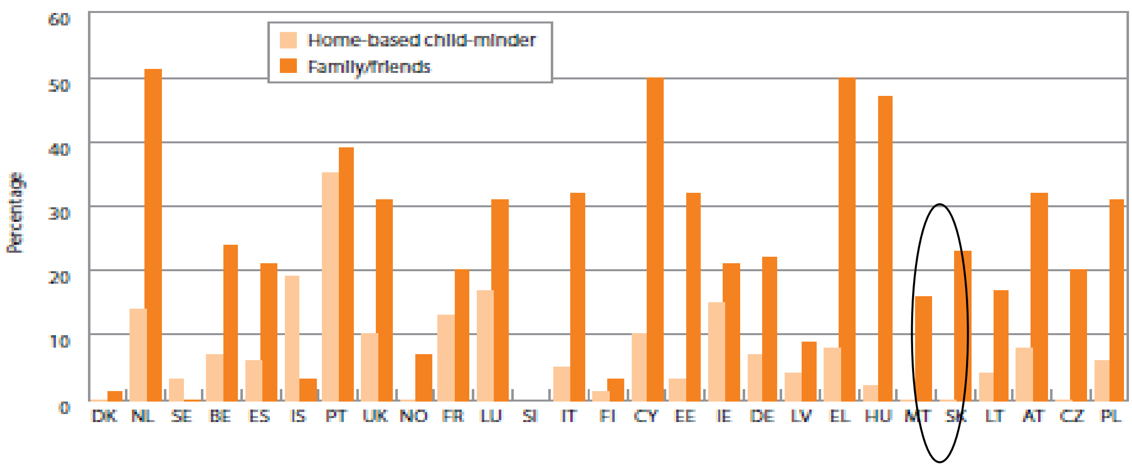
The low incidence of formal use of childcare services for children below 3 years of age and the active participation rate of women in the labour market in Malta is best demonstrated when Malta is comparatively assessed with MS' who have a very high female employment rate. This comparative assessment is shown in Table 13.

Table 13: 2009 - Formal Use of Childcare for Children who are 3 Years and Younger[49]

EU Member State	
Denmark	27%
Netherlands	51%
Sweden	37%
United Kingdom	65%
Mediterranean	
Italy	75%
Cyprus	78%
Spain	64%

The Figure below shows that Maltese families tend to depend on family members to assist them with childcare support - which would increase the overall representation of Malta's state of play with regards to the use of childcare arrangements other than formal childcare services.

Figure 10: Use of Home-Based Child Minder and / or Family / Friends: 0 - 2 Years Old[50]



[49] http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&language=en&pcode= tsisc100&plugin=0
[50] Ibid

A particular issue, however, that must be taken into account is that the informal childcare support provided by the extended family network is likely to fall over the period under review as a direct consequence of increased female participation in the labour market and more extended careers - which would likely see an increase in the incidence of women aged up to 65 years who will continue to be active in the labour market and, therefore, who will not be in position to provide informal childcare support to their grandchildren.

The argument put forward during the consultation process of why Malta should invest more in the setting up of childcare services and the subsidisation of the cost of such services is the classical argument that the availability of affordable good-quality childcare services has a positive impact on the female participation rate - where-in a higher participation rate increases gender equality, fosters economic growth, and helps improve the sustainability of the Malta's pension system, especially in the light of an ageing population.

Indeed, the point was repeatedly made that the cost of childcare services in Malta acts as an obstacle to the use of such services, and therefore, negatively impacts a woman's ability to enter into the labour market.

Theoretically the impact of childcare subsidies on labour force participation is rather straightforward: childcare subsidies reduce the relative price of childcare and therefore increase the relative return of market work[51]. Empirical studies of the relationship between childcare costs and labour force participation are consistent with this hypothesis: when costs of childcare services go down, labour force participation goes up, especially among mothers.

With regards to Germany, for example, studies show that extensive childcare possibilities intensify the labour market participation rate of mothers — above all in the former West Germany. For the Netherlands, studies show that the participation of women in the labour market has become less reliant on the presence of children. A recent study in Austria revealed a significant positive correlation between the labour-market participation of mothers and the availability of adequate childcare services and a clearly negative correlation if the childcare facility closes for lunch.[52]

The importance of childcare facilities has, also, been confirmed in a recent Norwegian study. This study concludes that the availability of high-quality, affordable childcare leads to higher rates of women making the transition to motherhood and continued active labour participation. The effects proved to be substantively large.[53]

EU MS' apply different policy mechanisms to render childcare affordable - a comparative assessment of which is shown the Table below.

Table 14: Comparative Assessment of Policies with regards to Childcare Affordability[54]

EU Member State	
Belgium	Parents pay an income-related fee, of between €1.99 and €28.04 per day - on average parents pay €13.07 per day. Childcare expenses can be deducted for tax purposes.
Denmark	Parents' fees are income-related and are free for parents on low incomes. A maximum is set at 25% of the costs for pre-school children aged 0 – 5 years and 33% for school-going children.
Netherlands	For most income levels childcare services are highly subsidised. For households with an income of 130% of the legal minimum wage, the price per hour for the first child is €0.33 and for the second child €0.19. In

51 Jaumotte, F. (2003). Female labour force participation: past trends and main determinants in OECD countries. OECD, Paris
52 Pg 25, The Provision of Childcare Services: A Comparative Review of 30 European Countries, EC's Expert Group on Gender and Employment Issues, European Commission, March 2009
53 Rindfuss, R. R. et al. (2007). Childcare availability and first birth timing in Norway. Demography 44(29), p. 345
54 Pg 51, The Provision of Childcare Services: A Comparative Review of 30 European Countries, EC's Expert Group on Gender and Employment Issues, European Commission, March 2009

	households where the earnings are three times the gross general income, the amounts are €2.20 and €0.46.
Sweden	Parents pay an income-related fee, which may differ by municipalities. The maximum fee is set at 3% of income for one child with a maximum of €130 per month, at 2% of income for the second child with a maximum of €86 per month and at 1% of income for the third child with a maximum of €43 per month. For leisure-time centers a similar arrangement exists.
UK	The government provides several forms of subsidy to parents for childcare costs. The most widely used one is via the funding of childcare provision, of which the one with the widest coverage is the free part-time pre-school nursery education place. There is also assistance with childcare costs for low-income employed families via the tax credits system, and for all employees if their employers adopt the tax-efficient childcare voucher system introduced in 2005.

It is to be noted that the Government, locally, has over the past years introduced a mixed policy framework directed to support working parents who use childcare services to enable both parents to remain active in the labour market. These specific childcare measures are shown in the Table below.

Table 15: Comparative Assessment of Policies with regards to Childcare[55]

The provision of a tax credit[56] of up to €1,000 to each family for sending their children to a childcare centre. It is reported that there were 913 and 1,218 beneficiaries in 2009 and 2010.
Opening up of Child Centres by Government in Gharghur, Paola, Luqa, Qawra, MCAST, Cospicua, Siggiewi, Pembroke, Floriana and Santa Venera and by Malta Enterprise in Bulebel, Hal Far, and other business centres.

The PWG 2010 expresses concern with regards to a fiscal incentive mechanism for childcare services that is designed on the basis of a tax credit given that such a mechanism discriminates against those families who are excluded to pay income tax due to the very fact that they are below the taxation threshold because they are low income earners.

The PWG 2010:

Strategic Review	Post Consultation Recommendation
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.	**Recommends** that the Government should set up a Working Group under the permanent Inter-Ministerial Working Committee on Active Female Participation Policy Design and Review (note Recommendation 16) that is constituted of the Ministry of Finance, Economy and Investment, the Ministry of Education, Youth and Employment, and the Ministry for Justice, Dialogue and the Family as well as representatives of civil society to assess the current framework with regards to the provision of childcare support services as well as supporting incentives to determine whether current policies are meeting the objectives set or whether calibration is required to increase the tempo for the realisation of the primary objectives - mainly, resulting in an increased number of female parents remaining active in the labour market. The PWG 2010 further recommends that the Working Group should be set up in April 2012 and mandated to deliver its report by October 2012.

[55] http://www.timesofmalta.com/articles/view/20110207/local/2-131-enjoy-tax-credits-on-childcare-centre-costs.349109

	The Pensions Strategy Unit upon its set up, is to be represented on the said Inter-Ministerial Working Group.

03.3.3.3 Before and After School Childcare Services and Females in the Labour Market

Representatives of women's organisations, employers, trade unions and teachers agree that before and after-school services should be introduced to enhance children's creative and social skills while allowing parents to work.

It is pertinent to underline that the Government, through MEDE, recognises that in Malta there is a need to provide a child- and family-friendly facilities to meet the care need of children whose parents' work or where the work schedules are incompatible with school timetables. To fully address the gaps between school hours and the parents' work schedules, such an after-school service is required to provide for the care needs of children before school starts in the morning, and after school finishes in the afternoon.

In this regard, the Foundation for Educational Services (FES) started providing a subsidised, fee paying after-school service in October 2009 with the aim to provide a service for school-age children outside of regular school hours where the children attend the facilities on a regular basis and access to the service is clearly defined by agreement with parents and guardians. The Table below demonstrates activity introduced by FES in this regard.

Table 16: After School Services Introduced by the Foundation for Educational Services

In October 2009, FES set up and launched a new after-school hours' service – *Klabb 3-16*. Klabb 3-16 is housed in school buildings contributing to the commitment of using schools as community centres. In 2009, FES opened three Centres – in B'Kara, Fgura and Naxxar Primary Schools.

FES' role in the provision of after-school services includes the co-ordination and monitoring of Klabb 3-16 centres, as well as being active in identifying additional locations for new Klabb 3-16 centres.

Currently there are 6 Centres, which were opened as follows:

October 2009: (Pilot phase): B'Kara, Fgura, Naxxar (closed in February 2010 due to lack of uptake making the service financially unviable to run)
February 2011: Mosta
July 2011: Żurrieq
October 2011: St. Paul's Bay
January 2012: Marsaskala

Klabb 3-16 caters for school-age children who attend State, Church and Independent Schools. A team of dedicated and professional staff run each Klabb 3-16 centre. Each centre has a Co-ordinator, who is responsible for the overall running of the respective centre; homework tutors who are qualified teachers and assist children with their homework; and play workers who organise hands-on fun activities.

The service runs from Monday to Friday between 2.00pm or 2.30pm and 6.00pm during school days, and from Monday to Friday between 7.15am and 5.15pm during holidays (mid-term holidays, Christmas, Easter and summer holidays).

The service is against payment and parents pre-book and pay a rate of €1.20 per hour or make use of fee packages if they use the service on a regular basis.

The number of children who benefited from the service since 2009 is shown in the Table below.

Table 17: Children Benefiting from Pre and After School Services Managed by the Foundation for Educational Services[57]

Centre	Opened	Scholastic year 2009 – 2010			Summer 2010	Scholastic year 2010 – 2011			Summer 2011	Schol year 2011 – 2012	Total for each Centre
		1st term	2nd term	3rd term	*	1st term	2nd term	3rd term	*	1st term	
		Oct – Dec	Jan – Mar	Apr – Jun	July – Sept	Oct – Dec	Jan – Mar	Apr – Jun	July – Sept	Oct – Dec	
B'Kara	Oct-09	40	72	92	255	50	45	45	293	51	943
Fgura	Oct-09	78	106	110	241	40	45	43	178	51	892
Naxxar*	Oct-09	38	–	–	–	–	–	–	–	–	38
Mosta	Feb-11	–	–	–	–	–	14	29	172	47	262
Zurrieq	Jul-11	–	–	–	–	–	–	–	10	6	16
St Paul's Bay	Oct-11	–	–	–	–	–	–	–	–	6	6
M'Scala	Jan-12	–	–	–	–	–	–	–	–	–	0
* Closed in February 2010						Total for all Centres since 2009					2157

The PWG 2010:

Strategic Review	Post Consultation Recommendation
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.	**Recommends** that the Government should set up a Working Group under the permanent Inter-Ministerial Working Committee on Active Female Participation Policy Design and Review (note Recommendation 16) that is constituted of the Ministry of Education, Youth and the Employment and the Ministry for Justice, Dialogue and the Family as well as representatives of civil society to assess the current framework with regards to the provision of Before and After school childcare support services to determine whether current policies are meeting the objectives set or whether calibration as appropriate. The PWG 2010 further recommends that the Working Group should be set up in April 2012 and mandated to deliver its report by October 2012. The Pensions Strategy Unit upon its set up, is to be represented on the said Inter-Ministerial Working Group.

03.3.3.4 Family Friendly Measures and Females in the Labour Market

The Government has actively demonstrated its commitment to the promotion and implementation of family-friendly measures over the past years. The PWG 2010 recognises that the Public Service in Malta is at the forefront in the provision of these measures. Various family-friendly measures have been introduced within the Public Service and include:

Parental leave
Paternity leave
Responsibility leave
Adoption leave
Leave to foster children

[57] Adhoc Report prepared by the Foundation for Educational Services for the PWG 2010.

Work on a reduced time-table

The 2005 – 2010 Collective Agreement also included new provisions with regards to:

More flexible use of parental leave and reduced hours
One year unpaid parental leave which may be availed of in 3-month periods
A once only maximum period of 5 years unpaid parental leave which can be utilised either as a whole period or reduced by multiples of 3 months
Possibility to work on a reduced time-table until the child reaches the age of twelve years.

As can be seen from the Table below the uptake of family friendly measures by public officers have been on the increase - nearly doubling between 2006 and 2010.

Table 18: Take-up of Family Friendly Measures in the Public Sector[58]

PUBLIC SECTOR		2006	2007	2008	2009	2010
FAMILY-FRIENDLY MEASURE	DURATION					
Maternity Leave	14 wks paid (13+1 unpaid before 2008)	93	138	161	216	581
Adoption Leave	5 weeks paid	4	3	5	5	5
Leave for Fostering	1 year unpaid	0	0	1	0	0
Responsibility Leave	1 year unpaid, renewable	32	31	37	30	56
Parental Leave	1 year unpaid	314	284	280	271	470
Career Break	Up to 5 years unpaid	213	207	240	234	272
Leave to acc spouse on govt asgmts abroad	1 year unpaid, renewable	5	3	8	7	12
Rdcd hrs – other amnts	1 year paid, pro-rata	771	879	934	995	989
Teleworking		0	0	117	225	414
Flexible Work Schedules		0	0	157	433	280
TOTAL		1,432	1,545	1,940	2,416	3,079

Additionally, in the 2012 Budget the Government announced that the duration of the maternity leave will increase by two weeks in 2012 and a further two weeks in 2013 - up to 14 weeks; where-in employees who will not get a full salary over the new statutory 14 week period will receive a basic €160 per week allowance which will be borne by the Government.

The PWG 2010:

Strategic Review	Post Consultation Recommendation
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.	**Recommends** that the Government should set up a Working Group under a permanent Inter-Ministerial Working Committee on Active Female Participation Policy Design and Review (note Recommendation 16) that is constituted of the Ministry of Education, Youth and Employment and the Ministry for Justice, Dialogue and the Family as well as representatives of employers and employees to further inculcate the introduction and uptake of family friendly measures within Government and the private sector; identify barriers limiting up-take; identify support measures such as the professional development of public and private sector management and employees with regards to the application and promulgation of new work practices such as flexi-time and tele-working, et al. The PWG 2010 further recommends that the Working Group

[58] May 2011, MCSD Newsletter

	should be set up in April 2012 and mandated to deliver its report by October 2012. The Pensions Strategy Unit upon its set up, is to be represented on the said Inter-Ministerial Working Group.

03.3.3.5 Informal Economy and Females in the Labour Market

One of the main recommendations presented in the consultation process with regards to incentivising women to move away from the black economy onto the formal economy is that a women who earned her own pension on the basis of her career should not be forced to choose following the death of her husband the highest pension amongst that respectively earned by both her husband and herself.

The fact that under the existing pension system a wife is, too often, forced to drop her pension to receive the highest pension earned, which traditionally would be that of the husband, is argued by civil society groups representing women to be one of the main obstacles that stops women to move out of the black economy into the formal economy.

It was, thus, proposed that the pension system should be reformed to ensure that a married woman who has by means of her contributory history earned the right to a pension should continue to enjoy this right following the death of her husband without forfeiting the right to continue to receive a survivor's pension - a right she also continues to be entitled to as the legitimate spouse of the husband who paid his contributory entitlements during the course of his employment.

It is pertinent to underline that further simulation carried out on the basis of data for 2012 shows that the implementation of Recommendation 22 of the Strategic Review is estimated to result in an annual increase on the pension system cost of €11.3m for 2012 alone.

Whilst there is no doubt that the implementation of a measure as proposed that would see a female person to retain her pension as well as the survivor's pension would act as a positive inducement towards increased female participation, the PWG 2010 cautions that the application of such a measure if implemented overnight may create short-term financial pressures on the pension system.

One other issue that is identified as an obstacle and which, according to bodies representing women incentivises a woman to work in the informal economy is that a person has to meet a contributory payment threshold for him or her to be in a position to draw up a pension that is relative to the person's contributory history. The contributory thresholds that have to be reached for a female worker, who is more likely to have an interrupted contributory history than her male counterpart, to be entitled to a pension that is relative to the contributions paid are presented in the Table below.

Table 19: Minimum Contributions Threshold for a Person to be Entitled to a Pension Relative to Contributions Paid

Group	Contributory Entitlement
Transitional (if the person never paid contributions after 1979)	Approximately 15.5 years
Transitional (if the person paid contributions after 1979 but not in last 10 years prior to retirement)	Approximately 14.5 years
Transitional (if the person paid contributions after 1979 and in last 10 years prior to retirement)	Approximately 10 to 14.5 years
Switchers (a person who would have paid contributions after 1979 to qualify for a pension).	Minimum 11.6 years

In essence the above means, that if a woman in the Switchers Category - 45 years and younger as at 1st January 2007 - worked for 10 years and decided to opt out of the labour market to raise a family will not qualify for a partial pension that is reflective of her contributory history given that she would not have accumulated the necessary contributions to meet the qualifying threshold.

The PWG 2010:

Strategic Review	Post Consultation Recommendation
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.	**Whilst recognising** the intrinsic value of the recommendations proposed by civil society groups representing women with regards to measures that would be sufficiently attractive to lure them away from the informal market and into the formal economy the PWG 2010 cautions that it is its considered view that the measures as proposed are not implementable as they would create unsustainable financial pressures on the pensions system. The PWG 2010 recommends that the Government should set up a Working Group under the permanent Inter-Ministerial Working Committee on Active Female Participation Policy Design and Review (note Recommendation 16) that is constituted of the Ministry of Education, Youth and Employment, the Ministry for Finance, Economy and Investment, the Ministry for Justice, Dialogue and the Family to design and assess measures and / or recommendations directed to incentivise females (and males) to join the formal economy and decrease participation in the informal economy on the basis that such measures are affordable and sustainable. The PWG 2010 further recommends that the Working Group should be set up in April 2012 and mandated to deliver its report by October 2012. The Pensions Strategy Unit upon its set up, is to be represented on the said Inter-Ministerial Working Group.

A female survivor should be eligible to the full pension on the grounds that a 5/6th pension entitlement is gender discriminatory given that if the female spouse passes away the male spouse will continue to receive the full pension entitlement as well as the fact that no economic value is given to the role the female spouse would have played as a home carer during her life time.

03.3.3.6 Egalitarian Family and Social Model and Females in the Labour Market

The PWG 2010 notes that in 2011 the Government implemented this recommendation where-in a sustained education campaign on different media was launched and continues to be underway directed towards increasing the awareness particularly of the male partners of a household to adopt a more equal sharing of family and / or caring responsibilities.

The PWG 2010:

Strategic Review	Post Consultation Recommendation
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	**Reaffirms Recommendation 15** and underlines that such campaigns should not be one-offs but rather sustained and on continuous basis until such time that an egalitarian family and social model is truly inculcated in the fabric of Malta's society. The competent authorities should, as they have done to date, seek to secure EU financing to fund such initiatives.

childhood through the inclusion of this subject in the school curriculum.	

03.3.3.7 Joined Up Policy Design, Development and Review and Females in the Labour Market

The PWG 2010:

Strategic Review	Post Consultation Recommendation
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.	**Reaffirms Recommendation 16** and underlines that the Government should set up a permanent Inter-Ministerial Committee tasked with the responsibility to ensure a joined-up policy design, development and review approach directed to build and nurture existing as well as future measures that would increase active female participation in the labour market. The PWG 2010 adds that the proposed Inter-Ministerial Committee should be constituted of the Ministry of Education, Youth and Employment, the Ministry for Finance, Economy and Investment, the Ministry for Justice, Dialogue and the Family (or representatives of entities within the said ministry portfolios) as well representatives from civil society. The proposed Inter-Ministerial Committee should be tasked to set-up Working Groups under its direction to present to Government by October 2012 the studies proposed in Recommendations 11, 12, 13 and 14 of this report. The Pensions Strategy Unit, upon its set up, is to be represented on the said Inter-Ministerial Committee.

03.3.3.8 Incentivising Active Participation in the Labour Market: Elderly (- Section 4.1.2.3 of the Strategic Review)

Tables 20 below compares the active participation rates of persons who are 55 - 64 and 65+ years of age respectively prior to the launch of the pension reforms in 2007 and as at 2011.

Table 20: Active Participation of Elderly Persons: Q2 2011[59] Compared to Q2 2006[60]

April - June 2011			April - June 2006		
Male	**No**	**%**	**Male**	**No**	**%**
55-64	14,966	13.6	**55-64**	10,295	9.9
65+	2,174	2.0	**65+**	1,160	1.1
Female	**No**	**%**	**Female**	**No**	**%**
55-64	4,085	7.1	**55-64**	2,276	4.8
65+	370[u]	0.6	**65+**	109[u]	0.2

It is evident that the measure introduced as part of the pension reforms in 2007 which removed the cap on income earned whilst continuing to enjoy the full pension has had a positive impact with regards to an increased presence in the labour market of persons who are older than 61 years of age.

[59] Pg 3, Labour Force Survey: Q2/2011, 185/2011, 29th September 2011
[60] Pg 3, Labour Force Survey, April-June 2006, 227/2006, 12th October 2006

Although the 55 - 64 age category includes males who are 61 years and younger the number of active persons in the labour market in 2011 is 3.7% higher than that for the same quarter in 2006. Similarly, the number of males in the 65+ age cohort increased by 0.9% over the same period.

Of significant interest, is that the number of women in the 55 - 64 age category increased by 79.50% on 2006; whilst the women in the 65+age cohort, although the sample size is too small to serve as an accurate basis, increased by 300%.

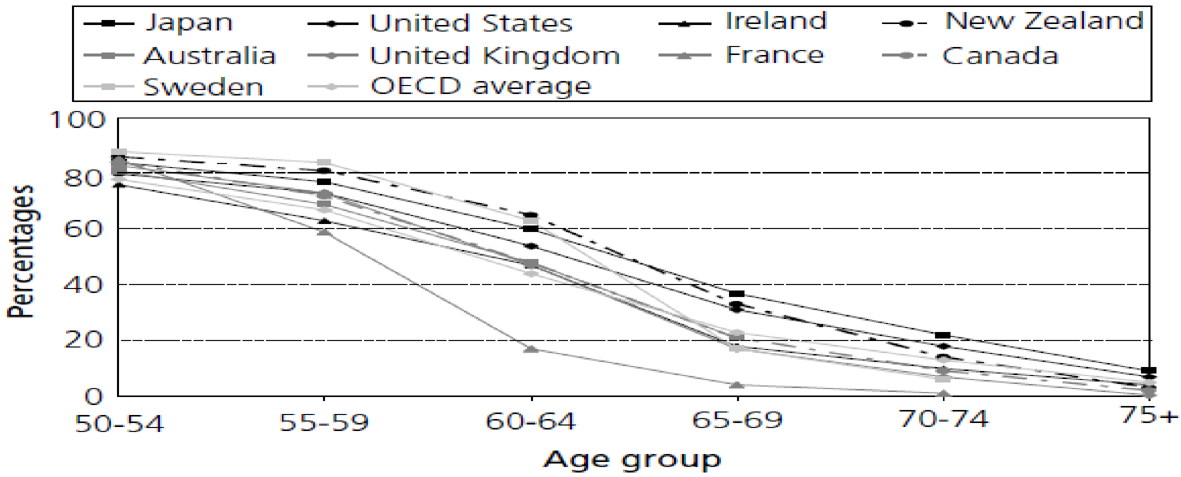
It is evident that this policy measure is rendering the results it was designed to achieve. Be that as it may, the presence of elderly persons in the active labour market compared to other overseas jurisdictions is insignificant. Table 21 presents a comparative assessment of the participation rate in the over 65 age group in select overseas jurisdictions.

Table 21: Participation Rates Among 65 Years and Over Age Group[61]

Country	65+ (OECD Ranking)
Canada	10% (11)
New Zealand	15% (8)
USA	17% (6)
Australia	9% (14)
UK	10% (12)
OECD Average	12%

As can be seen from the Figure below, with the exception of France, the countries reviewed reach the Malta cumulative active participation rates for elderly persons aged 65+ years **at** the 75+ year active participation cohort - demonstrating, clearly, how poorly Malta is performing in retaining elderly persons in employment once they reach their official retirement age.

Figure 11: Participation of Persons Aged 50+ in Selected Countries[62]



In this regard, it is pertinent to underline that there are countries which employ a policy where mandatory retirement is not permitted at any age. These include Australia, Canada, New Zealand and the USA. It is also to be noted that the United Kingdom abolished the default retirement age in 2011. In essence, this implies that mandatory retirement in these countries is illegal at any age and **that it is unlawful for an employer to discharge any individual or to otherwise discriminate**

[61] Pg 25, Wood, A., Robertson, M., Wintersgill, D., A Comparative Review of International Approaches to Mandatory Retirement, Research Report No 674, Department for Work and Pensions, 2010

[62] OECD (n.d). Statistical extracts: LFS by sex and age – indicators, available at http://stats.oecd.org/Index.aspx?DatasetCode =LFS_SEXAGE_I_R

against them with respect to their compensation, terms, conditions or privileges of employment because of that individual's age.

A policy measure to remove mandatory retirement is often seen as a positive leverage to secure an effective active aging environment. Research carried out overseas concludes that the abolishment of the mandatory retirement criterion has often led to employers choosing to adapt their working environment to provide more amenable working conditions for older employees, by, for example, providing flexible working and gradual retirement schemes.

There is a range of evidence to suggest that such policies can be successful in encouraging employees to work later in life, and so potentially lead to an increase in participation rates among older workers, particularly when these are supported by government initiatives.[63]

For example, in 2001, the Ministry of Social Development in New Zealand acknowledged the value of older workers and produced the New Zealand Positive Ageing Strategy.[64] This includes a set of Positive Ageing Goals and Objectives for improving opportunities for older people to continue to participate in the labour market. The elimination of ageism and the promotion of flexible work options is one of these goals and it contains several objectives, among them:

- implementing fair and inclusive human resource policies in the government sector that support the employment of older workers and entitlements to training; provide family-friendly workplaces, flexible-working options and recognise those with caring responsibilities.

- assisting those providing government services to older people to have an understanding and awareness of older people's issues.

- working with local government and the business sector to eliminate age discrimination in hiring practices, enable staff to participate in work-based training, and encourage the provision of flexible working arrangements that enable older workers to remain in paid work as long as they are able to.

- promoting the continuation of paid employment into later years for those who wish to remain in paid work, in order to both prepare for retirement and to supplement retirement income.

The success of this policy is best shown by the results of a survey carried out by the Ministry of Social Development in 2009 with regards to persons aged 65 years and over in New Zealand. 60% of the participants identified changes in terms of flexible working that they felt influenced them in deciding to continue working. The most commonly mentioned were:

- flexible working hours (27%).

- being able to take more unpaid leave (18%).

- job sharing (18%).

- working from home (16%).

- working only at times that suited, e.g. evening, weekends (15%).

A study[65] in Australia recognised older workers' preference for staying in work. The study showed that the Australian Commonwealth Government had attempted to reduce the extent to which mature-age workers were choosing to take early retirement. Measures included:

- changes to retirement income policies, including pensions and superannuation arrangements to redress incentives to early retirement.

[63] Pg 49, Pg 25, Wood, A., Robertson, M., Wintersgill, D., A Comparative Review of International Approaches to Mandatory Retirement, Research Report No 674, Department for Work and Pensions, 2010
[64] Ministry of Social Development (2001): New Zealand Positive Aging Strategy
[65] Encel, S. (2003). Age can work – the case for older Australians staying in the workforce, Report to the Australian Council of Trade Unions and the Business Council of Australia

- changes to superannuation arrangements to make it easier to contribute at an older age, and to make it easier for individuals who decide to re-enter the workforce.

- job search and placement assistance for older job seekers; and improved coordination among job placement agencies.

In the US, where mandatory retirement is abolished, according to AARP (formerly known as the American Association of Retired Persons) retirement is now seen as a gradual ‘process’, and no longer a straightforward transition from full-time work. Approximately one-quarter of workers who retired in the 1990s eventually returned to work in new careers.[66] In some instances, older workers can move into partial retirement where they retire from their main employer, collect pension benefits and continue to work in a ‘bridge job’.

Be that as it may, it is also true that research studies carried out in countries which prohibit mandatory retirement show, to varying degrees, employers do sometimes hold negative perceptions of older employees. In the US, for example, where mandatory retirement has been abolished, surveys conducted with human resource workers during 2007 found that the perceived disadvantages of working with older workers included inflexibility in completing tasks, lack of participation in training, difficulty in maintaining up-to-date skills, unease or unwillingness to learn new technologies and increased healthcare costs.[67]

Table 22 compares attitudes to men and women working beyond age 70 in Ireland, Sweden, France, UK, Norway, the Netherlands, Germany and Spain. The results are taken from the European Social Survey, in response to the question: *‘Apart from your own feelings, how do you think most people would react if a man/woman they knew well…carried on working after the age of 70?’* It is notable that France, which currently has a very low participation rate amongst the older population, also has a very high disapproval rating of those working beyond 70. Otherwise there is no clear pattern in terms of how attitudes relate to current participation levels. Disapproval of older working in Sweden and Ireland is in the middle of the range of countries, and both have far higher levels of disapproval than the UK.

Table 22: Attitudes to Men and Women Working Beyond Age 70 by Country[68]

	Views about women working after 70				Views about men working after 70			
	Base	Openly disapprove %	Secretly disapprove %	All who disapprove %	Base	Openly disapprove %	Secretly disapprove %	All who disapprove %
France	991	42	30	72	985	35	31	69
Spain	929	38	31	68	896	28	31	64
Germany	1,414	26	34	60	1,403	19	32	56
Netherlands	901	27	30	57	938	18	27	51
Sweden	920	15	29	45	957	13	27	42
Ireland	851	16	23	40	881	10	18	34
UK	1,193	13	20	33	1,173	8	15	28
Norway	869	3	14	17	871	3	12	16

[66] Johnson, R., Kawachi, J. and Lewis, E. (2009). Older workers on the move: recareering in later life quoting Maestas (2004)
[67] OECD (2005c). Ageing and employment policies: United States
[68] McKay, S. (2010). Never too old? Attitudes towards longer working lives

The PWG 2010**:**

Strategic Review	Post Consultation Recommendation
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.	**Reaffirms Recommendation 17** and adds that the Government should establish an Inter-Ministerial Committee constituted of Ministry of Health, Elderly and Community Care, the Ministry for Finance, Economy and Investment, Ministry of Education, Youth and Employment and the Ministry for Justice, Dialogue and the Family to undertake a holistic review that would lead to the design of an active aging strategy and policy framework. The PWG 2010 recommends that the terms of reference should include but not be limited to: Review and assessment with regards to the abolition of the mandatory retirement age. Flexibilisation of working hours by supporting legislative measures that is beneficial to both employers and employees. Flexibilisation of employment and industrial relations legislation to encourage employers to create new jobs and recruit older workers without the fear of penalties associated with dismissals for this category of workers. Introduction of protective measures concerning older workers with regards to payment of wages. Activation of measures targeting older workers through short term subsidies paid to employers. Provision of equal access of older workers to re-skilling, up-skilling and other forms of training measures. Inculcation of a culture the promotes, recognises and facilitates active aging Penalisation of early retirement to disincentive persons from retiring once they reach the 40 year contributory period and apply the opt-out clause: currently, the only disincentive in place is that such persons will be prevented from entering the labour market before 65 years of age. Rewarding prolonged employment by means of measures such as reducing the National Insurance contribution paid, the income tax rate, or a higher pension value for every additional year worked above the official retirement age, et al. The PWG 2010 further recommends that the Working Group should be set up in April 2012 and mandated to deliver its report by October 2012. Once the proposed PSU within the DSS is set-up the PWG 2010 recommends that this is represented on said mentioned Inter-Ministerial Working Group.

03.3.3.9 Incentivising Active Participation in the Labour Market: Atypical Employment (Section 4.1.2.4 of the Strategic Review)

In the consultation process, emphasis was made by stakeholders that part-time workers are in a particularly vulnerable position in old age, because often they have no, or only restricted, access to a pension system.

Even when access to a pension scheme is granted part-time workers are especially vulnerable to its regulations and provisions given that fewer working hours and lower monthly incomes over a long period of part-time work produce reduced pension entitlements which may subject such persons to a at-risk-of-poverty.

Women continue to predominate in the category of part-time workers. As can be seen from the Table 23, in Q2 2011 women exceed male part-timer workers by over 10,000. In Q2, 2006 women were practically double the number of males in part-time work - and although % wise the proportion of women in part-time work in the economy was marginally higher than that in Q2 2011, the actual number of women part-time workers in 2011 is practically double when compared to 2006.

Table 23: Active Participation of Part-time Persons: Q2 2011[69] Compared to Q2 2006[70]

April - June 2011			April - June 2006		
Male	**No**	**%**	**Male**	**No**	**%**
Full-time with reduced hours	512[u]	0.5[u]	**Full-time with reduced hours**	138[u]	0.1
Part-time	7,039	6.4	**Part-time**	4,534	4.4
Female	**No**	**%**	**Female**	**No**	**%**
Full-time with reduced hours	4,064	7.0	**Full-time with reduced hours**	1,586[u]	3.3
Part-time	17,318	17.7	**Part-time**	8,831	18.5

Although education at a tertiary level is dominated by women - as shown in Chart 18 of the Strategic Review[71], the logical interpretation of the above figures is that tertiary educated women more often hold part-time positions, and even when employed full time they are likely to be employed on fixed-term contracts.

During the consultation process entities representing women as well as unions stressed that the issue of part-time work is a leading gender issue. It is pertinent to underline that EU regulations stipulate that discrimination against part-time workers in social security and pension systems constitutes indirect gender discrimination.

Following the EU Part-Time Workers Directive, a part-time worker must be treated no less favourably than a “comparable” full-timer. Part-timers who are or have been excluded from an occupational pension retirement scheme membership may therefore argue that they were discriminated against. This means that unless employers can objectively justify exclusion, part-time employees, too, have to be provided with the same access to pension schemes as their full-time counterparts in the event that a mandatory Second Pension or a voluntary occupation retirement pension scheme is introduced.[72]

[69] Pg 3, Labour Force Survey: Q2/2011, 185/2011, 29th September 2011
[70] Pg 3, Labour Force Survey, April-June 2006, 227/2006, 12th October 2006
[71] Pg 33, Strategic Review on the Adequacy, Sustainability and Social Solidarity of the Pension System, 2010 Pensions Working Group, December 2010
[72] Pg 22, Ivosevic, V; Pension Reforms in Europe and Their Impact on Women, Education International, Belgium, September 2009

A number of EU pension systems[73] tend to allow employees working part time to buy off pension right entitlements. This provision can improve the old age security of part-time workers to a certain extent. The buying off of pension rights, however, implies an income large enough to be partly spent for this purpose. Therefore, the provision may be mainly beneficial to those part-time workers who have an additional income or a partner, or who are part-time workers for a shorter period of time.[74]

The PWG 2010**:**

Strategic Review	Post Consultation Recommendation
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.	**Reaffirms Recommendation 18** and underlines that the proposed Pensions Strategy Unit is tasked to carry out an in-depth assessment with regards to the pension system and part-time employment to determine the extent that the pension system will leave such persons at a greater at-risk-of-poverty and to submit appropriate recommendations to safeguard against such a risk. The PWG 2010 further recommends that the PSU should be mandated to deliver its report by October 2012.

03.3.3.10 Adopting a Targeted Immigration and Residency Policy (Section 4.1.3 of the Strategic Review)

The PWG 2010 with regards to**:**

Strategic Review	Post Consultation Recommendation
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.	**Reaffirms Recommendation 19**. Additionally, the PWG 2010 agrees with recommendations presented to it during the consultation process that such a measure should be supported by a national skills audit that links into Malta's enterprise and economic vision to determine the skills base that Malta requires to continue to grow economically. The results of such a national skills audit would constitute the base line of thrusts toward which higher education would be directed to build the appropriate indigenous human capital as well as the basis upon which EU or third country human capital would be invited to Malta in order to bolster skills gaps in the immediate, and short to medium term. It is proposed that responsibility for the design and launch of a national skills framework should rest with the Employment Training Corporation working closely with key agencies such as Malta Enterprise, Finance Malta, Malta Tourism Authority, University of Malta, Malta College for Arts, Science and Technology, etc. The framework for a national skills audit should be supported by a permanent capacity that will ensure the appropriate critical mass to sustain periodic survey reviews over time. In this regard, the PWG 2010 recommends that the Government should task the Employment Training

[73] EU Member States that allow part-time employees to buy-off pension right entitlements in 2009 included Belgium, Estonia, Austria, UK, Finland, and Poland amongst others.
[74] Pg 22, Ivosevic, V; Pension Reforms in Europe and Their Impact on Women, Education International, Belgium, September 2009

	Corporation to present to Cabinet by not later than May 2012 a strategic document setting out the methodology and process to be applied for the undertaking of such a national skills audit, how this would tie in with other complementary initiatives such as the Programme for the International Assessment of Adult Competencies, et al.

03.4 Recommendations for Consideration to Strengthen the Sustainability, Adequacy and Solidarity of the First Pension (Chapter 04.2 of the Strategic Review)

03.4.1 Increasing the Retirement Age (Section 04.2.1 of the Strategic Review)

The amendments to the SSA in December 2006 increased the official retirement age from 61 years to 65 years of age for persons who were 45 years and younger as at 1st January 2007 (and the retirement age increased incrementally from 61 years to 64 years for persons who were born between calendar years 1952 and 1961).[75] In essence this means that the official retirement age for both man and women is now 65 years of age - wherein it is now unlawful for employers to a set a mandatory retirement age below 65 years of age for both males and females.

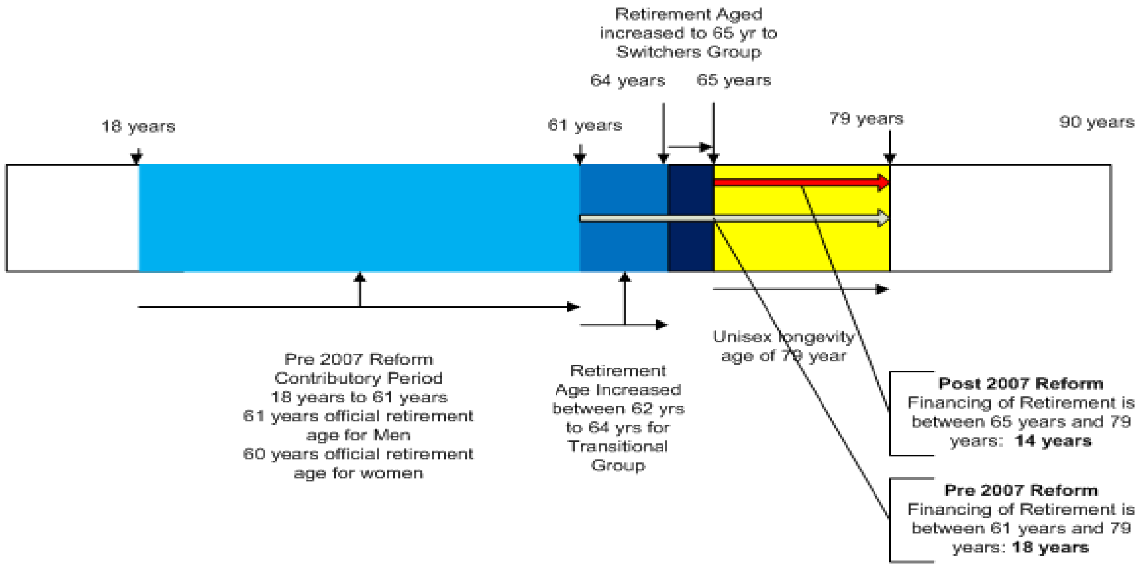
Employees have the opportunity to request an employer to consider a request for him or her to continue in employment beyond the official retirement age - and the decision on whether a person is retained in employment after 65 years of age rests with the employer. In order to incentivise persons who reach the official retirement age to continue in employment the cap on income earned was removed in 2008 thereby rendering it more attractive for a person to remain in employment he or she now had a right to the full pension and any income earned subject to payment of income tax and the National Insurance contribution (as a inter-generational solidarity measure).

Given that, the unisex longevity of a Maltese person in 2007 was estimated to be 79 years the pre-reform official retirement age of 61 years of age meant that the expected period that a person's pension would be for a retirement period of 18 years of age.

The 2007 reforms sought to increase the official retirement age from 61 years of age to 65 years in an incremental manner to bring the retirement age in Malta in line with other overseas jurisdictions facing sustainability issues as a result of an aging population.

[75] Social Security Act defines pension age to mean sixty five years of age provided that (i) (a) saving the provisions of paragraph (ii) hereof, in the case of a person born on or before the 31st December 1951, pension age shall be sixty-one years; (b) in the case of a person born during the calendar years 1952 to 1955, pension age shall be sixty-two years; (c) in the case of a person born during the calendar years 1956 to 1958, pension age shall be sixty-three years; (d) in the case of a person born during the calendar years 1959 to 1961, pension age shall be sixty-four years; (ii) in the case of a woman born on or before the 31st December 1951, pension age shall be sixty years;

Figure 12: Impact of 2007 Increase in Retirement Age on Pension Financing Period



The increase in the official retirement age from 61 years to 65 years, therefore, primarily, sought to reduce a person's retirement period and its financing. As persons live longer, every additional year in retirement over and above the longevity index has a negative impact on the financing of the pension system given that the longer a person lives, the higher is the overall value of the total pension sum that the pension system is to finance to meet its social contract with an individual pensioner.

The increase in the official retirement age to 65 years, therefore, means that the period of retirement that is to be financed with regards an individual person from the day he or she retires to the day he or she passes away the longevity index is, (as at January 2007), reduced from 18 years to 14 years.

Extending working lives not only reduces the length of the retirement period that needs to be financed but also increases the supply of labour, raises the potential levels of gross domestic product (GDP) and consumption. In addition, extending working lives is likely to lead to an improvement in the position of the public finances, in particular, through boosting tax revenues. Studies carried out by the PWG 2010 Strategic Review show that an increase of one year in the official retirement age has a 1% positive impact on the GDP vis-a-vis the pension system balance.[76]

It is pertinent to note that a study carried out by the Department of Work and Pensions in the UK shows that a one year extension of the working life increases real GDP by around 1% about 6 years after its implementation, which is around 80% of the increase in the labour force. The government budget would improve by 0.6% of GDP, and consumption per capita would be more than 1% higher than on the baseline.[77]

Longevity studies carried out by the AWG show that the unisex longevity index of the Maltese population is expected to increase by an additional 6 years between 2010 and 2060 - the period of review carried out by the PWG 2010. This means, therefore, that the unisex longevity age will increase from 79 years to 85 years of age by 2060. This also means, that if the unisex longevity increases by 2060 to 85 years of age as projected and the official retirement age remain unchanged at 65 years of age, the retirement period that would need to be financed will increase from 14 years to 20 years.

Assuming, therefore, that such an increase in the longevity index is not followed by a relative increase in the official retirement age to maintain the period of retirement at 14 years of age constant, the pension system will be subject to financial pressure that would render it unsustainable: indeed, the pension system balance to GDP would rapidly shift from (1%) in 2036 to (5.8%) in 2060.

[76] Pg 60, Strategic Review on the Adequacy, Sustainability and Social Solidarity of the Pension System, 2010 Pensions Working Group, December 2010
[77] Pg 3, Barrell, R., Kirby, S., Orazgani, A., The Macro-economic impact from Extending Working Lives, Working Paper 95, Department for Work and Pensions, UK, 2011

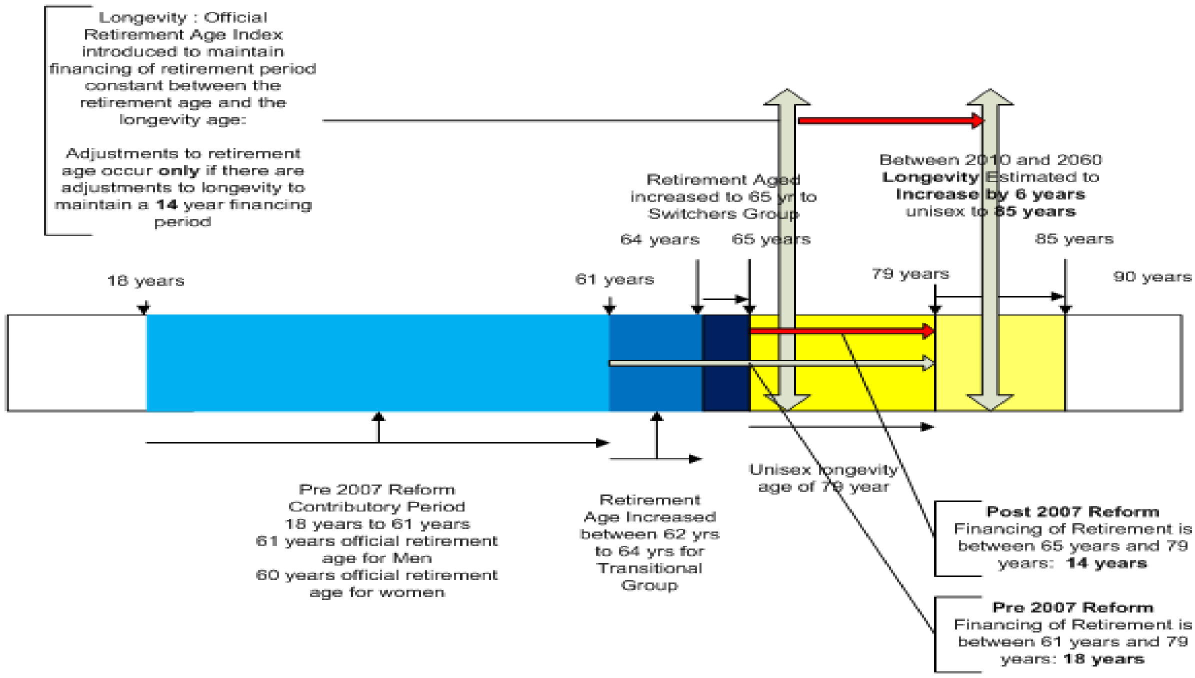
In order to render the pension system sustainable and reverse a projected deficit of (5.8%) in 2060, the PWG 2010 recommended in the Strategic Review that the Government should give consideration to the design of a longevity : official retirement age index that would be grafted onto the First Pension in order to **maintain** the period between the 65 year of age official retirement age and the 2007 longevity index **constant** over the continuum of time.

The recommendation proposed by the PWG 2010, therefore, would have no impact on the official retirement age of 65 years in the event that current projections with regards to Malta's unisex longevity index as at 2060 fail to materialise - that is, it remains constant at 79 years of age.

On the other hand, if projections with regards to the longevity index prove to be correct in part or in full, the proposed longevity : official retirement age indexation mechanism would automatically adjust the official retirement age in proportion to the increase in the longevity index in order to maintain the 14 year period benchmark constant.

This automatic adjustment, therefore, between the official retirement age and longevity would act as one of the triggers that would be inbuilt into the system to secure sustainability over time. The relationship between the official retirement age and longevity is presented in the Figure below.

Figure 13: Impact of Grafting a Longevity : Official Retirement Age Index onto the First Pension



In order to model the potential impact of a longevity : official retirement age mechanism index the PWG 2010 superimposed the Swedish Life Expectancy and Retirement Age Mechanism[78] onto the pension system. The projected results on the behaviour of the official retirement age between the period 2012 and 2060 are shown in the Table below.

[78] Pg 59, Strategic Review on the Adequacy, Sustainability and Social Solidarity of the Pension System, 2010 Pensions Working Group, December 2010

Table 24: Impact on State Pension Age as a Result of the Grafting of a Longevity : Official Retirement Age Index Mechanism

	Change to Official Retirement Age	Official Retirement Age
Up to 2038	No change to the official retirement age	65 years
2039	+1	66 years
2044	+1	67 years
2053	+1	68 years.

One concern that was raised during the consultation period was that it was unrealistic to expect persons over the age of 65 years to continue in employment due to the increased incidence in health issues - and that longevity does not necessarily translate in an improved quality of life.

The World Health Organisation (WHO) shows that the gap between Live Expectancy (LE) and Healthy Life Expectancy (HLE) for different life expectancies at birth is more or less constant regardless of life expectancy and that the average years spent in poor health is equivalent to 10 years of life at birth.

The PWG 2010 could not identify research that projects the LE and LHE for the Maltese society. Studies in the UK, however, by the Office for National Statistics (ONS) shows that projections on HLE for Great Britain, which it defines as years of expected life in either good or fairly good health (based on general health) or free from long standing illness suggest that whilst both LE and HLE are increasing the gap between them is widening. Trend analysis of ONS data since 1981shows that:

LE at birth will be 83.2 years in 2025 as compared with 79.1 years in 2005 (the latest year for which data are available), an increase of 4.1 years.
HLE will be 71.7 years at birth in 2025 as compared with 69.3 years in 2005 an increase of 2.4 years.

If correct, the above in turn implies 87.2% of life was spent in good or fairly good health in 2005 as compared with 86.2% that will be spent in 2025[79].

In essence this means, as discussed and demonstrated in Table 27 of the Strategic Review[80], that living longer does not necessarily mean that all persons in the target age cohorts will have a HLE. Thus, in the event that there is a favourable consideration towards the recommendation to introduce a longevity : official retirement age mechanism index to be grafted onto the First Pension, the design of such a mechanism should inherently take into account that there will be a cohort of persons who due to ill health or long term sickness directly related to aging will not be in a position to remain actively engaged in employment. The PWG 2010 argues that any action directed to graft such a mechanism onto the First Pension should, therefore, be complemented by strong safeguards direct to protect persons who will be vulnerable to age related health conditions.

During the consultation process a common position amongst most stakeholders was that active aging should be incentivised and that persons should be encouraged and retained in the labour market by means of well designed policy mechanisms to achieve such goals and not by further increases to the official retirement age - whether this is through a **longevity : official retirement age index** that allows for automatic corrections or through political decisions made at appropriate junctures between now and 2060.

[79] Pg 12, Mayhew, L; Increasing Longevity and the Economic Value of Healthy Aging and Working Longer, Case Business School, University of London, February 2009
[80] Pg 61, Strategic Review on the Adequacy, Sustainability and Social Solidarity of the Pension System, 2010 Pensions Working Group, December 2010

The recommendation proposed in the Strategic Review directed towards the grafting of a longevity: official retirement age index drew strong criticism from various stakeholders, including the Partit Labourite.

Such stakeholders emphasised the a policy orientation that favours the introduction of automatic adjustment mechanisms to retain a relativity of the retirement period expressed as the difference between the official retirement age of 65 years and the longevity index as at 2007 constant over time was not correct.

The argument presented by various stakeholders is that Malta's 'aging' deficit should best be tackled through the design and implementation of aggressive policy measures directed to increase the active employment rate in the labour market from 59.4% (employment rate 54.9%)[81] to, as a minimum, the EU average within the shortest time possible. The underlying hypothesis of this argument is that in bridging the increase between the current low active employment rate and the EU average the difference is so significant that this provides Malta with an unique opportunity that will allow for the strengthening of the pension system sustainability base given that the increase in contributors is so relatively large that it would compensate for the aging, and decreasing, population.

The PWG 2010 agrees that Malta's active employment rate is far too low and that a coherent and joined-up policy process needs to be mustered to ensure that this increases to the EU average in the shortest time possible. Indeed, in both the Strategic Review as well as in this report, the PWG 2010 identifies areas that require strengthening as well as consideration - such as the consideration for the removal of the official retirement age.

Additionally, the PWG 2010 also agrees with the hypothesis that increases in the active employment rate will buffer negative impacts to the financial sustainability of pension system that are a direct consequence of Malta aging population

The PWG 2010, however, differs with constituted bodies pressing for such a policy direction on the degree of the pervasive impacts of such an approach. Whilst a number of stakeholders are presenting the opportunity arising from increasing Malta's low active employment rate to the EU average ***as the*** solution to the pressures that Malta's aging population will place on the sustainability of the pension system, the PWG 2010 continues to be of the considered opinion that such a measure on its own ***will not suffice*** to buttress the arising financial pressures on the sustainability of Malta's pension system due to the direct impacts of Malta's aging population.

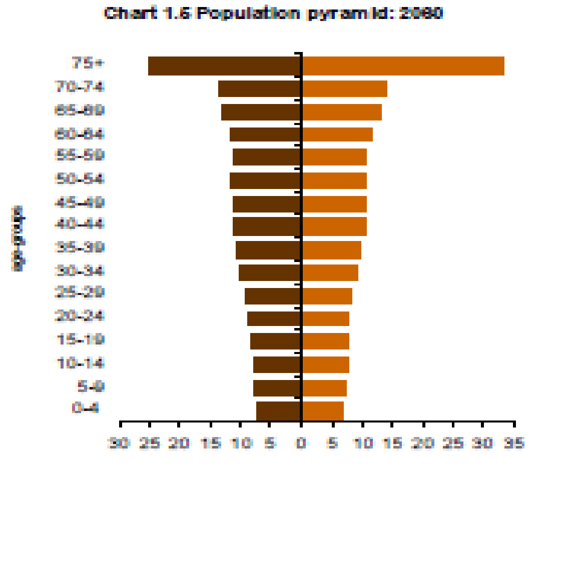
Whilst, as shown in the Sensitive Analysis discussed earlier, that there is no doubt that increasing Malta's active participation rate will have a positive effect with regards to the revenue base of the pension system, the impact arising from an increased labour participation rate will not suffice to address the sustainability issues of the pension system: the 0.4% increase in GDP as a result of a full female active participation rate scenario will barely then projected (5.8%) deficit to GDP that the pension system will reach in 2060 to secure an APRR of 45%.

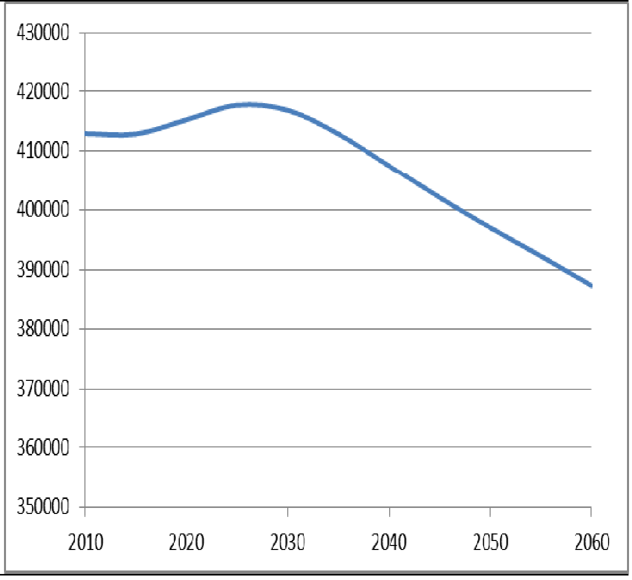
It is, therefore, the PWG 2010's conclusion that whilst a policy to increase active labour market participation is, undoubtedly, a policy objective that should be sought aggressively, it is the PWG 2010's considered opinion that such a policy is **only one** of the policy instruments that have to be applied.

[81] Pg 29, Ibid

Figure 14: Malta's Project Population Behaviour

Population Pyramid 2050[82]	Projected Total Population[83]





It is pertinent to add, that during the consultation process the PWG 2010 was urged to consider that rather than seeking to introduce mechanisms that would lead to the increases in the official retirement age, on policy measure applied in overseas jurisdiction that it should seek to replicate in Malta's pension system is the abolishment of official retirement age.

The PWG 2010 clarifies that the removal of the official retirement age from the pension system does not result in the abolition of an official age threshold that determines when a person can claim his or her pension. Rather, as discussed earlier in this report, the abolition of the mandatory retirement age is directed to the removal of the legal age by which an employer can demand an employee to retire.

The Table below reviews a number of pension systems in countries where a mandatory retirement is not permitted at any age.

Table 25: State Pension Age in Pension Systems which have No Mandatory Retirement Age[84]

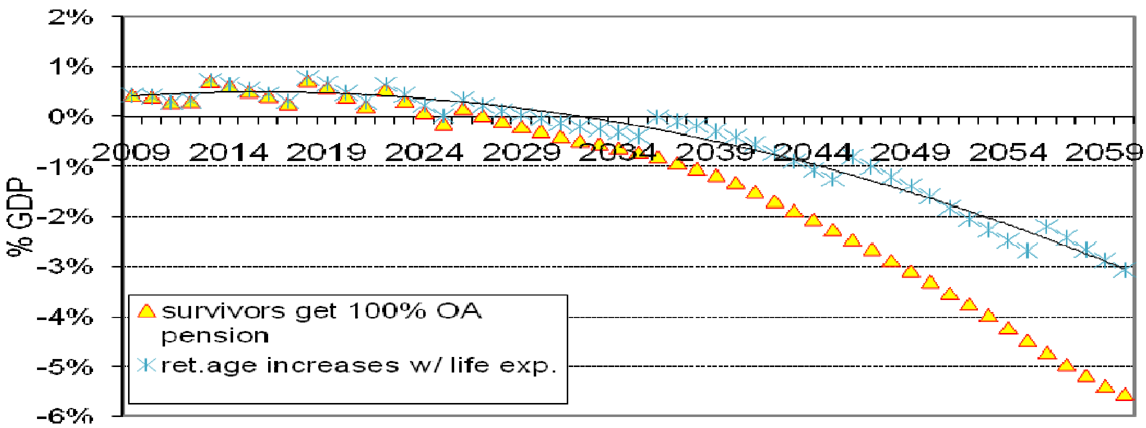
Country	Age when State Pension Can be Claimed
Canada	65 years of age. Early pension can be claimed from age 60 onwards. The earnings-related pension can be deferred, earning a 6% increment for each year after age 65 years: up to a maximum of 5 years.
New Zealand	65 years of age. A State pension cannot be taken before State Pension Age. Receipt of the State pension is not dependent on retirement from work. It is possible to combine pension and employment.
USA	66 years of age. Early retirement possible from 62 years. Late deferment can be made up to the age of 70 years, with a corresponding increase in benefits.

[82] Pg 47, Ibid
[83] Pg 34, Ibid
[84] Pp 27, 28, Wood, A., Robertson, M., Wintersgill, D., A Comparative Review of International Approaches to Mandatory Retirement, Research Report No 674, Department for Work and Pensions, 2010

Australia	Men 65 years of age and women 63 years of age. The State Pension age is to increase to 67 years of age by 2030.[85] Access to superannuation benefits possible after age of 55; individuals who are still working can also access their benefits from age 55 years.
UK	In the Budget Autumn Statement, on 29th November 2011, the UK Chancellor announced that the State Pension age will increase to 67 years of age between 2026 and 2028. The UK government stated it took this decision due of increasing life expectancy, to help manage the cost of State Pensions.

As can be seen from the above Table, despite the fact that the pension system in each of the above countries has no default retirement mechanism the pension system does not allow a person to claim a pension before he or she reaches the pre-determined State Pension Age; or if the person retires earlier is penalised by a lower pension. Moreover, as at 2012 the State Pension Age for 4 of the countries reviewed is 65 years of age, whilst that of the US is 66 years of age. The State Pension Age in both the UK and in Australia is expected to increase to 67 years by 2028 and 2030 respectively.

Figure 15: Projected Pension System Deficit % to GDP[86]



A First Pension system that comes closest to the removal of a statutory pension retirement age that acts as a fundamental parameter to the financial sustainability of the pension system is the Notional Defined Contribution PAYG pension system. The NDC PAYG pension system minimises the role of the 'normal retirement age' and it permits a more flexible choice between consumption (working longer) and leisure (retiring earlier) through rewarding the former by means of an increased pension return and penalising the latter through a reduced pension return below the pension value set at 61 years of age.[87] The consideration of a potential transition of Malta's Defined Benefit PAYG First Pension to a NDC PAYG First Pension is discussed in the next section of the report.

Thus, in the event that Malta maintains a Defined Benefit PAYG pension system as the base for its pension framework then parametric adjustments to the official retirement age as a means to maintain the financial sustainability of the pension system **cannot** be avoided.

The PWG 2010, with no equivocation, concludes that a state of play that does not factor an increase in the official retirement age in the period leading to 2060 is **neither realistic nor credible**. Indeed, the PWG 2010 fears that the prospects are potentially further aggravated by the current financial and economic crisis. Sluggish economic growth, budget deficits and debt burdens have and will continue to make it harder for pension systems, not just Malta's, to deliver on pension promises.

[85] Pg 16, A Sustainable State Pension: When the State Pension Age will Increase to 66, Cm 7956, Department of Work and Pensions, 2010
[86] Pg 60, Ibid
[87] Pg 29, Wood, A., Robertson, M., Wintersgill, D., A Comparative Review of International Approaches to Mandatory Retirement, Research Report No 674, Department for Work and Pensions, 2010

As Europe and the US tackle crippling public debts, under the close watch of volatile markets, EU countries have started to adjust the retirement age as a successful tool in the fight against increasing public debts and budget deficits across Europe. In the last two years, several EU members have had no choice but to raise the retirement age.

As pension reforms sparked outrage across Europe, the Italian parliament, for example, quietly increased the retirement age by more than three years. The Italian Government increased the retirement age from 65 to 68.5 years by 2050 by adjusting it gradually according to life expectancy projections. The first adjustment will occur in 2015, the second in 2019 and subsequent adjustments every 3 years thereafter.

Furthermore, given Malta's membership in the Euro zone as well as the agreement reached amongst the 17 euro zone MS' (together with the other 8 non euro zone MS') on a fiscal pact agreement that would be entrenched in each of the MS' constitution the EC's recommendation for a Council recommendation delivered in June 2011 on the National Reform Programme 2011 of Malta and the Updated Stability Programme of Malta 2011-2014 cannot, in the view of the PWG 2010, be ignored.

The EC recommends:

> "The long-term budgetary impact of ageing, including pensions, is significantly higher in Malta than the EU average. Moreover, the labour market participation of older workers is very low, due to a still relatively low retirement age, frequent recourse to early retirement schemes and the very low participation of older women. The 2006 pension reform increases the retirement age, albeit very gradually, and addresses the adequacy of future pensions, in particular through more generous indexation arrangements and the introduction of a guaranteed national minimum pension. The National Reform Programme reports on the ongoing consultation on the proposals for further pension reform put forward by the Pensions Working Group, including the establishment of an explicit link between retirement age and life expectancy and the introduction of a mandatory second pension pillar and a voluntary third pillar."[88]

The EC in the said recommendation Council suggests that Malta should take action within the period 2011 - 2012 to "ensure the sustainability of the pension system by accelerating the progressive increase in the retirement age and by linking it to life expectancy. [A]ccompany the higher statutory retirement age with a comprehensive active ageing strategy, discourage the use of early retirement schemes and encourage private pension savings."[89]

The recently published White Paper by the EC reiterates the above concerns with regards to Malta and in the pension related country specific recommendations proposes:

> "Take action to ensure the sustainability of the pension system such as by accelerating the progressive increase in the retirement age and by linking it to life expectancy. Accompany the higher statutory retirement age with a comprehensive active ageing strategy, discourage the use of early retirement schemes and encourage private pension savings."[90]

It is pertinent to add that the same concerns were raised with the PWG 2010 by the IMF in their fact finding visit in Malta in January 2012.

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[88] Pg 4, Recommendation for a Council Recommendation on the National Reform Programme 2011 of Malta and Delivering a Council Opinion on the Updated Stability Programme of Malta 2011-2014, Sec(2011) 812 final, European Commission, 7th June 2011.
[89] Pg 6, Ibid
[90] Pg 35, White Paper: An Agenda for Adequate, Safe and Sustainable Pensions, COM(2012) 55 Final, European Commission, Brussels, 16th February 2012.

The PWG 2010:

Strategic Review	Post Consultation Recommendation
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.	**Reaffirms Recommendation 20**. The desire to maintain the retirement age fixed at 65 years of age whilst a person's period in retirement increases as the longevity of the Maltese population is expected to increase between 2012 and 2060 is not realistic. As shown in this report a policy to abolish a mandatory retirement age is not the same as a policy to establish a State Pension Age which determines when a person is able to draw down his or her pension. It is the considered opinion of the PWG 2010 that the fairest way forward is to graft on the current or a reformed PAYG First Pension a mechanism that indexes longevity with the official retirement age.
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.	**Re-affirms Recommendation 21.** The mechanism that allows a person to opt-out from the pension system at the age of 61 years on a full pension entitlement (assuming that the full contributory history is paid) is to remain relative to increases to the official retirement age as longevity increases - otherwise this will constitute an undesirable exit route from the labour market.
New Recommendation A	The PWG 2010 is of the considered opinion that article 66(1)(a) of the Social Security Act which establishes the right for an individual to claim for a non-contributory Old Age Pension, subject to meeting the relevant entitlement criteria, on the attainment of the age of 60 years constitutes a 'back-door' exit for persons who wish to opt out of the active labour market. Given the importance of ensuring that persons remain active in the labour market to the extent possible, unless due to circumstances beyond their control for which safety nets are provided through both the Contributory National Insurance Scheme as well as non-contributory benefits, the PWG 2010 recommends that the Old Age Pension should be re-defined to mean 65 years of age: (a) saving the provisions of paragraph (e) hereof, in the case of a person born on or before the 31st December 1951, pension age shall be sixty-one years. (b) years 1952 to 1955, pension age shall be sixty-two years. (c) in the case of a person born during the calendar years 1956 to 1958, pension age shall be sixty-three years. (d) in the case of a person born during the calendar years 1959 to 1961, pension age shall be sixty-four years. (e) in the case of a woman born on or before the 31st December 1951, pension age shall be sixty years.

New Recommendation B	The PWG 2010 recognises that increased longevity does not necessarily result in healthy longevity. The PWG 2010 is of the considered opinion that if a decision is reached to graft a longevity : official retirement age index mechanism to the First Pension then the design of such a mechanism must be sensitive to age induced debilitating conditions or diseases.

03.4.2 Survivor's Pension (Section 04.2.3 of the Strategic Review)

The Strategic Review proposed that the Government should consider replacing the Survivor's pension by the eligible full pension to be provided to the serving 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.

The PWG 2010 carried out further simulation on the basis of data for 2012. In the event that this measure is introduced for current pensioners this measure would affect pensioners in receipt of the Early Survivor's Pension (totalling 1,774) and the Survivor's Pension (totalling 5,687) - a total of 7,461 pensioners. The cost of implementing this measure in 2012 is estimated to be 0.179% of GDP - which is somewhat higher than the 0.075% of GDP estimated previously.

The PWG 2010**:**

Strategic Review	Post Consultation Recommendation
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.	**Whilst reaffirming the principles underpinning Recommendation 22 the PWG 2010** recommends that this measure is introduced incrementally with the regards to the Transitional and Exempt Groups respectively and fully with regards to the Switchers Group in order to phase the financial implications related to the implementation of this measure.

03.4.3 Widow's Pension (Section 04.2.4 of the Strategic Review)

The PWG 2010**:**

Strategic Review	Post Consultation Recommendation
Recommendation 23: The 2010 Pensions Working Group recommends that the Government in 2011 should consider amending the Social Security Act to allow a widow with dependent children over years 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.	**Reaffirms Recommendation 23.**

03.4.4 Gaps in 40 Year Contributory Accumulation Period of Higher Education Students (Section 04.2.5 of the Strategic Review)

The PWG 2010**:**

Strategic Review	Post Consultation Recommendation
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.	**Reaffirms Recommendation 24.**

03.4.5 Changing Family Norms and Securing Social Solidarity

During the consultation process stakeholders underlined that the Strategic Review shied away from reviewing changing family norms and the changes required in the pension system to ensure that solidarity in this regard is provided.

It was stated that Malta's society is undergoing a fundamental transformation with regards to its family norms. Since the drafting of the Strategic Review the issue of Malta with regards to the legal recognition of divorce as a civil status is now resolved.

Given that divorce is relatively new there is no data on the divorce rate in Malta. Be that as it may, the number of persons who are legally separated as at 2008 stood at 11,640. This is shown in the Table below. The number of female persons separated stands at 6,240.

Table 26: Number of Persons Separated by Marital Status[91]

Marital status	No.			% sex		
	Males	Females	Total	Males	Females	Total
Under 16	35,740	33,470	**69,210**	51.6	48.4	**100.0**
Single (never married)	56,040	47,310	**103,350**	54.2	45.8	**100.0**
Married	99,030	98,740	**197,770**	50.1	49.9	**100.0**
Widowed	5,300	17,250	**22,550**	23.5	76.5	**100.0**
Separated / Divorced	5,400	6,240	**11,640**	46.4	53.6	**100.0**
Not specified	:	:	:	:	:	:
Total	**201,520**	**203,030**	**404,550**	**49.8**	**50.2**	**100.0**

Over the coming years, Malta's family changing norms will see an increase in divorce rates, co-habitation and if overseas patterns are replicated in Malta, a potential decrease in the number of marriages.

With divorce now a legitimate civil status and Government stating that it will present a Bill with regards to the establishment of a legislative framework for cohabitation and / or civil partnerships, the introduction of amendments to the SSA to provide an appropriate base-line safety mechanism with

[91] Pg 6, Statistics on Income and Living Conditions 2009, National Statistics Office, Malta, July 2011

regards to the consideration of pension benefits within a divorce settlement of civil partnership dissolution becomes an important measure.

The PWG 2010**:**

Strategic Review	**Post Consultation Recommendation**
New Recommendation C:	The PWG 2010 **recommends** that given the enactment of the divorce legislation and the forthcoming tabling of a co habilitation Bill the DSS should draft and seek enactment of appropriate legal provisions that would safeguard the interests and protect the pension rights of the divorcing spouses and cohabitating partners.

03.4.6 Consideration of Migrating from a Defined Benefit PAYG to a Notional Defined Contribution PAYG (Section 04.2.6 of the Strategic Review)

In the Strategic Review the PWG 2010 proposed that the Government should establish a special task force with the appropriate expertise to assess the feasibility of migrating from the current Defined Benefit PAYG to a NDC PAYG pension system.

Like funded defined contribution schemes, a NDC pension system imposes a clear link between contributions and pensions. A particular feature of a NDC pension system is that unlike funded defined Contribution schemes, future pension funds in a NDC system are not determined by real funds but by a promise from the Government to pay on the basis of explicit and objective rules.

In a NDC PAYG pension system, notional accounts switch the method used to compute pensions from a defined benefit formula (as the case with the existing PAYG pension system) to a defined contribution formula without actually changing the scheme's underlying PAYG financing. Each pay cycle, contributions are credited to workers' notional accounts. Each year, accounts are credited with a notional 'interest' where the rate is determined by an economic proxy, such as the rate of growth in economy wide wages.

At retirement, notional account balances are used to compute benefits on the basis of average life expectancy. In fact, notional accounts appear (and function) like defined contribution accounts. The key difference between the two is that notional accounts are simply an administrative mechanism for tracking contributions and notional interest: there are no underlying cash transfers or balances.

Under a NDC system, contributions are used to finance pensions in the same way that they are under any PAYG scheme but a NDC pension system also generates a nominal credit for current members (and future pensioners).

The promise replicates the logic of a financial account, however, there are no actual funds and the returns are not defined by the result of fund investments. Rather, at retirement age, individuals have the right to receive a pension that is calculated as if a person's contributions have been accumulated and 'earned' on the basis of predefined 'notional' returns. The chosen rate at which contributions accumulate, therefore, becomes a key determinate of a NDC system.

The NDC benefit is a life annuity. It can be claimed at any time from the minimum retirement age. The generic NDC annuity embodies a rate of return based on the same internal rate of return that is credited to the pension account during the accumulation phase and, importantly, cohort life expectancy at the time the annuity is claimed. Since newly granted annuities reflect life expectancy, in principle, NDC is an actuarially fair pension system.

The introduction of these NDC public pension schemes was motivated, among other things, by the need to (i) to ensure the long term financial sustainability of the public pension system by indexing pension returns to economic growth; (ii) to reduce the existing distortions in the labor market, due to the existing strong incentives to retire early, (iii) to increase the inter-generational equity of the system, jeopardised by the different returns across generations; and (iv) to reduce the systematic political interference with public pension systems under aging conditions through the introduction of a sequence of automatic adjustments in the system that do not require government intervention.

In less technical terms, the benefits of a NDC PAYG pension system are seen to include[92]:

- Adapts itself automatically through an internal interest mechanism to the changed balance of contributors to pensioners without the necessity to intervene discretionarily.

- Through the actuarial conversion of the notional pension wealth into a lifelong pension, the system adapts itself automatically to changed life expectancies where-in reductions (or penalisation) for early retirement result automatically.

- Avoids arbitrariness of benefit indexation rules, adjustment factors, et al.

- Strengthens the equivalence principle and for this reason minimises the wedge between gross and net income, which results from the distortionary impact of taxes and tax-like contributions.

- Adds transparency to the PAYG Pension by clearly identifying individual contributions and the resulting benefit claims.

- Strengths the principle that pensions are based on lifelong earnings, and honours employees who enter the labour market early.

- When an employee retires, the accumulated balance in the notional account is converted to a pension, which is based on unisex life expectancy at the time of retirement - thus for two workers with the same notional account balance, the one who retires at a younger age will receive a smaller monthly pension to equalise lifelong benefits.

- A NDC scheme also has provisions designed to deal with fluctuations in the size of the labor force: for example, the Latvian and Polish schemes automatically adjust benefits for changes (including reductions) in the number of workers paying into the system; and in Sweden, an automatic balancing provision reduces the rate of return credited to the notional accounts if the system is out of financial balance in any given year.

- Although a NDC provides no guarantee against political intervention, however, it makes the results of political intervention more transparent than a conventional PAYG defined benefit pension scheme does.

- Involves risk sharing within each generation, thereby avoiding the inter-generational inequities of other systems that pass deficits down to the next generation.

The introduction of NDC systems in the 1990s has been often advocated as the appropriate reform to achieve several crucial objectives, such as the long run financial sustainability of defined benefits PAYG pension systems and the reduction of the distortions introduced in the labor market. Ten years after their introduction, an evaluation of NDC effects is overall positive. Indeed, on many of these desiderata, NDC systems performed reasonably well.[93] Auerbach and Lee provide a positive

[92]A selected examples of references include Borsch-Supan, A, What are NDC Pension Systems, Mannheim Institute for the Economics of Aging, 42-2003, February 2004; Barr, N., Financial Defined Contribution Pensions: Mapping the Terrain, Pension Reform: Issues and Prospects for NDC Schemes, World Bank, 2003; Blake, D; NDC v FDC: Pros, Cons and Replication, Discussion Paper PI-0913, Pensions Institute, September 2011; Marano, A., Mazzaferro, C., and Morciano, M., The Strengths and Failures of Incentive Mechanisms in Notional Contribution Pension Systems, Annual Meeting of the Italian Public Economics Association, Pavia, September 2011, Kangas, O., Lundberg, U., Ploug, N., Three Routes to a Pension Reform: Politics and Institutions in Reforming Pensions n Denmark, Finland, and Sweden; Kok, L., Hollanders, D., Dutch Lessons from the Swedish Pension Reform, March 2006; Whitehouse E. R. (2010): Decomposing National Defined-Contribution Pensions: Experience of OECD Countries' Reforms. OECD Social, Employment and Migration Working Papers, No. 109, OECD, Paris; Queisser M., Whitehouse E. R. (2006): Neutral or Fair? Actuarial Concepts and Pension - System Design. OECD Social, Employment and Migration Working Papers, No. 40, OECD, Paris; Holzmann R., E. Palmer (eds.) (2006): Pension Reform. Issues and Prospects for Non- Financial Defined Contribution (NDC) Schemes. World Bank, Washington DC; etc

[93] Pg 4,Boeri, T and Galasso, V., Is Social Security Secure with NDC? Institute for the Study of Labour, IZA DP 5235, Discussion Paper Series, Germany, October 2010

assessment of NDC's risk sharing properties (in particular in the case of Sweden), although they highlight their costs in terms of low returns on contributions.[94]

Most international institutions, also, share a rather positive assessment on the future financial sustainability of NDC systems. NDCs are considered to have better properties than non-NDC PAYG systems even when these comparisons are carried out across a homogeneous set of countries.[95]

Yet, some aspects of the implementation to NDC pension system raise some concerns to a NDC PAYG pension system. [96]:

- The assets are very poorly diversified internationally. In effect, the Swedish NDC system invests in a single stock called 'Sweden'. This means that Swedish pensions – in the NDC component at least – are wholly dependent on Swedish economic growth rates and Swedish demographic trends. Countries can become insolvent – and it is uncertain what happens then to NDC pension entitlements?

- Financial balance of an unsustainable PAYG system becomes more obvious as workers 'see' their declining benefits (while contribution rates are increasing) on their own accounts - thereby translating a general knowledge about the financial situation of the pension system into a pension concern.

- A NDC does not change the tension between the business cycle related earnings declines and long term spending commitments: therefore, a genuine liquidity reserve is necessary.

- Careful consideration is required with regards to the adoption of an indexation mechanism based on deviations in the growth of the wage bill (the contribution base) from the potential growth rate of the economy.

It is pertinent to underlines that a transition to a pension systems based on the NDC principle constitutes a **major structural reforms of their public pension system**. One of the issues which is of considerable concern to the PWG 2010 with regards to a potential transition from a Defined Benefit to a NDC PAYG pension system is the legacy costs that would have to be faced as a direct consequence of such a transition.

A key objective of reform to a pension system is to place the reformed system on a financially sustainable basis while adjusting the benefits system and their link to contributions in order to render the reformed system more equitable, affordable and less distortionary. Legacy costs constitutes of the additional financing needs required above and beyond those of the reformed and financially sustainable new system that reflect prior commitments. Analytically, the sources of the legacy costs can be differentiated depending on the scope of reform such as[97]:

Any acquired and honoured rights of current retirees and contributors reflecting leftovers of prior reforms that have not previously been addressed through explicit legacy financing – hence surpassing the steady-state benefit level of the current system.
The acquired and honoured rights of current retirees and contributors in excess of the sustainable benefits under the new contribution rate. These are new legacy costs that result from the transition from the old to the new and lower contribution rate equivalent to the (partial) move from an unfunded to a funded system. Hence the scope of these legacy costs are a political decision by how much the contribution rate and future benefits should be downward adjusted.

[94] Auerbach, A.J. and Lee, R. (2009) "Welfare and Generational Equity in Sustainable Unfunded Pension Systems," NBER Working Papers 14682, National Bureau of Economic Research, Inc

[95] [95] Pg 4,Boeri, T and Galasso, V., Is Social Security Secure with NDC? Institute for the Study of Labour, IZA DP 5235, Discussion Paper Series, Germany, October 2010

[96] Ibid

[97] Pg 7, Holzmann, R, and Jousten, A; Addressing the Legacy Costs in an NDC Reform: Conceptualisation, Measurement, Financing, Discussion Paper: IZA DP No. 5296, October 2010

The acquired, honoured and perhaps, non contributory rights of additional groups brought into the NDC (such as Treasury pensions to pre 1979 engaged public officers). Such rights are already in the system and do not reflect new financial arrangements as they would have to be financed in any case. Their inclusion, however, renders these costs explicit.

The estimated stock of legacy costs, however, says little about the timing of the flows and hence of the financing needs of governments. An immediate transfer of all current workers (and retirees) to the new system would see everybody from the new system entrant to the person one day before retirement would have his or her acquired rights transformed into a notional (initial) capital and continue the next day with the recording of contributions (with reduced contribution rates) on his or her individual account. Such a full immediate transition puts the highest cash-flow needs up front and concentrated on the next 40 years or so (unless coverage expansion takes place). It starts out with the difference between the broadly unchanged pension expenditure minus the revenues under the new and fixed contribution rate, with the reduction happening in an S-shaped curvature for many years[98].

The cash-flow needs for a more gradual transition for current workers would kick in also more gradually but the overall legacy cost would not necessarily be smaller; on the contrary. But it depends on the starting conditions and how the transition is staged[99]:

If the conversion to the new scheme concerns only the younger workers, say below age 40, while the older workers continue under the old system, the immediate cash flow is smaller but increasing until all workers are in the new scheme (say in 25 years, if the retirement age is 65). The overall legacy costs would remain unchanged if the reform would merely mean a move from an actuarially sound system with a high to one with a lower contribution rate. If the system was financially unsound to start with, the older workers under the old system would continue to acquire benefits beyond their contribution efforts and the overall legacy costs would increase.
If the conversion to the new scheme concerns only the new entrants while everybody already in the old system would continue to stay there, the cash flow needs would increase for the next 45 or so years and gradually be reduced thereafter for other 45 years. Again, the overall legacy costs would remain unchanged if the reform would merely mean a move from an actuarially sound system with a high to one with a lower contribution rate. If the system was financially unsound to start with, as all the older workers under the old system would continue to acquire benefits beyond their contribution efforts and the overall legacy costs would increase and have its highest value. It would be composed of the transition costs of moving from a high to a lower contribution rate equivalent to the move from an unfunded to a funded system plus the accrued costs of unsustainability for longest time.

There are essentially three ways to finance the legacy costs of a NDC pension reform[100]:

Reducing the size of the costs by reneging on some of the existing commitments (i.e. burdening the generations of current retirees and those soon to retire).
Reducing the size of the costs by increasing the value of the PAYG asset by coverage expansion (for a given new contribution rate)
The residual strategy consists of the use of general government revenues to finance the legacy costs with the understanding that these resources need to be levied in a less distortionary manner than contribution financing.

The PWG 2010 is concerned that the financing of a potential transition to a NDC PAYG First Pension is Malta is further complicated by the fact that since the creation of the National Insurance Contributory Scheme no administration in Malta created a ring fenced First Pension Fund. Indeed, given the fact that when the NI contributory retirement pension scheme was created in 1979 such a fund, today, would have had a substantial surplus that would have otherwise acted as a buffer vis-a-vis the cost of transition.

[98] Pg 13, ibid
[99] Ibid
[100] Pg 14, Ibid

The absence of such surplus reserves within a ring fenced First Pension fund, therefore, could render a transition onto a NDC PAYG pension system difficult to achieve.

The PWG 2010**:**

Strategic Review	Post Consultation Recommendation
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: (i) possibility of transforming the Two-Third Pension into a Notional Defined Contribution First Pension, (ii) short to long term impact of such a reform on the adequacy, sustainability and solidarity of the pension system, (iii) ability to migrate from a Two-Thirds Pension to Normal Defined Contribution First Pension; and (iv) implementation issues that would have to be addressed.	**Re-affirms Recommendation 25** and adds that a transition to a Notional Defined Contribution Pay As You Go pension system constitutes a major structural reform and one that needs in depth expertise study before reaching a way forward vis-à-vis its potential application as a reform instrument to render the First Pension on a more sustainable basis. The PWG 2010 recommends that the Pensions Strategy Unit should lead this review and should appropriate expertise in NDC design, transition and implementation engaged from supra-national institution as well as EU countries which have under gone such a reform. The PWG 2010 recommends that this study should be initiated in June 2012 with a target completion date of October 2013.

03.5 Introducing a Mandatory Second Pension Framework (Chapter 05 of the Strategic Review)

03.5.1 The Timing of Implementation and the Design of a Mandatory Second Pension Framework (Section 05.4.1 of the Strategic Review)

The PWG 2004 proposed a multi-pillared approach for the new pensions system – with the First Pension consisting of an adequate pension provided by the State; with a mandatory Second Pension consisting of savings made in a private funded pension by individuals and contributions by employers that are to improve an individual's life style by bridging the gap between pension income and income earned in employement; and a Third Pension that provides an individual with a choice to save more for his or her retirement should he or she wish to do so.

The multi-pillared approach proposed by the PWG 2004 was premised on the following principles:[101]

- The Defined Benefits PAYG First Pension provided by the State must be sufficiently adequate to allow a person to live well and in dignity during retirement. An adequate pension, however, does not mean that the pension income would equate to the level of income enjoyed when a person is in employment. Such an expectation is not correct and can never be met under any form of a sustainable pension system.

- A person must assume responsibility to increase his or her level of pension income during retirement should he or she wish to maintain a standard of living during retirement which is closer to that enjoyed by the individual whilst in employment.

The PWG 2010 in the Strategic Review maintained 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.

[101] Pg 38, Final Report: Pensions: Adequate and Sustainable, Pensions Working Group, 30th June 2005

The rationale supporting a **well balanced** First and mandatory Second Pension framework is that of diverting risk – where:[102]

(a) 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.

(b) 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.

Indeed, the PWG 2010 concluded 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 achieved through the bridging, to the extent possible, of the gab between the pension value provided by a First Pension and income earned during employment.[103]

It is the considered opinion of the PWG 2010, that all of the stakeholders have converged with the view that there is a need for the design of funded pension that complements a strong First Pension to meet this stated aspiration of the adequacy level that would be provided through a multi-pillared pension system approach.

It is the considered opinion of the PWG 2010 that the issues raised by most stakeholders during the consultation process with regards to a Second Pension are related to the form, design and timing, The key issues raised included the following:

(a) The majority of constituted bodies consulted favoured a mandatory funded pension framework that is grafted onto the First Pension (such as the Swedish Premium Pension) as against a Second Pension that is distinct from the First Pension.

 The rationale presented for such an approach is understood to include the following:

 (i) This presents a strong platform on the basis of which a Board of Trustees is constituted from representatives of Government, employers and employees which would be responsible for the design of the Investment Principles which would govern how private pension providers would manage investment in the private funded component of the First Pension.

 (ii) The grafting of the funded pension layer onto the First Pension would classify the funded pension arrangement as an extension of the Social Security governance framework thereby providing the Board of Trustees with more flexibility with regards to the design of a box of stringent prudent risks that will assure persons who are mandated to save in such a fund that their contributions will not degenerate into 'casino' style investment management.

 (iii) That the Government would act as a guarantor to the private funded component of the First Pension.

(b) The majority of the constituted bodies consulted expressed concern with regards to the introduction in the near or medium term of a mandatory Second Pension (whether as a funded pension arrangement grafted onto the First Pension or as distinct Second Pension in its own right) under the prevailing economic and financial conditions.

 It is argued that a mandatory Second Pension would increase costs to local and Foreign Direct investment as well as tip the local economy into recession in these difficult economic

[102] Pg 80, A Sustainable State Pension: When the State Pension Age will Increase to 66, Cm 7956, Department of Work and Pensions, 2010
[103] Ibid

and financial conditions as a direct consequence of reduced spending as consumption is deferred onto the future by the individual consumer, and the passing on by the private sector employer the cost of a mandatory Second Pension contribution to the consumer.

The PWG 2010 is not surprised with regards to the feedback presented to it - indeed these are complex issues which the PWG 2010 also grappled with, at length, during the course of its work on the Strategic Review.

It is pertinent to underline that the PWG 2010 was criticised by a number of constituted bodies that whilst in Recommendation 26[104] of the Strategic Review it proposed that the Government should introduce a mandatory Second Pension directed at persons who are aged 45 years and younger it failed to present a framework that sets out the details on such a fundamental reform measure that would allow political parties and constituted bodies as well as individual employers and employees to understand better the consequential implications of such a reform.

The PWG 2010 presented a recommendation based on principle for the need for a mandatory Second Pension to be **introduced at the earliest possible**. It refrained from forwarding a detailed framework of how a mandatory Second Pension should be designed (as was the case with regards to the recommendations of the PWG 2004 in its Final June 2005 report)[105] because it was strongly of the opinion that given the national import of such a decision and the challenges that its implementation would create to all stakeholders the best way forward was for the Government to lead national discussions that would result in a bi-partisan and civil society agreement on the important modalities that surround the introduction, setting up, implementation, and the phasing of the introduction of a mandatory Second Pension.[106]

Reforms to encourage individuals to save for retirement in the form of different private pensions structure that complement a First Pension have been widespread. Where mandatory Second Pension has been introduced they have invariably formed part of a holistic multi pillar reform process. In Sweden, for example, the reforms comprised the introduction of the Premium Pension Plan but also a switch of occupational pension schemes from a defined benefit to a defined contribution basis. In both Poland and Uruguay, the introduction of mandatory pension saving into a defined contribution scheme was part of wholesale reform of these countries' public pension systems.

The Table below provides an overview of key features of Second Pension schemes.

[104] Pg 83, Ibid

[105] The 2004 PWG in its June 2005 Final Report recommended the following framework with regards to the implementation of a mandatory Second Pension:

Recommendation	
No 59	Managing Benefits upon Maturity of a Second Pension Scheme: Upon maturity the pension should provide for 20% as a maximum that can be converted into a lump sum and 80% as a minimum that will be converted into a monthly annuity.
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 on the First Pension will be 9% by the Employer and Employee respectively as well as by the Self-employed].
No 63	Implementing the Second Pension Scheme: Contribution to mandatory Second Pension will incrementally increase as follows: 2011: +1% employers+1% employees+1% self employed 2020: +1% employers+1% employees+1% self employed 2025: +1% employers+1% employees+1% self employed
No 64	A Maximum Salary Limit of €35,000 (Lm15,000) is established as the ceiling for mandatory contributions to the Second Pension.

[106] Pp 83-84, A Sustainable State Pension: When the State Pension Age will Increase to 66, Cm 7956, Department of Work and Pensions, 2010

Table 27: Overview of Key Features of Second Pension Schemes[107]

Case Study Country	Details of Pension Scheme / Pension Reform	Is there a legal requirement on employers to automatically enrol eligible employees, with option for employees to opt out?	Compulsory employer contribution to DC scheme?	Compulsory employee contribution to DC scheme?	Total contribution required to DC scheme (as at 31/01/10)
UK	A duty on employers to automatically enrol eligible workers into qualifying workplace pension scheme. Employers have to provide a minimum contribution for participating workers. Government contributes 1% in the form of tax relief. If employers only pay the minimum contribution, workers need to contribute to bring the total contribution to 8%. Workers can opt out of the scheme.	✓	✓	✓	8% of qualifying earnings.
New Zealand	KiwiSaver introduced in 2007, a voluntary employer-based DC pensions with auto-enrolment and incentives to save.	✓	✓	✓	Minimum of 4% of Gross earnings.
Sweden	New public pension system introduced in 1999. Earnings-related notional account plus mandatory contribution by employees to a DC scheme (Premium Pension Plan).	✗	✓	✓	2.33% of pensionable pay.
Australia	Superannuation Guarantee, introduced in 1992, makes it a legal requirement for employers to contribute to a private pension plan.	✗	✓	✗	9% of qualifying earnings.
Norway	2005 Mandatory Occupational Pensions Act provided for shift from voluntary to mandatory establishment of occupational pension schemes. Can be DC or DB schemes. Mandatory employer contributions to DC schemes.	✗	✓	✗	2% of qualifying earnings.
Denmark	Review focused on Special Pension scheme (mandatory DC employee contributions) which was introduced in 1999. It is to be noted, however, that contributions to the Special Pension were suspended between 2004 and 2008. In 2009 it was decided to allow members to take out their Special Pension savings in order to boost the Danish economy. It is reported that the vast majority of Special Pension members have	✗	✗	✓	1% of gross earnings.

[107] Pp 13-14, Collard, S., and Moore, N., Review of International Pension Reform, Research Report No 663, Department for Work and Pensions, UK, 2010

	withdrawn their savings.				
Poland	New public pension system introduced in 1999, based on system of earnings-related notional accounts. New labour-market entrants and workers under 30 must also participate in a mandatory DC scheme - this means they are legally required to become members of a private open pension fund.	✗	✗	✓	7.3% of qualifying earnings.
Uruguay	Public pension system moved from PAYG to mixed system comprising publicly managed DB scheme and mandatory DC scheme.	✗	✗	✓	% of qualifying earnings depending on gross monthly income.

The following provides a more detailed background of the Secondary Pension schemes within the countries reviewed.[108]

Country	Description
Australia	The Superannuation Guarantee is a mandatory employer contribution to a private pension plan, which employers have to pay quarterly either direct to a regulated superannuation fund or via a commercially operated clearing house. The plans may be operated by the employer, industry associations, financial services providers or by individuals themselves. Employers do not have to contribute for employees earning less than €364 per month (€4,368 per year) before tax but they can choose to contribute for them. In addition, employers do not have to contribute for employees' pay above a certain limit. For each quarter of the year 2005 / 06, this limit was €27,303. This is equivalent to around 2.5 times average wages and is indexed to a measure of average earnings. In addition, employers in Australia are not required to contribute to the Superannuation Guarantee if the employee is: - under age 18 and works no more than 30 hours per week, or over age 70. - paid to do work of a domestic or private nature for 30 hours or less a week. - a non-resident paid for work done outside Australia. - a certain type of foreign executive. When the Superannuation Guarantee was first introduced in Australia in 1992, the mandatory contribution rate was 3% of qualifying employee earnings (4% for employers with a payroll greater than €809,801, or around £500,000), rising to 6% from 1st July 1996 and 8% from 1st July 2000. Since 1 July 2002, employers have been required by law to pay 9% of employee earnings. Employees are not obliged to contribute to the Superannuation Guarantee scheme, but from 2003 low to middle income workers have been encouraged to do so by means of government co-contributions (or matched savings), up to a maximum entitlement. From 1st July 2009, however, the match rate and the maximum entitlement were temporarily reduced, as follows:

[108] Pp 16-33, Ibid

	- 100% (€0,81 for every €0.81) for the financial years 2009 / 10 to 2011 / 12, with a maximum co-contribution of €810. - 125% (€1.01 for every €0.81) for the financial years 2012 / 13 to 2013/14, with a maximum co-contribution €1,214 - 150% (€1.01 for every €0.81) from 2014/15 onwards, with a maximum co-contribution of €1,214.
New Zealand	All new permanent employees aged between 18 and 65 years have to be automatically enrolled into KiwiSaver by their employer. They have from the second to the eighth week of their employment to opt out of the KiwiSaver scheme but can opt back in through their employer or direct through a provider. Anyone under the age of 65, including self-employed individuals and those not in the workforce, may choose to set up a KiwiSaver account. In addition, parents can open a KiwiSaver account for their children. New Zealand government employees working outside the country may also opt into KiwiSaver. While individuals are permitted only one KiwiSaver account, employees with multiple jobs can contribute to their account from each of their current jobs. When KiwiSaver was first introduced in 2007, employees could select a monthly contribution rate of 4% or 8% of their gross earnings. Employees who did not choose were automatically assigned a minimum 4% contribution rate but could increase their contribution rate to 8% at any time. The Government provided two incentives to encourage employees to contribute to their KiwiSaver account: a dollar-for-dollar tax credit of up to €655 per year per account holder, and a one-off tax-free payment of €629 to each account. Employees also received an annual fee subsidy of €25 to pay administrative costs. Employer contributions to KiwiSaver have been phased in over time. Up to 1st April 2008, employers had the option of paying part or all of an employee's KiwiSaver contribution. The employer's contribution of up to 4% of the employee's gross earnings was tax-exempt to the employer. From 1st April 2008, all employers were required to contribute to an employee's KiwiSaver account, starting with 1% of an employee's gross earnings in 2008 and increasing 1% each year until the mandatory employer contribution reached 4% of gross earnings by 1st April 2011. There are no earnings thresholds in respect of employer contributions, in other words they currently have to contribute 2% of total gross earnings.
Poland	Prior to the pension reform of 1999, Poland operated a PAYG public pension system. A new public pension system was introduced in 1999, which is based on a system of notional accounts. Younger workers are also required to participate in the funded (or defined contribution) scheme. Older workers could choose the funded scheme option. In total, contributions to the reformed pension system account for 19% of employees' taxable income, with employers and employees each paying half. Of that amount, 12.22% goes into the public notional account scheme, with 9.76% paid by employers and 2.46% by workers. The 7.3% contribution paid onto the Second Pension is paid entirely by the employee.
Sweden	A new pension system was introduced in Sweden in 1999, which consists of an earnings-related element based on a system of notional accounts and a small mandatory contribution to the Premium Pension, a defined contribution Second Pension scheme. Contributions of 18.5% of pensionable pay are credited to the pension system. Pensionable pay is defined as earnings less the employee contribution to the

	pension system of 7% gross earnings. This gives an effective contribution rate on gross earnings of 17.21%, 14.88% to the notional accounts system and 2.33% to the Premium Second Pension scheme. There is a lower earnings threshold on contributions to the Second Pension scheme, but no upper threshold. Contributions are only levied when annual earnings exceed a floor of €1,884 or just over 5.2% of average earnings which is around £1,748), and are due on the whole of earnings above this floor.
Norway	The public pension system in Norway consists of a flat-rate basic pension and an earnings-related supplementary pension. Pensioners with little or no earnings related pension are entitled to a special supplement that is income-tested against their earnings-related pension. A mandatory occupational pension was introduced in 2006, as part of a wider package of reforms. Around 60%of employees are covered by voluntary occupational pensions schemes. Membership of an occupational pension scheme is compulsory for eligible employees in Norway and they cannot opt out. All employees over the age of 20 must be covered, but newly hired employees with less than 10 years' service before reaching retirement age can be excluded if this is established as a general scheme rule. Part-time workers must be covered if they work at least 20% of full time working hours, and seasonal workers must be covered if they work at least 20% of full-year employment. The self employed are not covered, and they cannot establish profession-wide schemes. From 2006, employers must make a minimum contribution to a defined contribution plan of 2% of their employees' earnings. In Norway, contributions are only required on earnings between the basic amount and 12 times the basic amount.

As can be seen from the above assessment, different approaches have been adopted by the countries with regards to the introduction of a Second Pension framework in the respective jurisdiction. Of note is that each of the Second Pension frameworks introduced in each of the said countries constituted part of a broader reform directed to secure adequacy and sustainability of their respective pension system in view of challenges arising, primarily, from active aging.

In the design of a Second Pension framework the following policy debate is required:

(a) Is the threshold for a Second Pension contribution to be based on the basic wage, as is currently is the case with regards to the First Pension, or should it be earnings based?

(b) At what lower and upper level should the threshold for mandatory qualification for a Second Pension be set? The higher the threshold set - whether wages or earnings based - the lower will be the number of employees who will contribute to the scheme.

In the design of the new National Employment Savings Trust (NEST), which the UK Government introduced in 2011 following consecutive pension studies that showed that over seven million people were not saving enough to give them the retirement income they desire or expect, the following design considerations were taken into account.[109]

Setting the threshold at €8,786 would see 78% of the group no longer captured being women, (or 76% at €11,976 and 68% at €16,770) - which would have disproportionate impact on women.
Individuals who are low earners throughout their lifetime receive relatively high income in

[109] Pp 98-99, Johnson, P., Yeandle, D., and Boulding, A, Making Automatic Enrolment Work: A Review for the Department for Work and Pensions, Cm 7954, UK, October 2010

retirement without private pension saving. For example, an individual earning €11,976 per year from the age of 22 would, in the UK, see a replacement rate of around 97% from the State alone. For these individuals, the designers of NEST questioned whether it would be beneficial to re-direct money into private saving.

Where earnings increase over time, the individual is brought into pension saving when he or she has more money.

Separating the threshold at which NEST enrols an individual automatically €8,785; €11,976 or €16,770) and the band on which contributions are calculated and deducted (€6,846 to €45,736) means that when an individual is enrolled, he or she will start saving amounts of money that increase their income in retirement.

Additionally, the higher the threshold set - whether wages or earnings based - the lower will be the number of employees who will contribute to the scheme which is estimated to lead to both administrative and contribution cost savings to employers. The following design considerations were taken into account with regards to employers in the design of NEST[110].

Micro employers are expected to benefit most from the reduced administrative and contribution costs as they are more likely to employ low earners. In the UK it is estimated that around two thirds of individuals who work for micro employers earn less than €17,964, compared with around a third of individuals who work for employers with at least 20 workers.

Separating the earnings threshold from the lower earnings limits reduce the number of individuals who repeatedly start and then top making contributions because of fluctuating earnings and therefore reduces the administrative burden associated with individuals.

(c) At what level will contributions be set, and will these be introduced incrementally? The discussion above shows that in most instances where a Second Pension was introduced as part of a more holistic reform process, a level of the contributions to be paid by employers and employees was established at the design of the Second Pension but a phased implementation approach was adopted towards reaching the full contributory level to allow both employers and employees to manage the transition.

Funded pension arrangements - irrespective whether these are grafted on to a First Pension or created as a distinct Second Pension mechanism - have the potential to meaningfully increase levels the combined APRR levels. But – as was discussed earlier – their impact on replacement rates cannot be known with certainty in advance and will vary as a function of

(i) The contribution rate levied.

(ii) The real rate of return earned on invested assets.

(iii) The holding period over which contributions are invested (note that the compounding of investment returns implies that longer holding periods tend to generate substantially higher levels of income replacement than do shorter holding periods).

(iv) Issues relating to how benefits are computed at retirement (to include, for example, whether unisex life expectancy tables are used in the computation of annuities at retirement, whether annuities are fixed in nominal terms or indexed to inflation, and whether married couples are required to purchase joint annuities with the right of survivorship or are allowed to purchase individual annuities that terminate upon a participant's death).

[110] Pg 100, Ibid

The Figure below models, simulated by the World Bank in 2010, the levels of income replacement - based primarily on criteria for a mandatory Second Pension as established by the PWG 2004 - that could result from the introduction of a mandatory Second Pension in Malta under a set of assumptions consistent with the macro-assumptions framework applied for the base line model. The assumptions taken, by the World Bank, with regards to this model are the following:

Contribution rates will be equally shared between employers and employers - which is consistent with the 2004 PWG assumption for the mandatory Second Pension.

Contribution rates are set at 4% for employers and 4% for employees - which is consistent with the 2004 PWG assumption for the mandatory Second Pension.

The contribution rates will be introduced incrementally on the following implementation time frame:

Year	Contribution Rate
2015	2%
2017	4%
2020	6%
2023	8%

The implementation period is assumed to start in 2015 as against 2012; and the full 8% contribution rates to be paid equally by the employer and the employee will be reached in 2023 and not 2025 as assumed with regards to the PWG 2004 assumptions.

Furthermore, unlike the 2004 PWG no assumption is made that there will be a 1% employer + 1 % employee carve out rate from the Defined Benefit PAYG First Pension.

Thus, under the model simulated, the contributions assumed that will be paid by both employers and employees for both the First and Second Pension respectively are as follows:

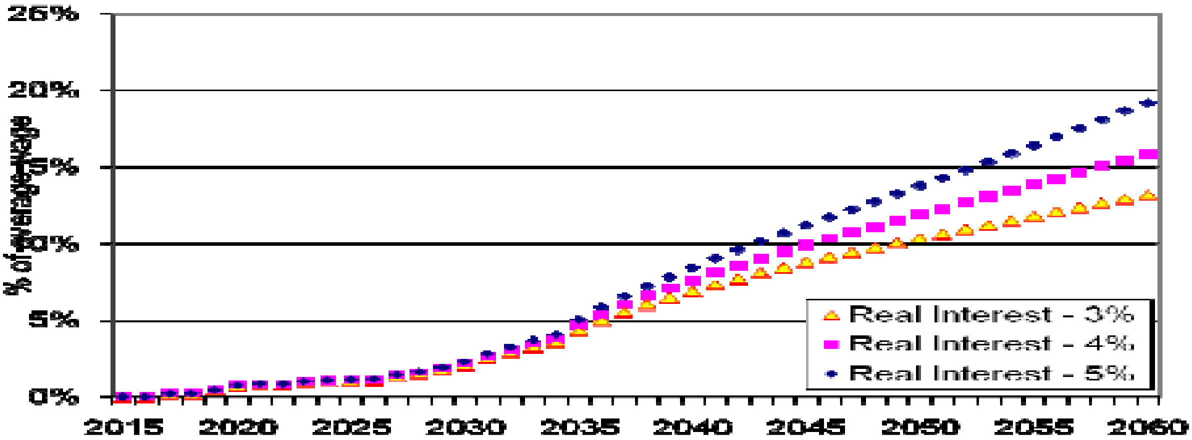
Year	Defined Benefit PAYG First Pension		Mandatory Second Pension	
	Employer	Employee	Employer	Employee
2014	10%	10%		
2015	10%	10%	1%	1%
2017	10%	10%	2%	2%
2020	10%	10%	3%	3%
2023	10%	10%	4%	4%
Total	10%	10%	4%	4%

The entirety of an individual's account balance is used to purchase an annuity at the point of retirement (i.e., lump sum payments are not permitted).

Annuities are indexed to inflation (indexing benefits to inflation will preserve their real value over time but will also result in lower *initial* levels of income replacement).

Annuities are computed using an assumed real discount rate of 3%.

Figure 16: Income Replacement in Malta Resulting from a Mandatory Second Pension[111]



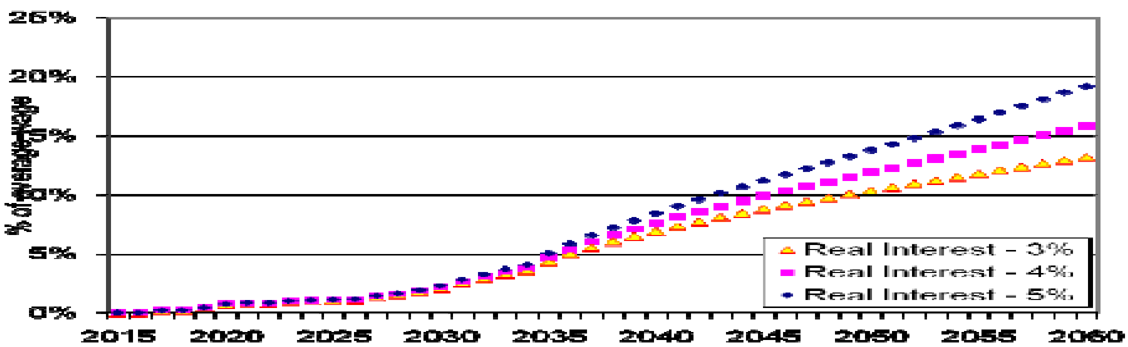
The different plots within the Figure show the resulting levels of income replacement at retirement for a male worker retiring in the years shown under three different assumptions - 3%, 4%, and 5% - for the real rates of return earned on the worker's individual investment account under the Second Pension.

Levels of income replacement for women are similar but slightly lower (by roughly 2% at most, in the final years of the projections) as a result of their retiring earlier than men.

Replacement rates trend upwards over the projection period because (i) the contribution rate is being increased over time and (ii) the length of the investment holding period grows with each additional year of participation in the Second Pension.

The Figure below illustrates the value of accumulated assets (expressed relative to GDP) that could result from the introduction of a mandatory Second Pension. The different plots within the figure show how the balance of accumulated assets will vary as a function of the assumed real return that is earned on Second Pension assets.

Figure 17: Value of Accumulated Assets Expressed Relative to GDP[112]

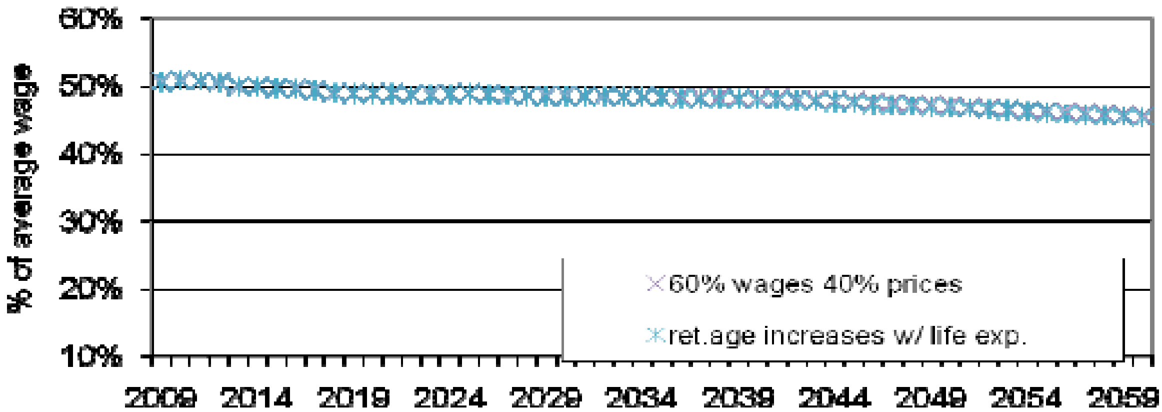


[111] Pg 66, Pensions in Malta: Actuarial Analysis and Options for a Second Generation Reform, Middle East and North Africa, Human Development Group, World Bank, November 2010.
[112] Pg 67, Ibid

The above are some of the design questions and issues that need to be taken into account in the setting up of a mandatory Second Pension framework. What is evident, however, from the model projected by the PWG 2010 is that a Second Pension framework that is based on an 8% contribution base that is incrementally introduced over a period of 9 years (2015 to 2023) will require 25 years – that is 2035 - from the date of the implementation (under all of the discounted rate options modelled) to reach an income replacement rate of 5% of the Second Pension.

This means, that in the event that a Second Pension framework is introduced in 2015, by 2035, a combined First Pension and Second Pension APRR would total approximately 53% - which is 2% below the 54.7% APRR enjoyed by current pensioners.

Figure 18: Degeneration of First Pension Average Pension Replacement Rate under Base-Line Model[113]



It so follows, therefore, that the longer it takes for Government to implement a Second Pension as a complementary pension to the First Pension, the longer it will take to secure a sustained and adequate pension for future pensioners that, is equal to the APRR enjoyed by current pensioners.

The PWG 2010 underlines, with no equivocation, that a Government will not be in a position to design and implement a mandatory Second Pension mechanism overnight. Should one assume that national consensus is in place today with regards to a mandatory Second Pension mechanism, the experience of overseas jurisdictions shows that a minimum of 4 years is required from when the principles for such a framework are agreed to until such time that the first persons are enrolled in a mandatory Second Pension.

Given Malta's capacity constraints, knowledge on Second Pension design, the acquirement of the underlying ICT base and its integration with the First Pension to provided a unified and integrated view on a person's combined pension entitlement, a 4 year period from concept to first enrolment is seen as a conservative time frame. Indeed, a more realistic time with regards to the introduction of a mandatory Second Pension from concept to enrolment is estimated to take between 6 to 8 years.

Thus, a decision to implement a Second Pension at the "earliest possible" means, assuming that all stakeholders reach agreement in 2012 on a mandatory Second Pension, that it would be as late as 2018, at best, that the first persons are mandatorily enrolled in a Second Pension, and, at worst, 2020.

This, therefore, would have such consequence on the following cohorts of persons active in the labour market:

Age Today 2012	Age Enrolled in Mandatory Second Pension Best Case Scenario: 2018	Age Enrolled in Mandatory Second Pension Worst Case Scenario: 2020

[113] Pg 67, A Sustainable State Pension: When the State Pension Age will Increase to 66, Cm 7956, Department of Work and Pensions, 2010

18 years	24 years	26 years
22 years	28 years	30 years
26 years	32 years	34 years
30 years	36 years	38 years
34 years	40 years	42 years
38 years	44 years	46 years
42 years	48 years: Potentially too late to enrol	50 years: Potentially too late to enrol
45 years	51 years: Potentially too late to enrol	53 years: Potentially too late to enrol

It is to be noted that the PWG has always argued that a mandatory Second Pension should be directed towards persons who would be 45 years of age and younger in the year in which it is introduced.

This would assure a 20 year investment period, on the basis of the official retirement age being 65 years of age, which would allow for the building of sufficient capital that would ensure an appropriate and adequate Second Pension income replacement rate to the person investing in it as well as a sufficient long period that would absorb cyclical economic behaviour.

Thus, as one can see from the above Table, a worst case scenario implementation of 8 years – 2020 – for the introduction of a mandatory Second Pension is likely to mean that a person who is 38 years of age today would not be afforded the opportunity to strengthen his or her First Pension income with a complementary Second Pension income as by the time the latter is implemented it would, probably, not render economic sense for such a person to invest in such a mechanism given that the returns to him or her from a funded Second Pension are likely to be small and the period may not be sufficiently long enough to allow for the buffering of a negative economic cycle.

The PWG 2010**:**

Strategic Review	Post Consultation Recommendation
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.	**Re-affirms Recommendation 26** and adds that a realistic target year of implementation from when a decision is reached to when the first enrolment of members takes place is expected to be at worst 8 years. This means, therefore, that should a bi-partisan decision be reached in 2012 with regards to the implementation of a mandatory Second Pension, the PWG 2010 is of the considered opinion that first enrolment of members is unlikely to take place before 2020.
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	**Re-affirms Recommendation 27** and adds that the Government should, by not later than July 2012, establish a National Commission for the Design of a Mandatory Second Pension that would be constituted of representatives of key stake holders and chaired by the Minister for Justice, Dialogue and the Family. The purpose of the National Commission would be that of attaining consensus on the introduction of a mandatory Second Pension, its design

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.	elements, contributions to be paid by employers and employees and critical modalities such as phasing, incremental implementation et al. It is further recommended that the National Commission should be tasked to complete its work by the end of 2012. Additionally, the National Commission should be supported the Pension Strategy Unit.
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.	**Re-affirms Recommendation 28,** and adds that the National Commission, as part of its Terms of Reference, should articulate supporting measures that are to be introduced during the period from when a decision is taken with regards to the implementation of a mandatory Second Pension and period leading to its introduction that would help employers and employees take the necessary steps that would allow them to buffer impacts arising from the implementation of a mandatory Second Pension.

03.5.2 The Design of a Mandatory Second Pension Framework (Section 05.4.2 of the Strategic Review)

All mandatory Second Pension frameworks reviewed in this report contain an element of fund choice for members. The extent of choice varies significantly, however, from four pension funds in Uruguay to over 700 in Sweden.

In the Strategic Review, the PWG 2010 expressed its concern that an open Occupational Retirement Pension approach to a mandatory Second Pension assumes that people are sufficiently educated in financial management to reach the right decision in designing the risk-return profile of their fund portfolio and that a person is able to choose an investment strategy/s that most suits his or her situation and risk preferences.[114] The Strategic Review debated this issue at length and there is no need to repeat this discussion in this report.

The key and underlying principle that the PWG 2010 continues to maintain is that a framework that mandates a person to invest in a pension framework designed under a designated Investment Principles regime for such purposes (as against exercising his or her individual choice to invest as he or she wishes in other financial instruments or investment assets) **demands** the presence of an alternative investment mechanism that provides the most appropriate degree of safeguard possible for those persons who are not able or unwilling to exercise their right of choice with regards to investment decisions.

In the Strategic Review report, the PWG 2010 concluded that experiences in overseas jurisdictions show that the best appropriate safeguard in this regard is the design and introduction of a default fund based on life cycle investment principles in which a person who is mandated to invest in a Second Pension chooses to invest in or is automatically enrolled in the event that he or she does not indicate an investment choice for whatever reason.

It is pertinent to underline that the mandatory Second Pension frameworks of Australia, New Zealand, Sweden, Poland and Uruguay all offer a designated default fund for pension fund members who do not want to make an active investment choice or are not able to do so.[115]

In the UK, a default option to the new NEST pension is defined as follows:

[114] Ibid
[115] Pg 86, Collard, S., and Moore, N., Review of International Pension Reform, Research Report No 663, Department for Work and Pensions, UK, 2010

"2.3 The Default Option

28. The default option is a combination of the pension funds and risk management mechanism that is selected automatically for a member joining a pension scheme, unless an alternative is specified.

29. Given that individuals cannot be required to make an active choice when being automatically enrolled, qualifying schemes used for automatic enrolment must have a default option in place.

The importance of the default option

30. It is likely that the vast majority of individuals being automatically enrolled will end up in the default option. Therefore the design, governance and communication of the default option will play an important role.

31. The default option should take account of the characteristics and needs of the employees who will be automatically enrolled into it. It is likely that employees in the default fund will not be engaged in financial decisions. Decisions will need to be taken for them about their risk profile. As such there should be an appropriate balance between risk and return for the likely membership profile and the charging structure should reflect this balance."[116]

There are different forms and frameworks that designated default funds can take. There is, for example, only one default fund in Sweden, the Premiesparfonden. It is managed by the Seventh AP Fund (or Sjunde AP-fonden in Swedish), a state authority which functions in the same way as a fund management company. At the end of 2007, 29 % of total Premium Pension Authority capital was held in the default fund; 80 % of assets in the default fund were invested in equities.[117]

In New Zealand, employees who are automatically enrolled into KiwiSaver are allocated to their employer's chosen KiwiSaver scheme, at least initially. Employees can subsequently choose to switch to a different scheme if they wish to. If an employee does not choose a scheme into which contributions are to be paid, and their employer does not have a nominated scheme, after three months the Inland Revenue allocates employees to one of six government-sponsored default providers. The intention is that each default KiwiSaver provider is allocated an equal number of members. Contributions are then invested in the default providers' conservative investment fund option. This may vary from provider to provider in relation to the exact investment portfolio but must contain growth (or equity) assets limited within the range of 15% to 25% of total assets. By the end of March 2009, 34% of all KiwiSaver members had been allocated to a default scheme via the automatic enrolment process, with 33% of all KiwiSaver contributions invested in this way.[118]

In Poland the Social Insurance Institution (ZUS), which administers the mandatory private pension scheme, is responsible for assigning members who have not made a choice of open pension fund (despite being required to do so) to a default fund option. This is conducted randomly by means of twice yearly 'lotteries'. Only funds that meet certain criteria may participate in the lotteries (in particular funds with a relatively large share of total assets being excluded) and they receive an equal share of the pool of members to be allocated. In 2006, four pension funds participated in the lotteries and acquired a total of 160,000 new members.[119]

The situation in Australia is different again. The default fund into which superannuation is paid is determined by the relevant industrial award which applies to the individual's workplace, where such an award exists. In absence of an award, the employer chooses a default superannuation fund for their employees from the wide range of funds available. For a fund to be eligible as a default option, it has to satisfy certain rules, such as minimum levels of death cover. The default fund investment portfolio is selected by the fund trustees and there do not seem to be any legally defined criteria for default funds in this respect. According to official figures, the majority of default assets are held in equities. Concerns have been expressed in Australia about the performance of superannuation

[116] Pg 10, Offering a Default Option for Defined contribution Automatic Enrolment Pension Schemes – Public Consultation', Department for Work and Pensions, UK, December 2010
[117] Pg 87, Collard, S., and Moore, N., Review of International Pension Reform, Research Report No 663, Department for Work and Pensions, UK, 2010
[118] Ibid
[119] Pg 88, Ibid

default funds. Studies have highlighted the significant variation in raw returns of a sample of default fund options, which implied differing risk characteristics for similarly labeled options. Work commissioned by the Australian Prudential Regulatory Authority proposed an approach to develop a low-cost and easy to understand national default Option. A more recent paper by the Australia Institute also sets out the argument for a government-sponsored universal default superannuation fund, which would include features such as a lifecycle approach to asset allocation and low fees.[120]

Table 28: Default Fund Asset Allocation[121]

	Sweden	Australia	New Zealand
Equities	82%	52%	16%
Private equity funds	2%	—	—
Hedge funds	2%	—	—
Bonds/fixed interest	8%	16%	40%
Property	—	10%	3%
Cash	—	9%	42%

The PWG 2010**:**

Strategic Review	Post Consultation Recommendation
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 IORP 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.	**Re-affirms Recommendation 29.**
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.	**Recommends** that the afore proposed Terms of Reference for the National Commission should include matters relating to the design of the default option including, but not limited to the following: - Design of the default fund option. - Design of formal mechanisms of how a person is informed of the default fund option. - Design of investment principles, the risk profile, life cycle principles with regards to a default fund option. - The number of default fund options and membership enrolment. - Mechanisms relating to the automatic enrolment in a default fund of persons who do not want or are unable to make an investment choice decision.

[120] Pg 89, Ibid
[121] Pg 88, Ibid

	- Governance of the default fund option. - Monitoring of the default fund performance. The PWG 2010 recommends that the Malta Financial Services Authority will work with the Pensions Strategy Unit in providing the necessary support to the proposed National Commission.

A second concern raised by the Strategic Review report relates to the charge fee structure for the administration of a mandatory Second Pension, including the default fund option given that 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.

Countries opt for different models and forms. Poland seems to have one of the more complex fee structures, with fees on contributions and an asset management fee (which are both capped) and a fund switching fee[122]. In Uruguay, the mandatory private pension scheme has fixed commission fees plus fees on contributions, with no limits on either.[123] Superannuation accounts in Australia have fixed commission fees, fees on contributions and an asset management fee. While these are not capped, the regulatory rules prohibit any administrative fees that exceed investment returns being charged on accounts with a balance less than €813, except in periods of bad investment returns (i.e. a period where investment returns are less than administration costs). In such a period, member balances may be reduced if costs are apportioned in a fair and equitable manner.[124]

In Sweden, Premium Pension plans attract an asset management fee, which is not capped. Sweden is considered to have relatively low fee levels, at less than 0.5%of assets under management. This is largely due to the clearing house system operated by the Premium Pension Authority (which since the beginning of 2009 now forms part of the Pensions Authority), which negotiates management fees directly with the provider. Premium Pension providers have no information on individual accounts (all records are all kept by the Premium Pension Authority) which reduces the incentive for providers to run expensive sales and marketing campaigns.[125]

The Premium Pension Authority also operates a discount schedule, based on the principle that the marginal cost of investing additional funds decreases the greater the volume of Premium Pension assets invested. As the scale of business increased over time, therefore, the required fund discounts increased as well. As a result, the total costs are estimated to fall from 0.45% of assets under management in 2007 to 0.23% - 0.27% by 2020.[126]

There is no prescribed fee structure or level of fees for KiwiSaver pension plans in New Zealand, although the KiwiSaver legislation prevents providers charging 'unreasonable' fees. The fees charged by default fund providers were negotiated by the Government and prescribed for each provider in their Instrument of Appointment.[127]

The PWG 2010**:**

Strategic Review	**Post Consultation Recommendation**
Recommendation 31: The 2010	**Recommends** that the afore proposed Terms of Reference

[122] Tapia, W. and Yermo, J. (2008). Fees in Individual Account Pension Systems: A Cross-Country Comparison. OECD Working Papers on Insurance and Private Pensions No 27. OECD
[123] Ibid
[124] ISSA/IOPS/OECD (2008). Complementary and private pensions throughout the world 2008
[125] Tapia, W. and Yermo, J. (2008). Fees in Individual Account Pension Systems: A Cross-Country Comparison. OECD Working Papers on Insurance and Private Pensions No 27. OECD
[126] Palmer, E. (undated) Sweden: Competition in the pensions sector – a low cost model (presentation). Uppsala University and Swedish Social Insurance Agency
[127] Pg 82, Collard, S., and Moore, N., Review of International Pension Reform, Research Report No 663, Department for Work and Pensions, UK, 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: (i) introduction of a fee capping structure; or (ii) establishment of the Department of Inland Revenue to act as a clearing house.	for the National Commission would include matters relating to the design of the appropriate fee structure for a mandatory Second Pension and the default fund option including, but not limited to the following: - Introduction of a simple and non complex fee structure. - Introduction of a transparent fee structure. - Consideration of reducing or capping marketing costs within a mandatory Second Pension fee structure. - Design of a framework that ensures that a person's right to exercise his or her choice to transfer from one pension provider to another is not restricted by high transfer and / or exit fees. - Consideration of introducing a fee capping structure. - Consideration of establishing the Department of Inland Revenue or any other entity as a clearing house.

03.6 Establishing a Third Pension Framework and Introducing Alternative Voluntary Mechanism for Saving for Retirement (Chapter 06 of the Strategic Review)

03.6.1 Establishing a Third Pension Framework (Section 06.1 of the Strategic Review)

The PWG 2010 agrees with the consultation feedback that Malta has unnecessarily delayed the introduction of Third Pension instrument that:

(a) Locks savings in a pension retirement fund.

(b) On the official retirement date provides the newly retired pensioner with a supplementary annuity or other investment pension income together with the ability to draw down a small part of the said locked pension savings as a lump sum.

(c) Supported through fiscal incentives.

It is pertinent to note that on August 5th 2011, the Government published the Retirement Pensions Act (RPA). Set to become Chapter 514 of the Laws of Malta, the Act is earmarked to replace the Special Funds (Regulation) Act of 2002 (SFA) and aims to enhance the regulation of Maltese retirement schemes, retirement funds and the related service providers.

The RPA, which has been approved by Parliament but is not yet in force (with the exception of article 57), introduces new concepts and makes a number of changes to the SFA. Although the RPA does not alter the fundamentals of the current legislation, it has a number of impacts.

Firstly, the Act officially widens the scope of retirement pension regulation. Whereas previously, the SFA did not explicitly cater for personal pension schemes but only for occupational or 'second pillar' retirement schemes, the RPA makes a clear distinction between the regulation of occupational and personal pension schemes. This is a much needed amendment since, in practice, only personal pension schemes have currently been registered with the MFSA.

Moreover, the RPA will regulate retirement scheme administrators, custodians, trustees and investment managers, collectively referred to as 'service providers', who operate in or from within Malta with the purpose of providing services to a retirement scheme or retirement fund.

In addition, the RPA will require any person who provides back-office administrative services to any retirement scheme or service providers, in or from within Malta, to be formally recognised by the MFSA in order to provide such services.

From a regulatory perspective, the RPA gives the MFSA new powers which were not present under the SFA. It creates the framework for new Pensions Rules to be issued (presumably these will replace or amend the current MFSA Directives for Retirement Schemes) and it cleans up the SFA so as to eliminate the replication of rules that applied to retirement scheme and retirement fund administrators, as currently found in the SFA and the MFSA Retirement Directives.

The RPA makes specific references to the Institutions for Occupational Retirement Provision Directive (Directive 2003/41/EC) to ensure the complete transposition of the directive regulating the activities and supervision of transnational occupational pensions into Maltese law.

It is pertinent to underline, that in the formal feedback received during the consultation process, the Malta Insurance Association states that:

> "Given the challenges of longevity risk management particularly under Solvency II, the lack of market size and the potential impact of the pending reversal of the Gender Directive carved-out for insurance in December 2012 [and that the Association's] view is that a traditional open market annuity product is unlikely to be attractive from a financial perspective for neither the insurance company nor the customer. As such to avoid the risk of a maturing lump-sum being frittered away, [the Association] would propose a controlled income drawn down product approach – with a maximum lump sum payable on maturity (say 25), followed by annual allowable withdrawal levels and the transfer to the estate of the deceased of the remaining investment in the case of early death".[128]

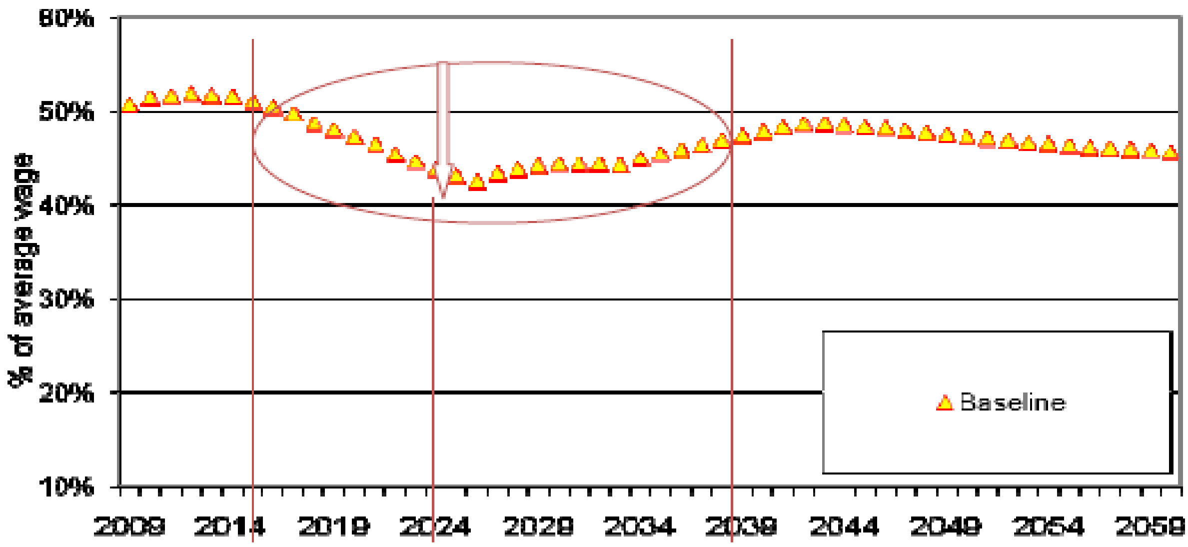
Additionally, it is to be noted that one of the largest financial services providers in Malta, MSV Life, agreed with the recommendation presented in the Strategic Report that would allow for persons who invest in a Third Pension would be able to seamlessly migrate such as an instrument into his or her mandatory Second Pension once this is introduced given the risk that a person may postpone a decision to subscribe to a voluntary arrangement, until he or she is aware what his or her mandatory future obligation is likely to be – which as discussed earlier in this report will require time.[129]

Moreover, it was also recommended that individuals who start saving through a Third Pension should be given the opportunity to have any future mandatory employee and / or employer contributions directed into the same pension, so long as the said Third Pension meets the criteria established for the mandatory Second Pension – which will reduce the number of pension plans (and the administrative charge fees) any one individual will hold and help in simplifying the retirement planning process.

The modelling carried out by the PROST simulation shows that the projected APRR is expected to be slightly over 50% of average wage between 2010 and 2015. Thereafter, the APRR will start to drop until 2027 where-in it reaches 41% of average wage before it starts to increase again until in peaks in 2040 to 49%. Once again, thereafter, the APRR starts to drop again reaching 45% of the average age in 2060.

[128] Malta Insurance Association, Reference 86/2011, July 2011
[129] Pg 7, Submission Report by MSV Life plc, July 2011

Figure 19: **Average Pension Replacement Rate 2009 to 2060**[130]



What the above Figure demonstrates, however, is that persons in the following the age cohorts will be worst hit during the transition period from the pre-reform and the 2007 parametric reformed First Pension systems respectively even when compared to the reduced projected 2060 APRR of 45%.

Reach/ed Age 45 Years	Reach 65 Years of Age	Age Today	Average Pension Replacement Rate of Current Pensioners	Projected Average Pension Replacement Rate on Date of Retirement	Projected Average Pension Replacement Rate in 2060
2007	2027	50	54.7%	41%	45%
2008	2028	49	54.7%	41.5%	45%
2009	2029	48	54.7%	42%	45%
2010	2030	47	54.7%	42.5%	45%
2011	2031	46	54.7%	43%	45%
2012	2032	45	54.7%	43.5%	45%
2013	2033	44	54.7%	44%	45%
2014	2034	43	54.7%	44.5%	45%
2015	2035	42	54.7%	45%	45%

Given the absence of a mandatory Second Pension as well as a specific tailored Third Pension financial instrument that locks savings for retirement and that provides a guaranteed annuity or programme drop-down income, such persons will be at a disadvantage when compared to current pensioners *as well as* future pensioners.

[130] Pg 55, A Sustainable State Pension: When the State Pension Age will Increase to 66, Cm 7956, Department of Work and Pensions, 2010

The Strategic Review report debated at length the importance of incentivising investment in pension saving instruments for one's retirement. The Strategic Review concluded that even in sophisticated markets where people have a high degree of literacy savings for one's retirement unless supported by fiscal incentives tend to be on the low side. The reasons for this is that 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 future needs – 'retirement' for new entrants in the labour market, for example, is decades away. The reasons identified as barriers to saving for retirement include inertia, myopia, herbolic discounting, bounded rationality, habits, loss aversion, mental accounting, etc.

The state of play in this regard in Malta is demonstrated in the Table below. Of the persons surveyed in a survey of the public perception of the pensions system carried out by the NSO on behalf of the PWG 2010 in September 2010, 70% of the respondents answered that that their sole source of income during retirement will be the First Pension, with only 10% stating that their First Pension income will be complemented by a private pension.

Table 29: Potential Pensioners by Sex and Possible Sources of Income after Retirement[131]

Sources of Income	Males		Females		Total	
	No.	%	No.	%	No.	%
Government pension	195	69.3	127	70.9	322	70.0
Private pension	26	9.2	23	12.6	49	10.5
Interests and other income from investments	15	5.3	10	5.7	25	5.5
Income from part time employment	15	5.4	4	2.0	19	4.1
Income from selling of property	5	1.7	3	1.7	8	1.7
Other	9	3.3	1	.8	11	2.3
Don't know	16	5.8	11	6.3	27	6.0
Total	282	100.0	179	100.0	460	100.0

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.

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 includes tax incentivisation for voluntary pension savings instruments.

The PWG 2010 **defines** a **Third Pension** savings instrument as a long term mechanism that 'locks' the savings made by the said person until he or she retires– where-in only a small part of the savings can be taken as a lump sum upon maturity with the remaining large part of the income to be received as a monthly annuity or a programmed annual / monthly drop-down income. This contrasts with traditional financial service saving mechanisms such as a savings account, fixed term accounts or life endowment and other insurance based financial services where a person receives all of the surrender value once the term of the financial service instrument matures or can terminate and exit, upon payment of termination fees, from such financial instruments at will.

Thus, the PWG 2020 re-affirms its position should that the introduction of a tax incentive framework for the Third Pension create a shift that substitutes savings, fixed terms, life endowment saving instruments et al by the leading of **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 goal is reached as persons would position their savings in locked environments for use only on retirement, rather than

[131] Pg 18, The Public Perception of the Pensions System, Supplementary Paper 2, 2010 Pensions Working Group, 2010

maintaining investments that may be subject to use in a person's pre-retirement life cycle period in accordance with behavioural decisions relating to life style choices.

The PWG 2010 has discussed with the Malta Financial Services Authority and agreed a number of principles which should be reflected in Pension Orders that are to be published under the RPA with regards to a Third Pension. Thus, the PWG:

Strategic Review	Post Consultation Recommendation
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.	**Recommends** that a Third Pension is introduced on the following principles: (i) Locks savings for retirement until, at the earliest, the person's official retirement date.*[132] (ii) The person may decide to defer his or her claim to the pension fund income until after his or her retirement date in order to have the flexibility and the opportunity to valorise his or her pension fund in the most suitable economic and financial conditions. (iii) A person may be able to drawn down a **maximum** of 30% of the pension fund as a lump sum.* (iv) A person will retain as a **minimum** 70% of the pension fund for the provision of a monthly annuity or annual / monthly programmed income draw-down or other forms of income generated from alternative investments as governed by the appropriate regulatory framework.* (v) In the event a person dies before his or her retirement age or the valorisation of his or her pension fund the beneficiaries of the said person will receive the said investment. (vi) In the event that the income from a Third Pension is not in the form of an annuity the transfer to the estate of the deceased of the remaining investment in the case of death following the drawdown of the pension income from the Third Pension.
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.	**Re-affirms Recommendation 33.**

[132] (*) Denotes that the matter was discussed between the PWG 2010 and the Malta Financial Services Authority and agreed to in principle

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.	**Re-affirms Recommendation 34.**
New Recommendation D	As shown in the final report, the PWG 2010 considers persons who are today aged 38 years and over to be a 'vulnerable' group compared to current and future pensioners as these persons are either negatively caught in the 2007 reform transition process or will not be afforded the opportunity to invest in a mandatory Second Pension for reasons articulated – a state of play which will respectively result in a lower Average Pension Replacement Rate as compared to current and future pensioners. The PWG 2010, therefore, **recommends** that the Government considers introducing an ad hoc tax incentive scheme directed at persons who are today 38 years over in order to spur them to invest in **existing** pension retirement schemes or other financial services instruments that are already present in the market as a means to neutralise negative impacts arising from a lower Average Pension Replacement Rate as compared to current and future pensioners.
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.	Recommends that a tax incentive framework is introduced with regards to the Third Pension proposed in Recommendation 32 on the following principles: (i) No tax is to be paid on the contributions paid on a Third Pension.* (ii) No tax is to be paid on the maturity of the surrender value of a Third Pension instrument.* (iii) No tax is to be paid on the maximum 30% part of the pension surrender value that a person can take as a lump sum.* (iv) A 15% maximum tax is paid on the 70% part of the pension surrender value that a person will receive as a monthly annuity or programmed drop-down income or any other form of income.* The PWG 2010 recommends that the Government considers implementing an Exempt - Exempt - Taxable framework for a Third Pension by 2013.
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	**Re-affirms** that appropriate legislation is harmonised to ensure that they reflect- contemporary tax principles that relate to pension funds.

legislation.

03.6.2 Creating a Fast Track Route to an Individual Third Pension Fund (Section 06.2 of the Strategic Review)

The PWG:

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.	**Recommends** that a scheme is introduced that will enable a person who today holds a financial or insurance services instrument such as a unit-linked policy, or a profit-linked policy or a life endowment policy to convert such a policy into a Third Pension subject to the following conditions: (i) Locks up to a **minimum** of 70% of the surrender value of the existing financial services instrument upon maturity into a Third Pension.* (ii) The 70% of the surrender value locked into a Third Pension will be tax free whilst the investor will pay 15% tax on the maximum of 30% of the maturity value taken as a lump sum. (iii) The minimum 70% of the surrender value now rolled over into a Third Pension is locked in the Third Pension until the person's official date of retirement or until such date thereafter that a person may decide to defer his or her claim to the pension fund income in order to have the flexibility and the opportunity to valorise his or her pension fund in suitable economic and financial conditions. (iv) The newly set-up Third Pension upon the official retirement date or as when thereafter claimed will result in a monthly annuity or annual / monthly programmed income draw down or other forms of income generated from alternative investments as governed by the appropriate regulatory framework.* (v) In the event that a person dies before his or her retirement age or the valorisation of his or her pension fund thereafter, the beneficiaries of the said person will receive the said investment. (vi) In the event that the income received from a Third Pension is not in the form of an annuity the transfer to the estate of the deceased of the remaining investment in the case of death drawdown of the Income from the Third Pension. (vii) A 15% maximum tax is paid on the 70% part of the pension surrender value that a person will receive as a monthly annuity or income.* The PWG 2010 recommends that the Government should consider implementing by 2013 the proposed scheme directed to incentivise persons who have invested in financial and insurance services products into a Third Pension by 2013.

03.6.3 Leveraging Mortgage Investment in Home Ownership into Income During Retirement (Section 06.3 of the Strategic Review)

The consultation feedback with regards to the introduction of home equity release schemes, home reversion plans, et al was cautious in tone – and bordered on the negative. Issues raised included:

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.
Intergenerational tensions and conflict between the desire to leave an inheritance and the need for money to live on in older age.
The implication of equity release products in relation to taxation and succession duties.
The not all private homes would interest financial services firms providing home equity products which would mean that such schemes would provide new forms of social injustice given that certain persons who can enter into a home equity release product will have a higher pension income in retirement than a private home owner who is not in a position to do so.

The PWG 2010 recognises that home equity release products have inherit issues – which include, though not limited to:

(i) A danger that a high stock of property may end up concentrated in the hands of a small number of private sector players.

(ii) That whilst the local housing market has traditionally proven to be stable it does not mean that Malta will not suffer declines in the prices of housing or for the matter that it may never suffer a negative equity collapse. It is pertinent to note, that the NSO has recently noted that the All Property Price Index decreased by 3% in the first quarter of 2011 – a decline which constituted a fall by 2% in the apartments index and 9.8% in the maisonettes index respectively.[133]

(iii) Increased investment in property which may create further pressures on a sector that is categorised by a high number of vacant property.

Be that as it may, the PWG 2010 is recognisant of the fact that home equity release transactions do occur today – particularly as elderly persons trade down their family home to smaller apartments or residential homes in sheltered environments.

It is correct for stakeholders to state that there are complex issues surrounding equity release products and that there have been negative consumer experiences with products sold in overseas jurisdictions.[134] Overseas experience suggests that there is a risk of mis-selling and that consumers may receive poor advice. Whilst the products have clearly been designed to meet consumer needs, the products are complex and, if used inappropriately or with poor advice, there are significant risks for consumers.[135]

It is, nevertheless, a concern to the PWG 2010 that such home equity release transactions are, today taking place in an unregulated environment – which may result in abuses given the vulnerability of the

[133] Pg 1, Property Price Index and Property Volume Index: Q1/2011, 6th July 2011, National Statistics Office
134 Pg 5, Equity Release Products, Report 59, Australian Securities and Investments Commission, November 2005
[135] Pg 9. Ibid

group targeted: elderly persons who may be underfunded with regards to cash and income but may hold a property of considerable value and who are vulnerable to making poor decisions due to constrained financial circumstances.

It is the considered opinion of the PWG 2010 that the existing regulatory system in Malta was not designed to address the issues raised by equity release products, which take the form of a credit arrangement but nevertheless have some of the attributes of an investment product. The current state of play, therefore, provides no succor to persons who enter into such schemes in today's non regulated market. Vulnerabilities, therefore, include:

The amount of equity that can be transferred is based on the open market value of the property, and it is, therefore, essential that the valuation is a true and accurate one.
Few tenants go through every word of a tenancy agreement, so there is potential for exploitation of the customer by including clauses in the agreement that are: - plainly disadvantageous to the customer (for example, conditions that prejudice the security of tenure of the occupier); or - too difficult for the typical customer to understand.
Many elderly people are unaware of their existing statutory rights or are reluctant to take legal action to defend themselves, mainly due to the prohibitive costs of litigation should their case fail.

The PWG:

Strategic Review	Post Consultation Recommendation
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.	**Recommends** that the MFSA is tasked to introduce a regulatory framework for the provision of home equity release products by December 2013 in order to ensure good governance and provide protection to vulnerable groups.

03.6.4 Establishing a Pensions Saving Culture at Birth (Section 06.4 of the Strategic Review)

The PWG 2010 was surprised to note that a number of stakeholders disagreed with the recommendation for the introduction of a Child Pension Account where-in parents may **voluntary** decide to lock-in part of the Children Allowance (CA) received into such an Account.

The stated objection to the establishment of such a Child Pension Account that is administratively opened by the Department of Social Security (DSS) at the **voluntary** request of the parents is that this would create a social injustice between families who can afford to make such a choice and families who are not in a position to do so given that the CA constitutes an integral part of the family budget.

The PWG 2010 finds it difficult to subscribe to this point of view - in that today, parents freely decide, should they wish to do so, to transfer the CA to a Bank Account under the child's name. The advantage of the recommendation presented by the PWG 2010 is primarily that given the critical mass of CAs issued, the DSS would be able to leverage attractive interest rates with financial institutions for such Child Pension Accounts.

The PWG 2010 is of the considered opinion that the **unstated** objection to this Recommendation is the fear that the recommendation constitutes a stealth measure that will over time transform the current nature of the CA into one that would mandate parents to invest the CA in a Child Pension Account.

The PWG 2010 recommends that the Government should work with the banks and other financial institutions to set up a Child Pension Account with favourable interest rates which would be incentivised as proposed in the Strategic Review. Whether parents decide to invest in such a Child Pension Account directly through their salary or other income or by means of viring part of the CA to such a Child Pension Account is, in truth, a moot point and should not act as an obstacle for the implementation of this recommendation.

The PWG:

Strategic Review	Post Consultation Recommendation
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.	**Recommends** that the Government works with banks and financial institutions so that the latter introduce a Child Pension Account or variants thereof with favourable interest rates.
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.	**Re-affirms Recommendation 40** and adds that the Government should consider implementing an incentive framework to accelerate the accumulation of capital in such Child Pension Accounts in the 2013 National budget.

03.7 Establishing a Framework for Financial Literacy (Chapter 07 of Strategic Review)

One of the striking aspects of the consultation process carried out by the PWG 2010 was the absence of youths from the discussion and from the submission of recommendations for the consideration of the PWG 2010.

Various attempts were carried out by the PWG 2010 to engage different youth cohorts to participate in the consultation process: ranging from activity at the University of Malta campus to teaming up with the Youth Agency to hold discussions with the various representatives on the National Youth Council.

The attempts to seek engagement with youths were not successful. Whilst behavioural economics provide an understanding of why young person do not engage in discussions on long term issues such as pensions and saving for retirement, the fact remains that the near absence of youths from the consultation process is, indeed, disconcerting.

This is so for a number of reasons. The quasi complete disengagement by youth organisations that traditionally mobilise on behalf of their respective members - as had occurred during the 2004 - 2005 consultation process - on issues that are sensitive to youths, seems to indicate that the visibility of financial education amongst youths seems to have been relegated further amongst the priorities of today's youths.

Secondly, in failing to participate in any form or manner in the consultation process, the youths abdicated the shaping of policy responses issues that will impact their future quality of life to other stakeholders. Indeed, the primary active stakeholders during the consultation process were primarily current pensioners' representative bodies lobbying, primarily, on issues that directly affect them, and organisations representing women.

The consultation feedback relating to the importance of establishing a framework for financial literacy was limited to agreement in principle to the recommendations of the PWG 2010 with little if any discussion.

The PWG 2010, strongly, re-affirms its primary recommendation that that MJDF together with the MFEI should establish 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 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.

An immediate first step of the proposed Task Force on Financial Literacy should be the undertaking of a specifically designed survey that will provide a baseline and which will act as the starting point for assessing adult financial literacy in Malta.

The PWG:

Strategic Review	Post Consultation Recommendation
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.	**Re-affirms Recommendation 41** and adds that the Permanent Task Force on Financial Literacy should issue the proposed survey by July 2012.
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.	**Re-affirms Recommendation 42** and adds that: (i) The proposed Terms of Reference should be extended to empower the proposed Task Force to explain and communicate to the public at large a basic understanding of how the current pension system works and how decisions taken today impact the future pension value.

	(ii) The Permanent Task Force on Financial Literacy should be set up by May 2012.
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.	The implementation of this Recommendation is underway.
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: (i) the Employment and Training Corporation to introduce financial literacy training programmes for persons in employment; and (ii) appropriate constituted bodies to assist employers to introduce seminars on financial literacy to their staff.	**Re-affirms Recommendation 44.**

03.8 Strengthening Capacity for the Management of the Pension System (Chapter 08 of Strategic Review)

The PWG:

Strategic Review	Post Consultation Recommendation
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	**Re-affirms recommendation 45** and adds that the Pensions Strategy Unit should be formally established within the Department of Social Security with immediate effect and that a call for applications for the appointment of a Director issued no later than April 2012.

03.9 Analysis of Claims of Anomalous Situations to Current Pensioners and Cost Estimation of Solutions Proposed (Supplementary Paper 6 to the Strategic Review)

The National Association of Pensioners, the National Council for the Elderly, the Alliance of Pensioners, the UHM Pensioner's Union, and the GWU Pensioner's Union apart from presenting individual feedback following consultation reports also submitted a joint position paper. The respective submissions – whether separately or jointly – relate to issues of the how the pensions system ***affects*** current pensioners.

It is pertinent to underline, that in the Terms of Reference presented to the 2010 PWG (as well as the 2004 PWG) the Government always maintained that the focus of the work of the respective PWGs should be limited to *future* pensioners. The Government's position in this regard has been that issues relating to current pensioners are not to form part of a pension system reform directed towards future pensioners but rather would be subject to policy instruments limited to current pensioners to be introduced as budget measures.

Be that as it may, the 2010 PWG sought to understand the issues raised by the associations representing current pensioners both prior to the drafting of the Strategic Review as well as during the consultation process.

During the consultation process, the 2010 PWG concludes that the key issues that the representative bodies of current pensioners seek understanding and resolution on are the following:

Alleged Anomalous Situation	**Explanation**
Maximum Pensionable Income Ceiling and Application of the 70% Wage : 30% Inflation Indexation	The 2007 reform moved from a single Maximum Pensionable Income (MPI) ceiling to three different ceilings. This was the direct result of a reform strategy that differentiated between: - **Exempt**: Current pensioners and persons who were 55 years and over as at 1st January 2007. This cohort of persons and pensioners were separately identified given that no negative change of the pension system stemming from the reform would affect them. Indeed this cohort of persons were positively impacted by the reforms as follows: - The MPI was allowed to increase annually by the Cost of Living Adjustment (COLA) from €16,077 to €17,475. - A person who reached his or her official retirement age could continue to work without forfeiting his or her pension subject to the payment of the NI contribution as an inter-generation contribution and the payment of income tax. - **Transitional**: Persons in employment who were between 46 years and 54 years of age as at 1st January 2007 and who would be affected in different degrees by different measures stemming from the reform; with a person being more significantly affected the closer he or she was to the 46 years of age cohort. The MPI for this group was to increase annually by COLA from €16,077 until it reaches €20,970. - **Switchers**: Persons in employment who were 45 years of age and younger as at 1st January 2007. This cohort of persons was affected by the full impact of the reforms: increase in the official retirement age to 65 years of age; increase in the contribution period from 30 to 40 years; changes in the calculation rules from the best 3 consecutive years in the last 10 years to the best 10 years out of a 40 year period, etc. The MPI was to increase to €20,970 in three equal tranches between 1st January 2011 to 1st January 2013 – and thereafter to increase by an indexation of 70% wage inflation: 30% price inflation. The bodies representing current pensioners argue that this differentiation in the MPI and in the indexation mechanism is discriminatory.

	Their position is that Government implements, on the basis of a phased approach, a measure that will allow the MPI relating to current pensioners to increase not to €17,475 but to €20,970 and that the MPI is, thereafter, annually adjusted by the indexation mechanism introduced for the Switcher cohort.
Guaranteed National Minimum Pension	One of the outcomes of the 2007 reforms was the introduction of a Guaranteed National Minimum Pension (GNMP). The GNMP was established to ensure that the minimum level of a pension that will be received by a person in the Switcher cohort when he or she retires in 2027 would not be less than 60% of the National Median Income as the appropriate Minister may from time to time establish. The purpose of the GNMP was to peg the minimum pensionable income to a threshold which is above the at-risk-of-poverty EU threshold. The bodies representing current pensioners argue that the introduction of the GNMP even though it will primarily come into effect in 2027 for the Switchers cohort is discriminatory. Their position is that Government implements, as appropriate, the GNMP as established under Article 50A of the Social Security Act to current pensioners.
Service Pension	The acceptance by Government that a person may have more than one pension and that the receipt of a Second Pension does not impact the pensionable income received (through the acceptance of the principle of a Second Pension and a Third Pension) now constitutes a discrimination with regards to current pensioners who are governed by different rules. The bodies representing current pensioners acknowledge that the Government over the past recent years has introduced annual budgetary measures to rectify in part the current state of play. The concerns raised in this regard are that (i) Government has not adopted a consistent approach as it did not introduced such a budgetary measure in 2009; and that (ii) the amounts being allocated to address the issue are too small to leave any impact on the quality of life of a pensioner.

The 2010 PWG assessed in Supplementary Paper No 6 to the Strategic Review titled ‘Review of Position Submitted by Pensioners’ Representatives with Regards to Anomalies in the Social Security Act’, dated December 2010, all of the claims presented by the representative bodies in this regard.

In the said Supplementary Paper, the 2010 PWG sought to define the term ‘anomaly’ given that it was its considered opinion that a conclusion reached by the stakeholders involved that a particular provision of the law or impact of the law results in an anomaly is subject to a representative’s body interpretation of the particular legislative provision or arising impact. The PWG 2010 defined ‘anomaly’ to mean a state of play that deviates from the norm or common order or rule as established by the pension system.[136]

In essence, what representative bodies termed as “Anomalies”, the PWG 2010 classified the submitted claim into the following three distinct categories:

[136] Pg 1, ‘Strategic Review titled ‘Review of Position Submitted by Pensioners’ Representatives with Regards to Anomalies in the Social Security Act’, Supplementary Paper No 6, December 2010

Category I	Anomalies where-in the provisions of the SSA truly present results that are irregular and difficult to explain.
Category II	Requests to change specific 'basis' principles of the social security system.
Category III	Requests to change the specific provisions of the law without affecting the principles behind them.

In the Supplementary Paper the 2010 PWG concluded that none of the aligned 'anomalous' situations presented by the representative body were in fact anomalous in nature.

03.9.1 2007 Reform Measures Directed at Persons at the Switchers Group Alleged to Create an Anomalous Situation with regards to Current Pensioners

Two of the claimed 'anomalous' situations presented above – the MPI and 70% Wages : 30% Inflation Indexation and the GNMP – are the result of reforms directed towards the Switchers' Group (45 years of age and younger as at 1st January 2007) given the fundamental changes made to the rules of the pension system in their regard – persons whose APRR is projected to, at best reach, 45% compared to the 54.7% enjoyed by current pensioners.

The new MPI and indexation mechanism as well as the GNMP are mechanisms that were introduced as an integrated component of the pension reform directed to balance impacts on the Switcher Groups arising from the reforms already stated earlier but important to re-iterate:

- increase in the official retirement age from 61 years to 65 years of age.
- increase in the contribution period from 30 years to 40 years.
- increase in the calculation period from the best 3 consecutive years of the last 10 years to the best 10 years from a 40 year contributory history.

It is pertinent to underline, that **none** of the above measures – which have a negative impact on the Switchers Group – **affected** current pensioners. Indeed the only measures that were introduced and directed towards current pensions were the following positive measures:

- the MPI was allowed to increase from €16,077 – the highest level of MPI that current pensioners paid the maximum 10% contribution – to €17,475.
- the removal of the ceiling placed on income earned whilst continuing in employment following retirement and thereby allowing current pensioners in employment to obtain the full income earned and receive the full pension.

Furthermore, the new MPI as introduced with regards to the Switchers Group results in a corresponding increase in the contribution paid – that is, as experienced in 2011 and 2012 where the MPI for the Switchers Group was increased to €18,174 and to €19,572 respectively this resulted in an increase in the contribution paid by those persons whose wage now fell within the newly increased MPI ceiling.

Moreover, in the design of the 2007 pension reform recognisance was taken of the fact that the full affect of the GNMP would come into play in 2027 when the first members of the Switchers Group retire - and not in 2007 which would have rendered the implementation of this measure not possible to consider due to the financial costs required.

The PWG 2010 rejects now, as it rejected in the Strategic Review the assertion by representatives of current pensioners that the measures related to the MPI and indexation mechanism and the GNMP give rise to an anomalous situation with regards to current pensioners – thereby requiring corrective action by Government with regards to current pensioners.

Strategic Review	Post Consultation Recommendation
New Recommendation E:	**Re-affirms recommendation 26 of Supplementary Paper Number 6** that the Maximum Pensionable Income and indexation mechanism and the Guaranteed National Minimum Pension are measures directed to balance impacts on the Switchers' Group as part of the holistic 2007 parametric reforms directed towards persons who are aged 45 years and younger as at 1st January 2007 and these do not create an anomalous situation with regards to current pensioners given that they were not affected by such reforms – which reforms are directed to secure a Average Pension Replacement Rate of 54.7% enjoyed by current pensioners.

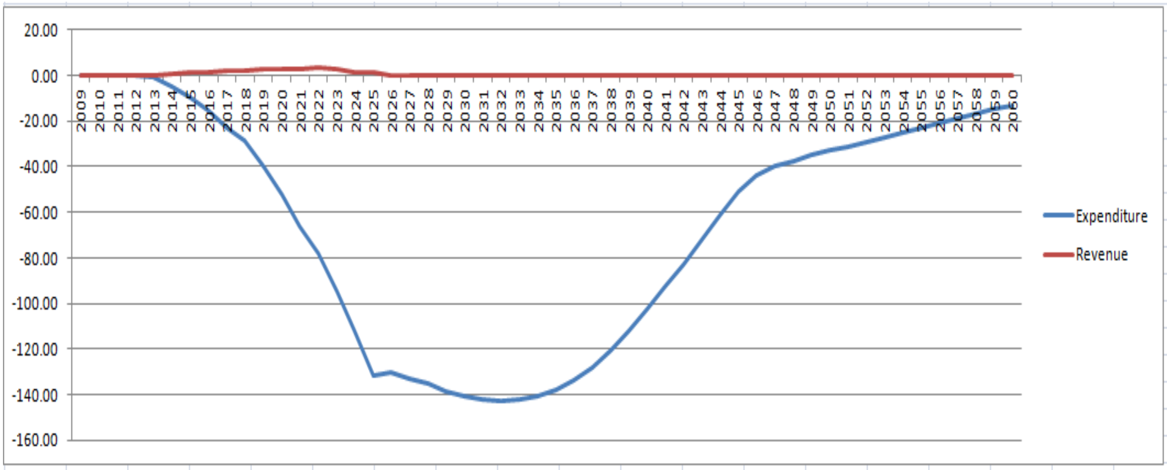
Be that as it may, the PWG 2010, on the direction of Government, committed itself to carry out modelling to assess the impact of introducing these measures for the benefit of current pensioners.

03.9.1.1 Increasing the Maximum Pensionable Income of Current Pensioners by the Indexation Mechanism of 70% Wages : 30% Inflation

Given that it is current Government policy to award the COLA in full, as a budget implementation measure, to current pensioners (2/3 on the First Pension and 1/3 on the Bonus to pensioners) the PWG 2010 concludes that current pensioners will incrementally reach a MPI of €20,946 and beyond over time as this is increased as a direct result of COLA awards from one year to the next.

Figure 20 demonstrates the impact of implementing the Wages 70% : Inflation 30% mechanism with regards to current pensions once the MPI of €20,946 is reached. The adoption of this recommendation would see the cost of the pension expenditure increasing by an additional (€3,039,630,000) between 2013 to 2046 - peaking (€142.93m) in 2032. The fact that this measure is extended to the Transitional Group would see very minimal revenue of €27.48m generated between the periods 2013 to 2046.

Figure 20: Maximum Pensionable Income of Exempt and Transitional Group is Indexed by the Wage : Inflation Indexation after Reaching €20,946[137]



03.9.1.2 Implementing the Guaranteed National Minimum Pension for Current Pensioners

The simulation was carried out on the basis of SABS data for 2012. The highest payable rates of the National Minimum Pension are currently €113.25 for a single person and €131.52 for a married person. According to the Survey on Income and Living Conditions (SILC) 2010, the 60% median national equivalised income stood at €6,260 (annual), which when uprated on the basis of 2011 RPI

[137] Modeled by the PWG 2010 together with the World Bank

inflation translates into €123.65 per week for a single person and €185.47 per week for a married person.

For modelling purposes it was assumed that persons with 'married' and 'separated maintaining wife' would be eligible to the 'married' rate while other persons would be eligible for the 'single' rate.

It is assumed that persons in receipt of pensions under reciprocal agreement arrangements would receive only a fraction of the GNMP rate.

Under the assumptions listed above, it is estimated that 2012 expenditure for current pensioners would raise expenditure by **€84.5 million**.

The PWG 2010 **recommends**:

Strategic Review	Post Consultation Recommendation
New Recommendation F:	That replacing the COLA mechanism for current pensioners by the indexation mechanism designed for the Switchers Group is, in the form presented by the representatives of current pensioners, not implementable as it would render the pension system unsustainable.
New Recommendation G:	Extending the Guaranteed National Minimum Pension designed for the Switchers Group to current pensioners is, in the form presented by the representatives of current pensioners, not implementable as it would render the pension system unsustainable.

03.9.2 Changes to the Definition of Service Pensions in the Social Security Act and its Economic Impact

With regards to the service pension issue successive administrations, having taken into consideration the various representations made by interested parties on the subject, have sought to introduce measures to address these representations. The following measures were in fact implemented:

Year	Measure
1986 (Labour Administration)	The rate of the flat rate 'Retirement Pension' (i.e. the basic retirement pension payable) was reviewed and a higher flat rate Retirement Pension was introduced which was applicable specifically to persons in receipt of a service pension payable by or on behalf of the Government of the UK. At the time, given that the difference between the flat rate retirement pension applicable (i.e. Lm12.10 per week) was substantially less than the proposed retirement pension applicable to persons in receipt of a service pension payable by or on behalf of the Government of the UK (Lm19.60 per week for a married man maintaining a wife), it was decided to introduce this latter rate in two instalments, the first instalment in 1987 and the second in 1988.
1987 (Nationalist Administration)	Following the election of the Nationalist government in 1987, the decision to award the 'new' flat rate retirement pension for UK service pensioners was reviewed and instead of the increase being paid in two equal yearly instalments, the new retirement rate was paid in full from January 1987. This distinction still exists today, that is, where there is a flat rate Retirement Pension rate applicable to persons receiving a service pension payable by or on behalf of the Government of the UK and a lower flat rate retirement pension payable to any other person in receipt of a service pension from any other source.

1992 (Nationalist Administration)	Three measures were taken and the definition of service pension was redefined to mean that: (a) Where two or more service pensions are received by a pensioner, only the highest service pension would be considered for social security purposes. (b) Where a service pension was commuted in part and the pensioner had reached 72 years of age, 50% of that commuted pension would no longer be considered in the calculation of the social security pension rate. (c) Where a service pension was fully commuted, only 50% of the amount of pension so commuted would be considered in the calculation of the social security pension due.
1996 (Nationalist Administration)	With effect from the 6th January 1996 any increase awarded in the service pension after the 7th January 1995 was to be ignored for Maltese social security pension purposes. In effect this meant that the Department no longer took into consideration any increase in the amount of service pension received by the pensioner.
1997 (Labour Administration)	The term 'service pension' was redefined to mean "a service pension which, net of any subsequent increases for cost of living awarded from the date the service pension was first payable, was higher than Lm200 (€466) annually." Where a service pension was fully commuted then no account of such service pension was to be considered for social security pension purposes.

The following table gives an indication of the various categories of service pensioners which currently have their service pension considered in the calculation of their social security pension entitlement.

Table 30: Service Pensioner Categories

Type of Pension	No. of Pensioners	Total amount of service pensions (incl. commutations)
MDD Pensions	73	€244,065
British Pensions	970	€801,268
Malta Government	10,739	€64,088,892
Other Pensions	969	€6,341,385
Totals	**12,751**	**€71,475,610**

It is evident from the above that various attempts have been made to rectify the situation of service pensioners. The principal stumbling block, however, has always been the question of the fiscal implications involved. One other important point that should also be considered is the emphasis made in our pension reform on the need for citizens to partake in 2nd and 3rd Pillar pensions in order to enhance the adequacy of their retirement income. This contrasts with the current situation where service pensions are being considered in the calculation of a service pension.

It is also important to highlight that the issue of service pensions cannot be viewed by simply considering just one category of service pensioners. To do so would place government in a position where claims of discrimination by other categories of pensioners would be hard to defend.

The additional recurrent expenditure involved would be in the region of €39,610,000 with specific regard to Treasury pensioners. It is important to point out that given that the number of Treasury Pensioners is expected to increase up to the year 2021 and also that such pensioners will be retiring with higher amounts of service pensions, hence the additional expenditure on social security expenditure is set to increase proportionately annually.

Strategic Review	Post Consultation Recommendation
New Recommendation H:	The Government should continue with its current policy with regards to service pension by phasing out them out through the extension of similar budget instruments applied to date.

03.9.3 Replacing Collective Agreement Adjustment Mechanism by the Indexation Mechanism of 70% Wages : 30% Inflation

One of the policy instruments reviewed by the PWG 2010 is the replacement of the current Collective Agreement Adjustment Mechanisms by the Indexation Mechanism of 70% Wages : 30% Inflation. The advantages of this policy measure would be as follows:

(i) A potential anomalous situation that arises from Article 59(3) of the SSA which deals with the revision of the pensionable income of a pensioner which could then result in an increase in the pension entitlement given that a revision of pension is carried out under the parameters of Article 59. Part of the basis for such a claim is the adverse result that can often result between pensioners of the same category. The following is being requested by the pensioner groups:

(a) The pensionable income (average of 3 years in the case of employed) is eliminated and a system of current salary introduced;

(b) The Department considers 'unearned' increments when revising a pensionable income; and

(c) Pension reviews are carried out with effect from the date of the collective agreement and not from the first Saturday in January of each year.

In the afore mentioned Supplementary Paper the PWG2010 had recognised that the DSS has always acknowledged the anomalous results that can occur in cases of reviews where collective agreement increases are involved. - an issue which has been raised since the early 1990s.

The PWG2010 had recognised that the DSS has carried out a number of alternative scenarios of the pensionable income calculation but these prove that the anomalous situation would continue to appear where the pensionable income is calculated on a period and not on the last salary.

The only scenario that worked was the one where all collective agreement increases in the years taken for the average three year calculation are taken out of the three year calculation adding two-thirds of these increases being added at the end of the three year average calculation. Such an approach would eliminate the problem but is very complicated to put into practice and increases the burden on the administration of the system.

The DSS has, subsequently, worked upon a more streamlined approach that would eliminate completely the pensionable income review and introduce in its stead a system whereby pensions are increased by a mechanism that is constituted of an increase made up of 70% average wage increases 30% inflation. The PWG2010, in the Supplementary Paper, has stated its agreement with the DSS that this would be the fairest way forward.

The PWG2010 had stated in Recommendation 14 of the Supplementary Paper that the PWG 2010 would carry out the necessary appropriate modelling with regards to determining the financial feasibility of a policy change that indexes the pensionable income to a formula of 70% Wages : 30% Inflation and that it would submit its recommendations to the Ministry responsible for Pensions for its consideration.

(ii) Such a measure would streamline operations within DSS with regards to such Collective Agreement adjustments extensively - which would allow for such adjustments to be administratively processed within a far more rationalised period.

The pre-modelling hypothesis by the PWG 2010 was that the implementation of such a policy instrument would be more socially just than the current mechanism and should lead to a neutral financial impact.

In the design of the appropriate model, the indexation rule was interpreted as follows: the rule is backward looking and takes into consideration 70% of the increase in averages salaries in the previous calendar period (basis of data, being the LFS) and the 30% of COLA the year in question (which would have been determined towards the end of the previous calendar period). On the basis of this assumption, the increase in pensions for the period 2008 - 2012 would have been €33.46.

Table 31: Interpretation of Indexation Rule[138]

	2007 €	2008 €	2009 €	2010 €	2011[139] €
Average Salary (LFS)	12,999	13,611	13,826	14,468	15,056
COLA for Period *t+1*	3.49	4.08	5.82	1.17	4.66
Wage Increase: 2007 -2011	39.56				
COLA 2007 – 2011	19.22				
70% Wages : 30% COLA	33.46				

The application of the indexation mechanism is considered to affect pensioners receiving the earnings related pensions shown in Table 31 below and is projected on pensioners that were in retirement in 2008.

Table 32: Current Earnings Related Pensions Schemes to Which Indexation Rule would be Grafted

Type of Pension	Number of Current Pensioners
Increased National Minimum Pension	2,672
Increased Retirement Pension	2,080
2/3 Retirement Pension	25,773
Early Survivors Pension	1,555
Survivors Pension	4,251
Increased Invalidity Pension	160

It is further assumed that persons in receipt of pensions under reciprocal agreement arrangements receive only a fraction of the pension increase entitled. The increases in pensions were subject to a maximum rate which did not exceed the maximum pension of €223.95 per week for retirees and widows and €122.99 per week for invalids.

The impact of shifting to a 70% Wage and 30% COLA indexation was calculated as follows:

Weekly_Rate_in_2008 + CLBO_2008 + Increase in Weekly Rate_2008 – 2012	**LESS**
Weekly_Rate_in_2012 - CLBO_2012	

where the full increase in the weekly rate for the period 2008 - 2012 is estimated to be €33.46. The impact of the shift in indexation would be to raise expenditure on current pensioners as shown in the Table below.

Thus, the modelling shows that expenditure in 2012 would, as a result of the introduction of the proposed policy instrument, be increased by an additional €22m in the event that the indexation mechanism is applied with regards to current pensioners. This does not reflect the pre-modelling hypothesis of the PWG 2010.

[138] PWG 2010
[139] Estimates since 2011 - full year data is currently unavailable

Different scenarios were also modelled for indexation mechanisms that are designed on the basis of a 60% Wage Growth : 40 % COLA ratio and 50% Wage Growth : 50 % COLA ratio respectively: which would result in 2012 in increases to the pension system of €18.8m and €14.8m respectively if this indexation is extended to current pensioners.

Additionally, in interpreting the results the PWG 2010 underlines that following points should be noted:

(i) The results focus on a selective group that was in receipt of pensions in 2008. Since 2008 more beneficiaries have retired, while there were persons that were alive during the period and died before 2012. Such persons would have also benefited from the shift in the indexation mechanism. Thus, this to an extent may underestimate the impact of the adoption of such measure.

(ii) The results are sensitive to the interpretation of the indexation mechanism. An alternative view would be to index the weekly rates on the basis of a composite index based on wage and price inflation increases. This would lead to different results.

Strategic Review	Post Consultation Recommendation
New Recommendation I:	The policy instrument to replace the Collective Agreement by an indexation mechanism proposed as a potential solution by the PWG 2010 in the Supplementary Paper, No 6 to the Strategic Review with regards to resolving the anomaly arising from Section 59(3) of the Social Security Act is not feasible as it is not financially sustainable.

03.10 Older Persons and Risk of Poverty

One of the general strengths of income poverty mechanisms is that they are tied to median income. This has the advantage of not cutting the poor off from general movements in income and the changes in quality of life and purchasing power that they imply. In the EU a threshold of 60% of the median income is taken as the poverty line. Another advantage is that income lines provide a uniform measuring rod and they are easy to apply. In addition, income poverty lines pick up on a fundamental goal of policy and a widely-accepted yardstick of a fair and good society – so they can be a good means of testing whether policy is achieving results or not and are a good shorthand of the quality of society. There is also the fact that incomes are directly responsive to the policy levers of government and are certainly more responsive than indirect measures.

The recently published Salient Indicators on income and living conditions issued by the NSO in January 2012 show that during 2010, the total number of households was estimated at 143,680, with each household reporting an average gross income of €25,968 and an average disposable income of €21,847.

Both types of income edged down by around 1% when compared to the previous year. Household disposable income is used to derive the equivalised income, which serves as the basis for the calculation of monetary poverty with regard to individuals. The at-risk-of-poverty threshold for 2010 stood at €6,260. Of the surveyed individuals, 63,474, or 15.5%, fell below this threshold and thus were considered to be at-risk-of-poverty.

Compared to 2009, the at-risk-of-poverty rate edged up by 0.2 percentage points. In spite of the trend emerging over the past few years, this indicator for Malta remained lower than the EU average. Other main monetary poverty indicators include the S80 / S20 ratio, calculated at 4% and the Gini coefficient, which was estimated at 28%.[140]

Analysis by age group shows that persons aged below 18 and those aged 65 and over were at a greater risk of being poor, with respective rates of 20% and 19%.

[140] Pg 1, Statistics on Income and Living Conditions 2010: Salient Indicators

Table 33: At Risk-of-Poverty Rates by Age: 2009 - 2010[141]

Age	Sex	2009	2010	
		%	%	Number of persons below threshold
All ages	**Total**	**15.3**	**15.5**	**63,474**
	Male	14.7	15.0	30,611
	Female	15.9	16.0	32,863
Under 18	**Total**	**21**	**20**	**16,053**
18-64	**Total**	**13**	**13**	**36,066**
	Male	11	12	16,559
	Female	14	15	19,507
65 and over	**Total**	**21**	**19**	**11,355**
	Male	22	21	5,457
	Female	20	18	5,898

As can be seen from the Table above, the total number of persons who are 65 years and over who are at a risk-of poverty has fallen by 2% when compared to 2009 – with the female cohort, at 2% reduction, experienced a better improvement than males with a 1% reduction in the at-risk-of-poverty rate.

The PWG 2010 **agrees** with the appropriate stakeholders that there is a need for a profound discussion on pensioners and their exposure to at-risk-of-poverty. The PWG 2010 is, however, of the considered opinion that such a discussion and the corrective measures that need to be considered should not be limited to a simple reconciliation of the pension income that an elderly person receives with the median income at any point in time.

The PWG 2010 agrees with research that underlines that a simple median income benchmark has, at least, two fundamental problems. First, such benchmarks are quite crude as they simply count the number of people who fall below an income threshold. This means that those with incomes a cent apart may be classified as poor and non-poor, despite having similar circumstances. Secondly, they tend to measure income inequality rather than poverty mainly because they are based on a relative cut-off point of average income rather than a cut-off point that indicates need in some absolute sense. Furthermore, the income cut-off point chosen is a matter of judgement.[142]

The fact is that Malta has a broad framework directed to safeguard social inclusion that goes beyond minimum pension guarantees embedded in the pension system. Indeed, a pensioner can, if his or her personal circumstances so require, be supported by non contributory income benefits as well as other support mechanisms that are provided to all elderly persons. A cursory review of such non contributory and other supporting measures are shown in the Table below.

Table 34: Social Inclusion Supporting Framework

Measure	**Maximum Contribution €**
Social Assistance	Basic weekly rate of €95.43 to one person households.
Supplementary Allowance	Maximum weekly and annual rates of €8.13 and €422.69 to married persons and €4.57 and €237.81 to single persons.

[141] Pg 2, Ibid
[142] Pg 10, Daly, M., Measured or Missed: Poverty and Deprivation Among Older People in a Changing Ireland, School of Sociology, Social Policy and Social Work, Queen's University Belfast, Older and Bolder, October 2010

Energy Benefit	The Energy Benefit for those who qualify automatically includes: a) an amount to offset 30% of the consumption of electricity prior to the eco reduction up to a maximum assistance of €75 per year per person in the household, and b) a subsidy of not more than €65 per year in respect of the rent of electricity meter, and c) a subsidy of not more than €59 per year in respect of the rent of water meter. Or who qualify on humanitarian grounds includes:- a) an amount to offset 80% of the consumption of electricity before the eco contribution reduction, and b) a subsidy in respect of the rent of an electricity meter of not more than €65 per year in the case of a single phase meter or not more than €195 per year in the case of a three phase meter, and c) a subsidy of not more than €59 per year in respect of the rent of water meter.
Medical Assistance	Medical assistance weekly rate of €23.29 for one patient in household and an additional €18.16 for every additional patient in a household.
Handyman Service	The objective of this service is to help older adults and persons with special needs to continue living as independently as possible in their own home. The Handyman Service offers a range of around seventy repair jobs that vary from electricity repairs to plumbing, carpentry and transport of items. Those holding a Pink form issued by the DSS are entitled to this service free of charge, while those not holding a Pink form can receive this service against a payment.
Telephone Rebate	The scope of this service is to benefit older persons by providing them with discounted telephone rentals. For those subscribers who satisfy all the eligibility criteria, the rent payable is €14.95 yearly instead of € 71.70. The applicant is an elderly person, i.e. in possession of kartanzjan.
Meals on Wheels	The scope of the Meals on Wheels is to support elderly persons and others who are still living in their own home but who are unable to prepare a decent meal. Each meal costs €2.213.
Kartanzjan	The Kartanzjan entitles its holder to obtain certain rebates and concessions on services in Malta and Gozo. These include reductions on public transport bus fares.

The above excludes social inclusion measures such as the provision of free health, fee medicines, et al. Thus, the PWG 2010 is of the considered opinion that the Government should study the option of creating a at-risk-of-poverty protection mechanism for current pensioners who are 65 years of age and older that is, however, based on the following considerations:

(i) Introduced on the basis of a budgetary instrument.

(ii) Is means tested.

(iii) The at-risk-of-poverty gap is calculated on the basis of a holistic methodology that accounts for a pensioner and / or pensioner household income on the basis of designated income and non-income support measures which are subsequently reconciled against an equivalised poverty index benchmark.

(iv) In the event that there exists a at-risk-of-poverty gap, then a non contributory payment that reflects the size of the said gap is made to the pensioner – which non-contributory payment can be annually or over a designated term re-assessed subsequent to which it is increased or decreased accordingly.

Figure 21: Designing a Risk-At-Poverty Protection Mechanism Based on a Means Tested Holistic Income and Non Income Support Review

The PWG 2010 **recommends** that the Government assigns to the proposed PSU with the DSS once this is set up the task to carry out a "holistic risk-of-poverty assessment methodology", vis-a-vis pensioners who are not within the designated Switchers Group supported by appropriate social impact assessments.

The PWG 2010 **recommends**:

Strategic Review	Post Consultation Recommendation
New Recommendation J:	That Government assigns the Pensions Strategy Unit to study the introduction of a at-risk-of-poverty protection mechanism that would be based on the following principles (i) is a budgetary instrument; (ii) is means tested; (iii) is calculated on the basis of a holistic methodology that accounts for a pensioner and / or the pensioner household income on the basis of designated income and non-income support measures which is subsequently reconciled against an equivalised poverty index benchmark; and (iv) in the event that there exists an at-risk-of-poverty gap, then a non-contributory payment that reflects the size of the said gap is made to the pensioner – which non contributory payment can be annually or over a designated term re-assessed subsequent to which it is increased or decreased accordingly. The PSU should be tasked to conclude the study by October 2012.

The PWG 2010 recommends the following next steps:

			2012										2013											
	Rec		M	A	M	J	J	A	S	O	N	D	J	F	M	A	M	J	J	A	S	O	N	D
Review of Post Consultation Report by MJDF																								
Review of Post Consultation Report by Cabinet																								
Publication of Post Consultation Report by Government																								
Presentation to MCESD and general public of Accepted Principles of Reform by Government																								
Consultation on Principles of Reform																								
Establish Pensions Strategy Unit within the Department of Social Security	45																							
Issue call for applications for Director of Pensions Strategy Unit	45																							
Appoint Working Group on Pro-natal Policy Framework	06																							
Conclude review of new disability pension framework	08																							
Appoint Inter-Ministerial Task Working Group on Pensions and Care for the Elderly	10																							
Appoint a Working Group	11																							

to assess current childcare services support																								
Appoint Working Group to assess Before and After school support	12																							
Appoint Working Group to review and assess Family Friendly measures	13																							
Appoint Working Group to review and recommend measures to incentivise females to join the formal economy	14																							
Appoint Permanent Inter-Ministerial Working Committee on Active Female Participation Policy Design and Review	16																							
Appoint Inter-Ministerial Working Committee on Active Aging Strategy	17																							
Pensions Strategy Unit to assess atypical employment and incidence to at-risk-at-poverty	18																							
Employment Training Corporation present a strategic document for the undertaking of a national skills audit	19																							
Presentation of amendments to the Social Security Act with regards to pensions and divorce and cohabitation	C																							
Initiate an in-depth study on Notional Defined	25																							

Contribution application in Malta as a measure to reform the First Pension																								
Establish a National Commission for the Design of a Mandatory Second Pension	27																							
Introduce a Third Pension	32																							
Introduce a tax incentive on current fiscal measures with regards to identified vulnerable group	D																							
Introduce an EET tax incentive framework for a Third Pension	35																							
Introduces a tax incentive for current policy holders to roll over financial instruments upon maturity into a Third Pension	37																							
MFSA introduces a regulatory framework for home equity release products	38																							
Implement an incentive framework to accelerate accumulation of capital in a Child Pension Account	40																							
Appoints as Permanent Task Force on Financial Literacy	42																							

Permanent Task Force on Financial Literacy to complete first national literacy survey	41																							
Pensions Strategy Unit presents studies with regards to a non contributory at-risk-of-poverty protection mechanism for current pensioners	I																							

Appendix I: 2010 Pensions Working Group

The 2010 Pensions Working Group is constituted as follows:

Chairperson:
David Spiteri Gingell

Members:

Joseph Rapa
Director General, Economic Policy Department, Ministry of Finance, Economy and Investment

Joe Camilleri
Director General, Department of Social Security, Ministry for Justice, Dialogue and the Family

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

Frankie Micallef
Director for Social Benefits, Department of Social Security, Ministry for Justice, Dialogue and the Family

Godwin Mifsud
Director for Structural Economic Research, Economic Policy Department, Ministry of Finance, Economy and Investment.

The 2010 Pensions Working Group primarily assisted by Ms Pauline Mercieca, Economic Analyst, Economic Policy Department, Ministry of Finance, Economy and Investment and Mrs Jackie Cordina, Executive Secretary to the Group.

The Group extends its thanks to the World Bank for its continued assistance in the modelling required to support the Final Report and to the Malta Information Technology Agency for meeting the Groups requests for data. The Group specifically thanks Mr Richard Schembri, Project Manager for the Social Benefit Administration System, Malta Information Technology Agency.

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