PENSIONS
ADEQUATE & SUSTAINABLE

WHITE PAPER - NOVEMBER 2004

Appendices

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Consultation Carried Out

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Government	Dr Lawrence Gonzi	Prime Minister
	Dr Louis Galea	Chairperson, Cabinet Committee for Social Policy
	Ms Dolores Cristina	Minister, Family Affairs and Social Solidarity
	Mr Tonio Fenech	Parliamentary Secretary, Ministry of Finance
	Members	Cabinet Committee for Social Policy
MCESD	Mr Victor Scicluna	Chairperson
	Mr Gordon Cordina	Economist
NWCR	Mr Joe Schembri	Chairperson
Public Service	Mr Joseph R Grima	Principal Permanent Secretary
	Mr Joseph F Scicluna	Cabinet Secretary
	Mr Paul Zahra	Permanent Secretary, Ministry of Finance
	Mr Joseph Camilleri	Director, Department for Social Security
MFSA	Prof Joe Bannister	Chairperson
	Dr Andrè Camilleri	Director General
ETC	Ms Sue Vella	General Manager, Strategy
NSO	Mr Alfred Camilleri	Director General

APPENDIX II

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II

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APPENDIX III

The Value System Adopted to Shape the Design of the Reform of the Pensions System

III

The principles and recommendations proposed by the Pensions Working Group in its Report are directed to meet the following broad elements for the modernising of pensions endorsed by the European Union at the Gothenburg Council (2001):

(a) Adequacy of Pensions

(i) Ensure that older people are not placed at risk of poverty and can enjoy a decent standard of living; that they share in the economic well being of their country and can accordingly participate actively in public, social and cultural life.

(ii) Provide access for all individuals to appropriate pension arrangements, public and / or private, which allow them to earn pension entitlements enabling them to maintain, to a reasonable degree, their living standard after retirement.

(iii) Promote solidarity within and between generations.

(b) Financial Sustainability of Pension Systems

(iv) Achieve a high level of employment through, where necessary, comprehensive labour market reforms, as provided by the European Employment Strategy and in a way consistent with the Broad Economic Policy Guidelines (BEPG).

(v) Ensure that, alongside labour market and economic policies, all relevant branches of social protection, in particular pensions systems, offer effective incentives for the participation of older workers; that workers are not encouraged to take up early retirement and are not penalised for staying in the labour market beyond the standard retirement age; and that pensions systems facilitate the option of gradual retirement.

(vi) Reform pension systems in appropriate ways taking into account the overall objective of maintaining the sustainability of public finances. At the same time sustainability of pension systems need to be accompanied by sound fiscal policies, including, where necessary, a reduction of debt. Strategies adopted to meet this objective may include setting up dedicated pension reserve funds.

(vii) Ensure that pension provisions and reforms maintain a fair balance between the active and the retired by not overburdening the former and by maintaining adequate pensions for the latter.

(viii) Ensure, through appropriate regulatory frameworks and through sound management, that private and public funded pension schemes can provide pensions with the required efficiency, affordability, portability and security.

(c) Modernisation of Pension Systems in Response to Changing Needs of the Economy, Society and Individuals

(ix) Ensure that pension systems are compatible with the requirements of flexibility and security on the labour market; that, without prejudice to the coherence of Member States' tax systems, labour market mobility within Member States, and across borders, and non standard employment forms do not penalise people's pension entitlements and that the self employed are not discouraged by pension systems.

(x) Review pension provisions with a view to ensuring the principle of equal treatment between women and men, taking into account obligations under EU law.

(xi) Make pension systems more transparent and adaptable to changing circumstances, so that citizens can continue to have confidence in them. Develop reliable and easy to understand information on the long-term perspectives of pension systems, notably with regard to the likely evolution of benefit levels and contribution rates. Promote the broadest possible consensus regarding pension policies and reforms. Improve the methodological basis for efficient monitoring of pension reforms and policies.

APPENDIX IV

Modeling Options on Changes to the Current Pensions System

IV

The modeling software used for running simulations on options on changes to the current pensions system is the Pensions Reform Options Simulation Toolkit designed by the World Bank. The various models simulated were carried out by the World Bank on behalf of the Pensions Working Group.

The assumptions inputted into the PROST model are on two tiers: (i) Macro Economic Variables; and (ii) Pension Specific Variables.

The following are the key assumptions applied.

Macro-Economic Variables

01. Demographic Data

The demographic data applied is the data used by the World Bank in its report of March 2004. This data was obtained from the World Bank through MCESD. This data is consistent with the projections made by the National Statistics Office.

Two parameters were however introduced to this data. These are:

- The work force will increase annually by the addition of 500 immigrants.

  This is modeled on the further assumption that equal number of male and female immigrants with labour force participation is equal to those of the Maltese males and females assumption.

  70% are assumed to be in age cohort of 18 to 45 years of age: workers of a young age who are either assigned to Malta on projects or wish to migrate to Malta.

  30% are assumed to be in the age cohort of 45 to 60 years of age: persons with experience or who wish to live in Malta and then retire here.
- The work force will increase annually by the addition of 150 returned migrants.

  This is modeled on the further assumption that equal number of male and female returned migrants with labour force participation is equal to those of the Maltese males and females assumption.

  100% are assumed to be in age groups of 36 to 40 years of age: second generation persons of Maltese parents who seek to return to the country of their parents.

02. GDP Growth in Real terms

Economies behave in a cyclical manner. The assumption made here is that as restructuring takes place Malta will enjoy a GDP Growth of 4% per annum until 2020. This is leveled at 2.5% thereafter to account for both high and low GDP growth during future economic behaviour.

03. Inflation Rate

Inflation has been reasonably low in Malta. Inflation is assumed to be 2.5% over the modeling period to account for both high and low inflation cycles during future economic behaviour.

04. Collection Rate

The changes proposed argue for a far more aggressive compliance and enforcement regime. It is thus assumed that the Government will collect 95% of the contributions due to the State for contributory benefits.

05. Discount Rate

The discount rate is assumed at 5% in real terms. This is equivalent to approximately 7.5% in nominal terms.

06. Women's Participation

Women's participation in the economy is expected to increase. The traditional behavioural pattern that men work and women take parental responsibilities is changing amongst younger generations of women. Nevertheless, women who are currently 40 years of age and above and have opted out from the work force are not expected to return in large numbers into the work force. It is thus assumed that till 2020 the current women participation rate will increase to 55%.

As the demographic structure of women changes, and today's 20 and 30 year old women age, it is expected that this cohort of women are more likely to continue to work in later years even though they will be married and have parental responsibilities. It is thus assumed that women's participation will increase even further from 2020 onwards. This increase will also be supported by pension measures designed to assist persons to return to work after taking career breakouts due to parental responsibilities. Thus, it is assumed that the employment participation rate from 2021 onwards will increase to 62%.

The assumption can be argued to be a cautious one. A higher participation rate has not been favoured as it is assumed that complete behavioural change that will see the considerable majority of women working during marriage will take time to happen.

07. Unemployment Rate

Malta will over the next ten years undergo considerable structural change to render it more competitive. Over this period of time unemployment is assumed to be 7%. It is further assumed that once the structural changes take place the economy will perform better. It is thus assumed that from 2015 onwards the unemployment rate will be 6%.

08. Employment Rate

The employment rate is assumed to be endogenous.

09. Annual Real Wage Growth

Given the necessity to maintain the labour share of the GDP in face of a declining labour force the Annual Real Wage Growth is assumed to be 3%.

Pension Specific Variables

The recommendations proposed by the Pensions Working Group is based on the following changes. This is referred to as the Base Model.

01. Current Pensioners

Current pensioners and individuals who will retire prior to the implementation of the proposed changes which are assumed to be introduced on 1st January 2007 will not be effected by the recommendations proposed.

02. Retirement Age

The retirement age will be increased to 65 years of age for both men and women. This will be introduced as follows:

(a) In terms of women, the pension age will be 61 years of age with effect from 1st January 2007.

(b) The increase of pension age for all to the 65 years threshold will start from 1st January 2007, persons holding the following years of age will retire as follows:

Years of Age as at 1st January 2007	Retirement Age
55 years of age and over	No change
52 years of age to 54 years of age	62 years
49 years of age to 51 years of age	63 years
48 years of age and below	65 years.

03. First Pillar Pension

03.1 The minimum pension guarantee currently is:

Single	Lm40.45 per week
Married	Lm46.39 per week

This is assumed to increase annually as from 1st January 2007 by the rate of inflation based on the Retail Price Index.

03.2 The contribution period for the accumulation of the Two-Thirds First Pillar pension should be increased from 30 years to 40 years as from 1st January 2007 as follows:

Years of Age as at 1st January 2007	Accumulation Period
46 years of age and over	No change from current accumulation period
40 years of age to 45 years of age	35 years.
39 years of age and below	40 years.

03.3 The base line for the calculation of the Two-Thirds First Pillar pension will be changed from the best consecutive three years from the last ten years for employees and from the average of the last ten years' net income for self employed persons to the average of the 40 year contributions accumulation history for both employees and self employed as from 1st January 2007 and will be introduced as follows:

Years of Age as at 1st January 2007	Base-line for Calculation of First Pillar
55 years of age and over	No change from the current base-line calculation period
50 years of age to 54 years of age	Average of best 5 years
45 years of age to 49 years of age	Average of best 10 years
44 years of age and below	40 years.

03.4 As from 1st January 2007 the Two-Thirds First Pillar post retirement pension income is annually built up for all pensioners by inflation based on the Retail Price Index.

03.5 A person may continue to opt to work beyond the new statutory retirement age whilst enjoying the Two-Thirds First Pillar (and Second Pillar) pension with no capping on income earned subject to the payment of the First Pillar contribution. This measure will come into effect in tandem with the recommendations proposed on the retirement age.

03.6 The current invalidity pensions scheme should be reviewed with a view to tighten the eligibility criteria as well as to adopt the principle of 'rehabilitation or alternative work before pension'.

03.7 The ceiling of the First Pillar's Maximum Pensionable Income will as from 1st January 2007 be the current Maximum Pensionable Income adjusted yearly to reflect inflation.

03.8 The Class I and Class II contributions should remain unchanged.

03.9 For modeling purposes only it is assumed that 2% of the social security contribution paid by an employee (Class I share is 10%) and 1% of the State Grant (Class I share is 10%) is channeled to the Health Fund.

03.10 As from 1st January 2007 all non-contributory benefits will be financed through the Consolidated Fund.

03.11 For modeling purposes it is assumed that a policy that credits ones person by two years for every child born subject that the said person must return to employment for the same period is introduced as from 1st January 2007.

04. Second Pillar Pension Scheme

04.1. The Second Pillar Pensions Scheme is introduced on a voluntary basis as from 1st January 2006. The following take-up rates are assumed:

2006	4%
2007	5%
2008	6%
2009	7%

For modeling purposes only it is assumed that the contribution to be paid by the employer and employee during this period will be 2% respectively.

04.2 For modeling purposes it is assumed that the Second Pillar Pension Scheme is introduced on a mandatory basis for persons who are 45 years of age and younger. Contributions are assumed to be as follows:

2010 to 2024	2% each from employee and employer
2025 onwards	5% each from employee and employer

04.3 Administration costs of the Second Pillar Pension Scheme are assumed to be Lm1,000,000 for each of the first three years from when this is introduced mandatorily. This is then assumed to fall to Lm750,000 annually given that the initial mobilisation costs would have been made.

04.4 The rate of return on private fund investments taking into account the 'prudent-person' rule as well as quantative diversification criteria is assumed to be 5% in real terms.

04.5 The following annuitisation rules are assumed:
- Assumed life insurance companies use 4% in calculating annuities to cover longevity risk
- Assumed annuities based on unisex life tables
- Assumed annuities are inflation-indexed.

04.6 For modeling purposes only it is assumed that a Pensions Compensation Fund will be created which will be financed from the Second Pillar Pensions Scheme itself where 1% of total annual contributions to the Second Pillar Pension Scheme are channeled to this Fund.

05. Definitions of Wage Earners

The following assumptions are taken in defining wage earners:

05.1 High Wage Earner:
Starts work at 24 years of age. Retires at 65 years of age. Begins work at twice the average wage of a 24 years old person. Annual wage growth is 10% higher than the average wage growth. Mortality rate is 10% lower than the average. Takes one year off in his / her career to undertake studies.

05.2 Average Age Earner:
Starts work at 22 years of age. Retires at 65 years of age. Begins work at the average wage of a 22 years old person. Annual wage growth is equal to average wage growth. Mortality rate is average. Takes one year off at the age of 26 years

05.3 Low Wage Earner:
Starts work at 18 years of age. Retires at 65 years of age. Begins work at 60% of average wage of a 18 year old person. Annual wage growth is 10% lower than the average wage growth. Mortality rate stands at 10% higher than average. Unemployed for 2 years.

APPENDIX V

Chronology: Social Security in Malta

V

1927: Widows' and Orphans' Pensions Act

1929: Workmen's Compensation Act

1948: Old Age Pensions Act

1956: The National Assistance Act

1956: The National Insurance Act

1957: Blindness Pension

1965: Extension of National Insurance Act to Self-Employed and Non-Employed

1965: Invalidity Pension

1972: Annual Bonus

1974: Childrens' Allowance

1974: Disabled Pension Scheme

1979: Two-Thirds Pension

1979: National Minimum Pension

1981: Maternity Benefit

1987: Social Security Act (1987)

1988: Disability Child Allowance

1988: Parental Allowance

1989: Family Bonus

1989: Emergency Assistance for Destitute Women

1991: Widowers' Pension

1991: Orphans' Supplementary Allowance

1992: Carers' Pension

1996: Supplementary Allowance

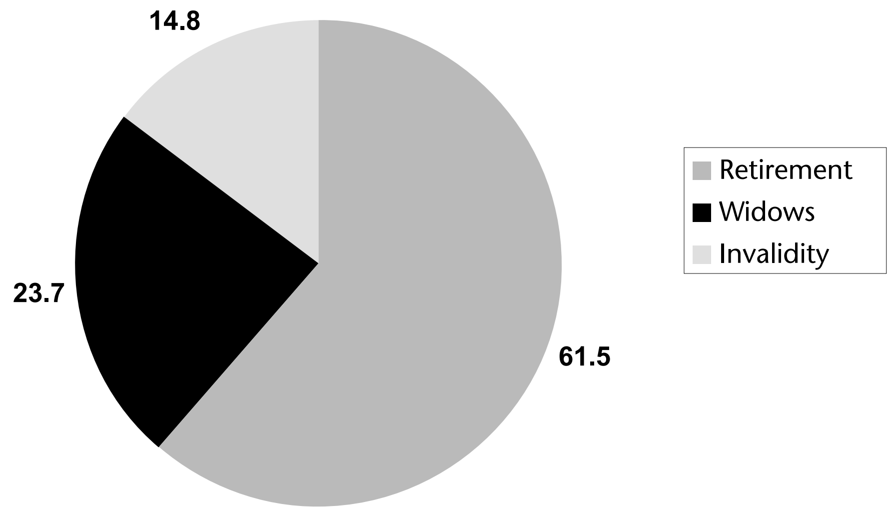
APPENDIX VI

Analysis of Pensions Benefits Issued Under the Current Pensions System

VI

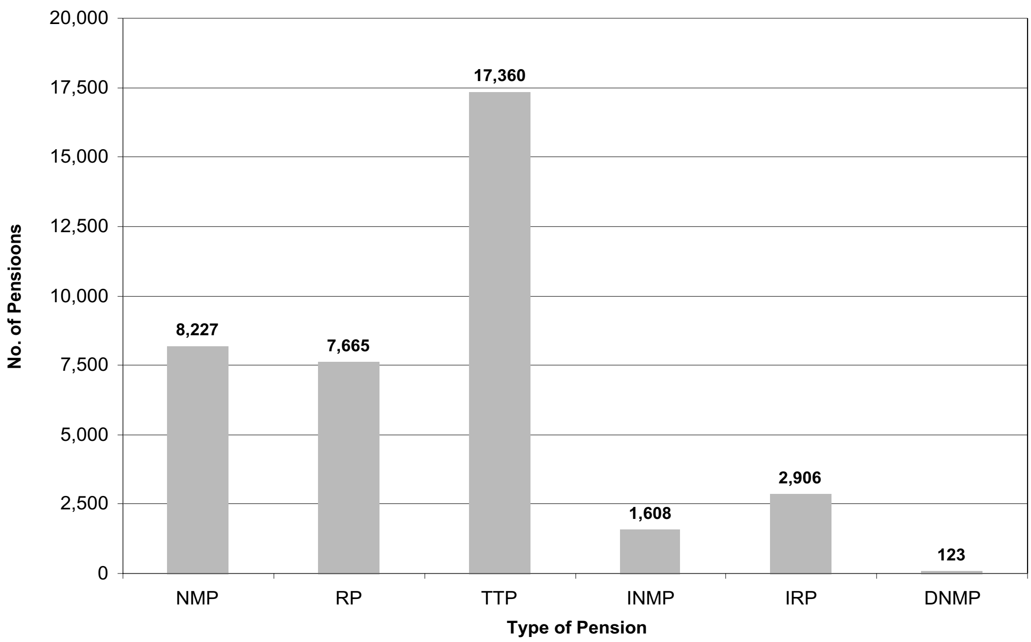
Chart 01 shows a distribution of the categories of contributory benefits. 61.5% relates to retirement benefits; 23.7% to Widows' benefits and 14.8% to Invalidity benefits.

Chart 01: Categories of Contributory Benefits



Graph 13 shows the contributory benefits related to retirement pensions. 21.7% of the beneficiaries of the retirement related benefits are dependent on the National Minimum Pension.

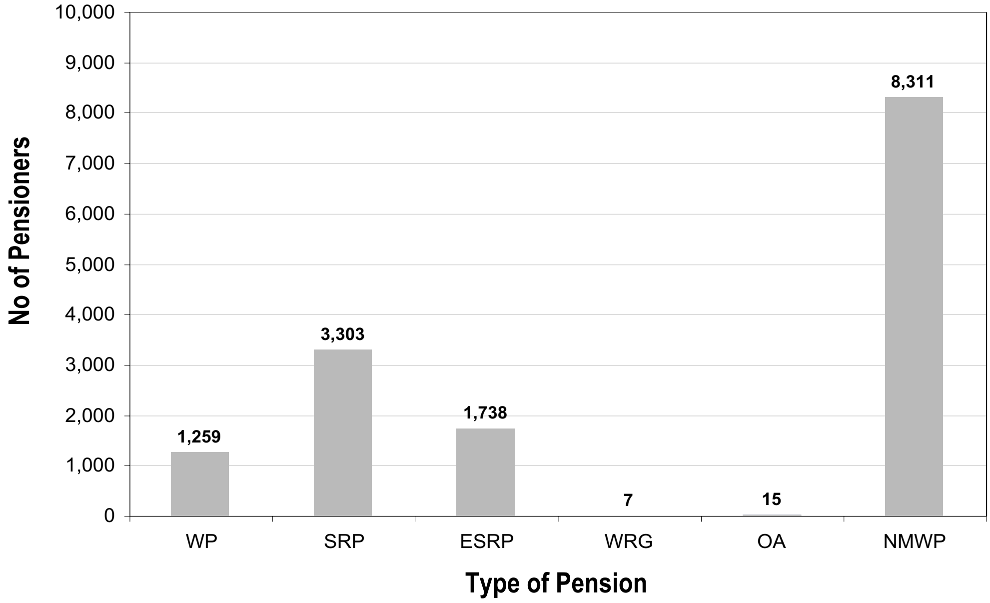
Graph 13: Retirement Related Benefits



NMP: National Minimum Pension
RP: Retirement Pension
TTP: Two Thirds Pension
INMP: Increased National Minimum
IRP: Increased Retirement Pension
DNMP: Decreased National Retirement

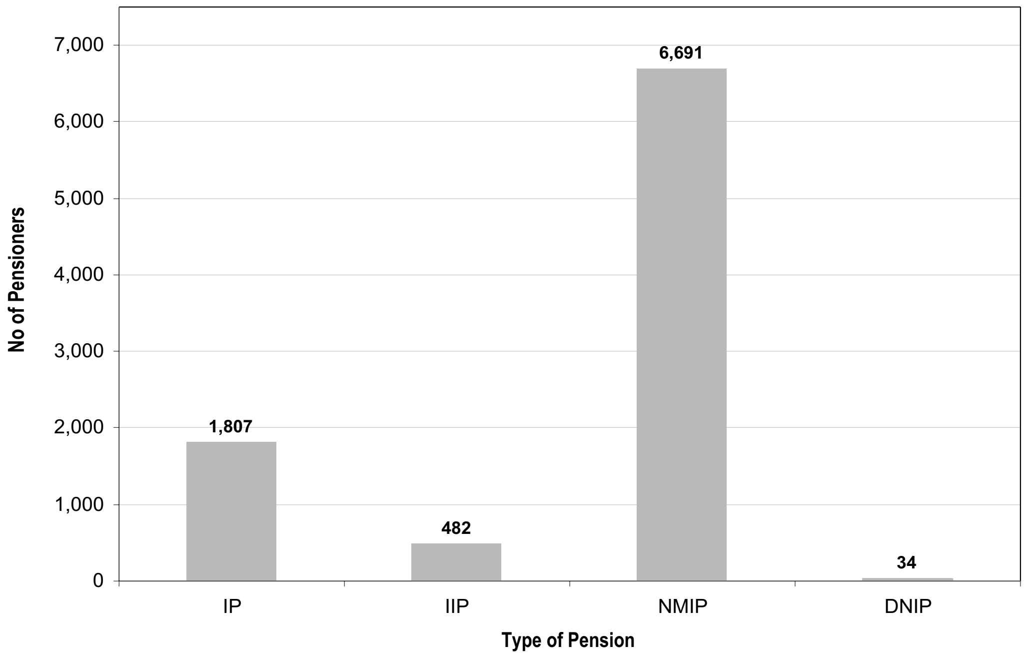
Graph 14 shows the contributory benefits related to Widows pensions. 56.8% of the beneficiaries of Widows benefits are dependent on the National Minimum Widows pension.

Graph 14: Widows Related Benefits



Graph 15 shows the contributory benefits related to Invalidity pensions. 74.2% are to the beneficiaries of Invalidity benefits are dependent on the National Minimum Invalidity Pension.

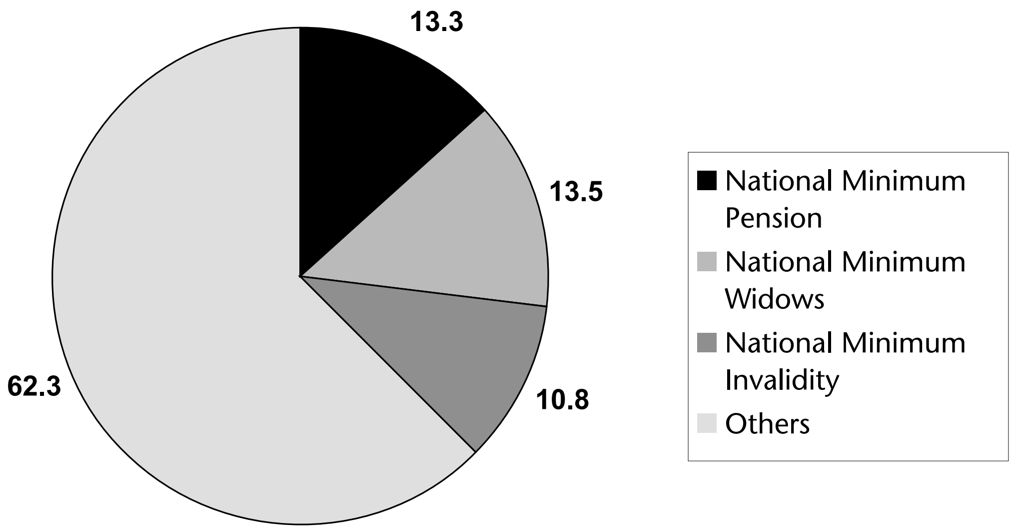
Graph 15: Invalidity Related Benefits



IP: Invalidity Pension
IIP: Increased Invalidity Pension
NMIP: National Minimum Invalidity
DNIP: Decreased National Invalidity

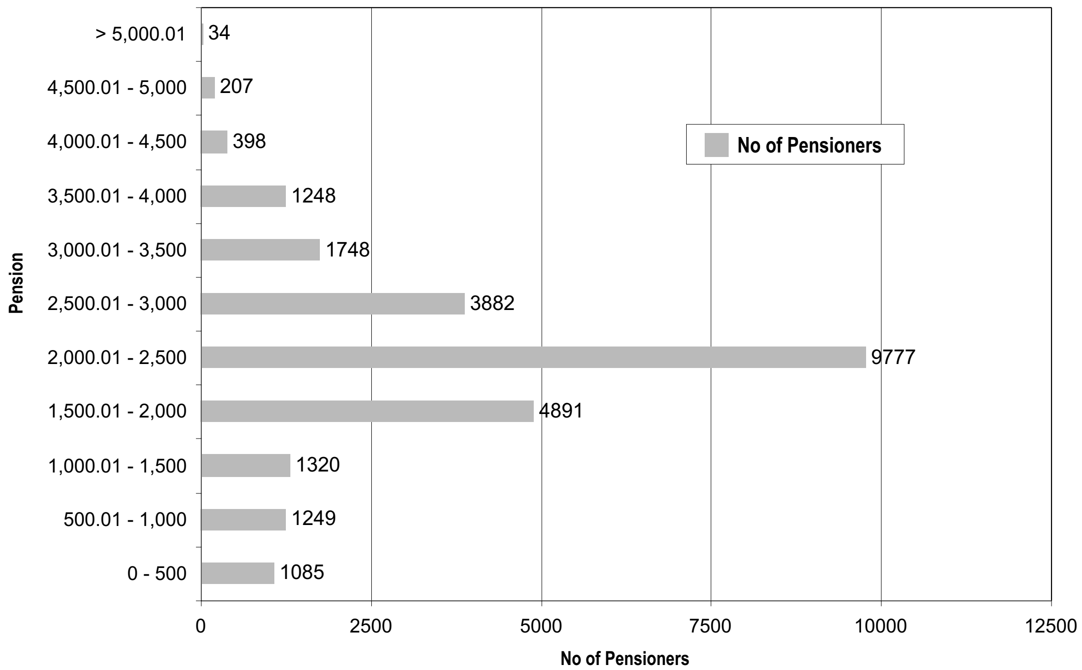
Chart 02 shows that beneficiaries on national minimum pensions constituted 38% of total beneficiaries.

Chart 02: Distribution of National Minimum Pensions



Women pensioners stand at 25,839 as at 31st December 2003 – that is 42% of the total pensioners. It is to be noted that of this number 3,303 are entitled to a Survivors Pension and 1,738 to an Early Survivors Pension. Graph 16 shows a breakdown of women pensioners by pension income earned.

Graph 16: Women Pensioners by Pension Income Earned



18.9% qualify for a pension income between Lm1,500 to Lm2,000. 37.8% qualify for a pension income of Lm2,001 to Lm2,500 and 15% qualify for a pension income of Lm2,501 to Lm3,000.

The total number of persons who are still in employment but will benefit from a pension under the Public Service Occupational Pension is 3,341. 81% are employed by Government ministries and departments whilst 19% are employed by public sector entities. It is to be noted that these figures excludes Occupation Pensions related to Police Officers, Army Officers, etc. Table 14 shows the age distribution of this category of workers.

Table 14: Workers who are yet to retire on Public Service Pension

Age	Ministries and Departments	Public Sector Entities
38	1	1
42	1	0
43	8	0
44	15	6
45	55	16
46	58	22
47	84	36
48	102	26
49	116	50
50	116	37
51	129	46
52	130	41
53	179	37
54	205	39
55	260	44
56	244	35
57	225	36
58	224	43
59	215	46
60	206	45
61	30	5
Over 61	109	18
Total	**2712**	**629**

Table 15 on page 5 shows the number of workers who are projected to retire between 2004 to 2015 and the current income earned. The majority of the expected retirees are within the Lm50 – Lm100 weekly salary bracket. It is also pertinent to underline that a considerable number of worker are identified to have paid less than the statutory contributions entitlement and are therefore not accounted for pension benefits unless they rectify this position.

Sources: With the exception of Table 14 the source is the SABS System of the Department of Social Security. The source for table 14 is the Employment and Training Corporation.

Table 15: Persons Expected to Retire between 2004 and 2015

Year	a	B			Year 2000 Weekly Salary						LmYear 2001 Weekly Salary						LmYear 2002 Weekly Salary					
	Contributions Less than 50	Males	Females	Total of persons	0-50	50-100	100-150	150-200	200-250	250~	0-50	50-100	100-150	150-200	200-250	250~	0-50	50-100	100-150	150-200	200-250	250~
2004	1050	2496	2437	4933	106	930	372	43	9	10	79	859	458	75	19	14	43	750	501	81	20	15
2005	1308	3405	2328	5733	116	1348	568	63	20	21	87	1263	680	112	34	23	50	1096	732	116	38	24
2006	1379	3262	2530	5792	126	1435	520	64	14	25	115	1305	651	118	25	25	61	1156	707	707	32	25
2007	1400	3325	2625	5950	125	1527	554	61	19	27	108	1381	717	112	34	32	62	1220	775	116	36	32
2008	1280	3470	2675	6145	142	1663	523	59	16	27	114	1526	704	107	28	25	60	1392	763	111	28	27
2009	1185	3331	2554	5885	155	1693	499	72	21	33	136	1587	671	98	34	50	69	1430	751	109	39	43
2010	1164	3267	2629	5896	164	1646	557	68	16	31	125	1552	708	121	23	37	68	1413	787	125	22	48
2011	989	3309	2563	5872	167	1732	508	92	20	45	146	1635	680	120	34	51	82	1498	769	116	48	61
2012	963	3010	2560	5570	182	1597	503	76	25	32	132	1496	701	116	37	34	73	1372	771	123	40	39
2013	895	2994	2549	5543	189	1658	419	94	34	25	155	1538	598	129	62	37	71	1417	712	123	56	38
2014	837	2933	2617	5550	185	1603	443	79	22	37	157	1518	608	122	31	44	79	1430	711	110	41	45
2015	870	2962	2637	5599	186	1686	459	89	23	39	153	1636	612	131	36	35	78	1531	697	119	58	37

APPENDIX VII

National Commission on Welfare Reform: Terms of Reference

VII

The Government of Malta:

- Recognises the need to review the present national welfare system in view of the challenges facing future generations as a result of demographic realities.
- Refers to the reports commissioned by the Malta Council for Economic Development (MCED) and the Forum for a Better Economy.
- Acknowledges the need to identify solutions within a broad national framework which involves all the key players.
- Appoints a National Commission on Welfare Reform with the following terms of reference.

The Commission shall:

(i) Gain an actuarial understanding of current and prospective pensions' financing.
(ii) Gain an understanding on the welfare gap as it results from existing legislation.
(iii) Gain an increased understanding of the strengths and weaknesses of various pensions options as revealed by experience abroad.
(iv) Recommend proposals for the reform of pension funding and provision as well as possible incentives and related measures.
(v) Identify the demographic, social and economic attributes of the context within which proposals for welfare reform are formulated.
(vi) Assess the likely impact of these proposals upon social groups, industry and the economy.
(vii) Estimate the administrative costs and skills required to implement proposed reforms.

The objectives of the Commission shall be:

- To consider the present Social Security Act, all contributory and non-contributory benefit schemes that are granted under the Act, and their present and future cost within the context of the Government's financial situation.

- To recommend new legislation that would (a) be simpler, (b) ensure an equitable distribution of benefits without lessening their present levels to those beneficiaries for whom such benefits were originally intended, (c) provide for a system of administration of such benefits that would promote efficiency and efficacy at less input costs while securing against abuses and waste, and (d) ensure projected financial sustainability to beneficiary and contributor alike, both private and State owned.

The Minister for Social Policy shall make available to the Commission the resources necessary for it to meet its mandate, namely relevant documentation, data, research and administrative support.
It is expected that the Commission Members will meet regularly to discuss, direct, plan and control all inputs relevant to its workings.
The Commission shall be at liberty to source any expertise which it deems necessary for it to achieve its objectives as outlined in these terms of reference.
The Commission shall present an interim report to Government by not later than the 31st October 1999.

Chairperson:	Mr Anthony P Galdes
Members:	
Dr A Borg Barthet	Attorney General
Mr Alfred Buhagiar	Representing the C.M.T.U / U.H.M
Mr Ray Cachia Zammit	Representing the Ministry for Economic Services
Mr Mario Cutajar	Representing the General Workers' Union
Prof Emanuel Delia	Representing Employers' Associations
Mr Edward Gatt	Director (Social Security) representing the Ministry for Social Policy
Mr Vincent Grech	Director General (Financial Administration) representing the Ministry of Finance
Ms Natasha Meli	Representing the National Youth Council
Mr Emanuel Micallef	Director (Corporate Services), representing the Ministry of Health
Mr Maurice Petrococchino	Representing the Pensioners' Association
Mr Victor Scicluna	Representing Employers' Associations
Mr Albert Tabone	Representing the Pensioners' Association
Ms Sue Vella	Executive Secretary.

Ms Natasha Meli was replaced by Ms Brigitte Zammit on the 29th October 1999, replaced in turn by Mr Joseph Mifsud on the 20th January 2000.

Mr Anthony P Galdes was replaced by Mr Joseph Schembri in 2002.

APPENDIX VIII

Brief Overview of the Special Funds (Regulation) Act, 2002 and Supporting Draft Directives and Legal Notices

VIII

Introduction

The Special Funds (Regulation) Act, 2002 ("the Law") came into force on 1st October 2002 and is intended to facilitate the establishment of funded second pillar retirement arrangements. The Law provides a regulatory framework for:

- o The arrangement pursuant to which an employer or contributor promises the employee or beneficiary retirement benefits (called a Retirement Scheme). The Law requires a Retirement Scheme to be registered.
- o The types of funds (called Retirement Funds) that are required to be used as investment vehicles by a Retirement Scheme and which require registration under the Law.
- o The types of service providers that may provide services in connection with a registered Retirement Scheme and / or Retirement Fund.

The Law is an enabling law and is to be supported by means of subsidiary legislation in the form of Legal Notices containing more detailed regulations. The Law is also to be supplemented by Directives which do not have legal force but constitute registration conditions and which are issued by the Competent Authority under the Law. The supporting Legal Notices and Directives were issued for consultation with the industry in July 2003 by the Malta Financial Services Authority ("MFSA"), as the appointed Competent Authority under this Law.

As the Competent Authority, the MFSA has the role of monitoring the ongoing compliance of registered Retirement Schemes and Retirement Funds, as well as related service providers, with the requirements of the Law, the proposed Legal Notices and Directives.

Structure of the Law

The Law is divided into three main parts as follows:

(i) Part I Contains the Basic Definitions
- o Contributors may be the employer or the employer together with employees.
- o Beneficiaries are the members of the scheme eligible for retirement benefits.
- o Retirement Benefits are defined as a pension or other benefits that are payable to a beneficiary after retirement, permanent invalidity or death.
- o A Retirement Scheme is a contract between the Contributors and the Beneficiaries with the Retirement Scheme Administrator.
- o A Retirement Fund is the investment vehicle where contributions paid under the Retirement Scheme are to be invested.

(ii) Part II contains the essential requirements for the registration and operation of Retirement Schemes and Retirement Funds, as well as related service- providers

The SFA stipulates the structure to be followed in the establishment of Occupational Pension Scheme, as well as applicable registration requirements. The Law also stipulates the operational conditions that need to be satisfied by Retirement Schemes, Retirement Funds and their related parties. Operational conditions include the carrying out of specific duties, funding requirements, permitted investments, disclosure requirements and rights arising from the Retirement Scheme. Further details of these requirements are provided below.

(iii) Part III contains general provisions describing the powers of the Minister and the MFSA and the various penalties for non-compliance

The Law also grants various powers to the Competent Authority as follows:

- Power to levy penalties and public statements of misconduct.
- Power to carry out regular as well as ad-hoc inspections.
- Power to issue Directives.

This part of the Law also determines what constitute offences under the Law and contains various powers to prescribe detailed requirements, including provisions relating to the advertising and promotion of Retirement Schemes and Retirement Funds, the spread of investments to be included in a Retirement Fund and the extent to which investments or loans may be made in or to Contributors.

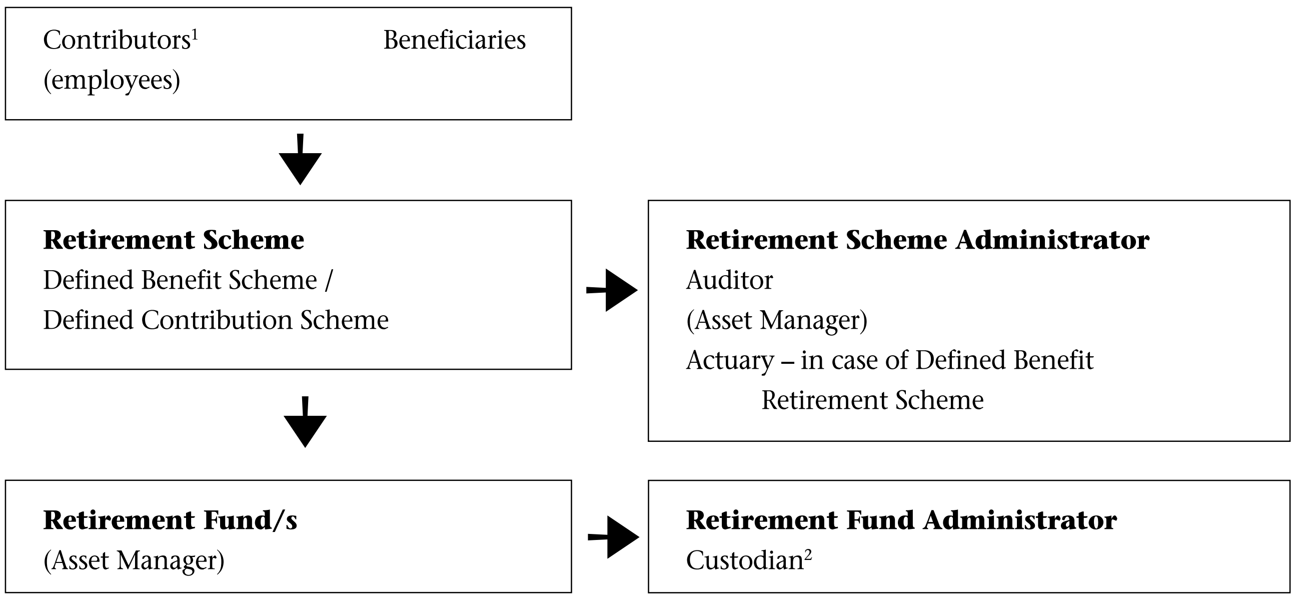
Structure of the Directives issued under the Law

The proposed directives are divided into five main parts (parts A to D of which are herewith attached):

- Part A provides an introductory overview of the Law and specifies the registration process and registration criteria applicable to Retirement Schemes, Retirement Funds and related parties.
- Part B sets out the standard operational conditions for Retirement Schemes and Retirement Funds and related parties registered under the Law.
- Part C contains Other General Guidelines, relating to areas such as outsourcing and penalties.
- Part D includes the reporting Schedules for Retirement Schemes and Retirement Funds and related parties.
- Part E contains application forms and related information.

Structure of Retirement Schemes and Related Parties

The structure established by the Law for Occupational Retirement Schemes is as follows:



A Retirement Scheme:

- Is constituted by way of contract under Maltese law, which governs the rights and responsibilities of a Retirement Scheme Administrator and Contributors thereto, and under which payments are made to Beneficiaries for the principal purpose of providing Retirement Benefits. Retirement Benefits means pension or other benefits payable to a Beneficiary after retirement, permanent invalidity or death.
- Requires registration under the Law.
- May be either a Defined Benefit Scheme or a Defined Contribution Scheme.
- Is required to appoint a Retirement Scheme Administrator to manage its affairs.
- Is required to invest its Contributions into one or more Retirement Funds also registered under the Law.

The Retirement Scheme Administrator:

- Requires registration under the Law.
- Must have at least three Directors.
- Is primarily responsible to manage the affairs of the Retirement Scheme in terms of the contract with the Contributors and Beneficiaries. Duties (which are defined by Law) typically include:
    - investing all contributions in Retirement Funds according to the terms of the Scheme document;
    - ensuring that the retirement scheme collects all payments that are owed to it by its contributors;
    - ensuring that all disbursements are effected in accordance with the Retirement Scheme documents; and
    - maintaining accurate records.
- May appoint an Asset Manager to advise on or manage the investment of all or any of the Retirement Scheme's assets or may undertake such functions itself (if duly registered as Asset Manager).

A Retirement Fund:

- Is a collective investment company with fixed or variable share capital incorporated under the Companies Act, 1995, set up for the principal purpose of holding and investing the Contributions made to one or more Retirement Schemes.
- Requires registration under the Law.
- Is required to appoint a Retirement Fund Administrator to administer its affairs and custody of its assets.
- The appointment of an Asset Manager to the Fund is at the discretion of the Retirement Fund. Where an Asset Manager is not appointed, the asset management function shall be undertaken by the Board of Directors of the Retirement Fund who need to demonstrate competence in relation to this activity.

Retirement Fund Administrator:

- Requires registration under the Law.
- Performs duties associated with the ordinary day-to-day operations of the Retirement Fund and may carry out the custody function itself, where it satisfies the criteria applicable to custodians of Retirement Funds. Otherwise, assets must be entrusted to an entity which is registered under the Law as Custodian of Retirement Funds. The duties (as defined by Law) of a Retirement Fund Administrator. Administrator typically include:
    - managing the Retirement Fund;
    - ensuring compliance with all statutory and contractual obligations;
    - arranging for the necessary financial control of the Retirement Fund;
    - providing for the audit and actuarial examination of the Retirement Fund; and
    - carrying the overall day-to-day responsibility for the Retirement Fund.

Asset Manager:

- Requires registration under the Law.
- Performs investment management duties related to the Retirement Scheme or Retirement Fund.

Overseas Plan:

The Law also makes reference to Overseas Retirement Plans - which are bona fide schemes or arrangements, organised under the laws of a country outside Malta, which govern the rights and responsibilities of the parties related thereto, and under which payments are made to Beneficiaries for the principal purpose of providing retirement Benefits. An Overseas Retirement Plan does not require registration under the Law. However, it may either decide to establish a Retirement Fund registered under the Law or else invest its Contributions in an already established Retirement Fund registered under the Law.

Overview of Registration Requirements

- Retirement Scheme
  - The Law establishes certain disclosure requirements to be met by the Retirement Scheme Document (i.e. the contract establishing the occupational pension arrangement), which is to be approved by the Competent Authority.
  - The Law requires that a Retirement Fund is used as the investment vehicle of the Retirement Scheme.

- Retirement Scheme Administrator
  - The administrative role may be carried out by insurance companies authorised to carry out long term business in 'pension fund management' under the Insurance Business Act, 1998, or by Category 2 or 3 Investment Services Licence Holders under the Investment Services Act, 1994, having the appropriate organisational set-up, systems and resources. In these cases, an abridged application process shall apply. Other entities may also apply, in which case a full application process shall apply.
  - The entity registered as a Retirement Scheme Administrator under the Law may carry out asset management function itself (if also duly registered as asset manager under the Law) or delegate this function to a third party asset manager.

- Retirement Fund
  - Scheme Particulars - which describes the nature and objectives of the Retirement Fund – needs to comply with certain disclosure requirements.
  - May carry out asset management function itself or delegate this function to a third party asset manager.

- Retirement Fund Administrator
  - Role (excluding the custody function) may be undertaken by Category 2 or 3 Investment Services Licence Holders under the Investment Services Act, 1994. In these cases an abridged (rather than a full) application process shall apply. Other applicants will need to follow the full application process under the Law.
  - If the Retirement Fund Administrator wants to maintain custody, it would need to satisfy the criteria for custodians (as described below).

- Asset Manager
  - If acting for a Retirement Scheme Administrator, must be:
    - authorised to carry out long-term business under the Insurance Business Act in 'pension fund management'; or
    - licensed under the Investment Services Act, 1994 to provide discretionary portfolio management services; or
    - an overseas based firm which the MFSA is satisfied is subject to adequate regulatory supervision in the jurisdiction where based.
    - If acting for a Retirement Fund, it must fall within either of the preceding two categories.

- Retirement Fund Custodian – Must be an entity in possession of:
  - A Category 4 investment services licence under the Investment Services Act, 1994, or
  - Licensed under the Banking Act, 1994, or
  - A credit institution licensed in a country where in the opinion of the MFSA it is subject to an adequate level of regulatory supervision, having an established place of business in Malta, or
  - Such other entity acceptable to the MFSA having the business systems, experience and expertise deemed necessary by the MFSA for it to maintain custody of assets.

Overview of On-Going Registration Requirements

- The Shareholders, Directors and senior management of parties applying for registration, are required to satisfy the Fit and Proper Test, which involves the test of solvency, integrity and competence.
- The Parties are also required to satisfy various independence requirements, which are described further below.
- The Retirement Scheme Administrator, the Retirement Fund Administrator and the Retirement Fund Custodian are required to comply with minimum Financial Resources and Reporting Requirements - unless already subject to appropriate requirements under other licensing regimes. This exemption is intended to avoid duplication of requirements. Record keeping requirements also apply.
- Retirement Scheme Administrator and Retirement Fund Administrator are both subject to:
  - Various disclosure requirements to the Contributors and Beneficiaries and the MFSA, including:
  - Ensure that Contributors and Beneficiaries are sufficiently informed of the conditions of the Retirement Scheme, in particular of the contractual rights and obligations; the financial, technical and other risks embedded in the Retirement Scheme; the distribution of risks embedded in the Scheme to contracting parties.
  - Provide any Contributor or Beneficiary upon request with detailed information on applicable target level of benefits, actual financing of accrued pension entitlements, range on investment possibilities and actual investment portfolio and the investment policy and principles of the Retirement Scheme; a copy of the Scheme's annual report.
  - Information regarding pension rights and choice available to employees moving to other EU member country.
  - Submission of annual reports to the MFSA by the Retirement Scheme and Retirement Fund. The Retirement Fund is also required to submit monthly returns to the MFSA.
  - The MFSA is also to be notified of any under-financing of Defined Benefit Schemes, and provided with an actuarial report.
  - Related Parties are required to submit financial returns on a half-early basis to the MFSA regarding their financial status. An auditor's report is also required together with the annual audited accounts.

- Conduct of Business rules, including inter alia:
    - Regarding the custody of assets by Retirement Fund Administrator or Custodian.
    - Defined Benefit Schemes are subject to Minimum Funding Requirement to ensure that there are sufficient assets to cover the inherent liabilities and hence ensure that promised benefits are delivered. The Directives place a high degree of reliance on monitoring carried out by the Retirement Scheme Administrator and the Actuary in this regard.

      Where it is likely that the Funding Requirement will not be met (or where a deficit materialises), the Law obliges the Retirement Scheme Administrator to levy additional contributions in order to remedy the shortfall.
    - The Law imposes various reporting requirements on auditors and actuaries of Retirement Schemes and Retirement Funds, including whistle blowing obligations.

Independence Requirements

In order to provide additional safeguards and segregation of duties the following general principles were taken into account in establishing the independence requirements:

- The involvement of the employer (as a Contributor) with the other parties to the structure should be limited.
- With regards to a Retirement Fund, the administration/ custody function undertaken by the Retirement Fund Administrator and the asset management function shall be kept separate (in line with the independence requirements imposed for retail collective investment scheme in the Investment Services Act, 1994).
- A person shall not be appointed as auditor to a Retirement Scheme if he / she is employed under a contract of service by the Retirement Scheme Administrator or any Contributor or is a Contributor or Beneficiary to or of the Retirement Scheme.

In summary, the following independence requirements shall be applied:

Retirement Fund		**Independent From:**
Retirement Fund	-	Retirement Scheme Administrator
	-	Retirement Fund Administrator
	-	Contributor (where this is a business concern)
Asset Manager	-	Retirement Fund Administrator
	-	Contributor (Where this is a business concern)

Except as may be authorised by the MFSA, a person shall not act as a member of the Board of Directors of the Retirement Fund or of the Asset Manager or as an officer responsible for the administration and management of the Asset Manager and at the same time hold a similar position with the Retirement Fund Administrator or the Retirement Fund Custodian as applicable

Independence between parties		**Independent From:**
Retirement Scheme Administrator	-	Contributor(s) (While such independence does not preclude a Contributor from being represented on the Board of the Retirement Scheme Administrator, there should be a majority of Directors on the Board who are independent of any Contributor)
	-	Retirement Fund
	-	Retirement Fund Administrator

		Independent From:
Retirement Scheme Administrator	-	Contributor(s) of Retirement Scheme (While such independence does not preclude a Contributor from being represented on Fund Administrator, there should be a majority of Directors on the Board who are independent of any Contributor)
	-	Retirement Fund
	-	Asset Manager
	-	Retirement Scheme Administrator
Retirement Fund Custodian (where appointed)	-	Contributor to a Retirement Scheme (where this is a business concern)
	-	(Except as may be authorised by the MFSA, a person shall not act as a member of the Board of Directors of the Retirement Fund or of the Asset Manager or as an officer responsible for the administration and management of the Asset Manager and at the same time hold a similar position with the Retirement Fund Custodian).

Proposed Legal Notice regarding the Custody of Assets

Legal Notice establishes:

- A registration requirement for entities providing custody services to OPSs, stipulating the criteria of appointment.
- The power of the MFSA to refuse a registration of a Retirement Fund Custodian.
- The duties of a Retirement Fund Custodian.
- That the assets held by the administrators on behalf of the OPSs are a distinct legal patrimony from assets of Retirement Fund Administrator or any other entity that is entrusted with the custody of such assets.

[1] Employer / Employer and Employees

[2] The Retirement Fund Administrator may act as Custodian subject to satisfaction of relevant criteria

APPENDIX IX

Changes to the Introduction of the Two-Thirds Pension Ceiling

IX

	Maximum Pension Income Lm Annually	**Maximum Two-Thirds Pension Rate Lm Weekly**
20th January 1979	6,000	20.45,0
January 1980	6,000	31.08,0
5th January 1981	6,300	57.70,0
January 1982	6,300	70.50,0
1st January 1987	6,750	70.50,0
January 1988	-	70.50,0
January 1989	-	70.50,0
January 1990	6,750	70.50,0
January 1991	6,750	73.34,5
January 1992	6,750	74.34,5
January 1993	6,750	75.01,0
January 1994	6,750	76.01,0
January 1995	6,750	77.51,0
January 1996	6,750	78.85,0
January 1997	6,750	79.85,0
5th April 1997	6,750	80.02,0
3rd January 1998	6,750	81.02,0
2nd January 1999	6,750	82.19,0
1st January 2000	6,750	82.86,0
6th January 2001	6,750	83.86,0
5th January 2002	6,750	84.86,0
4th January 2003	6,750	86.03,0
3rd January 2004	6,750	86.53,0

Source: October 2004, Ad hoc Report, Department of Social Security

NOTE: Since 1994 the Maximum Rate of the Two-Thirds Pension was increased by two-thirds of the cost of living award.

APPENDIX X

Pensions Reform in Selected EU Member States

X

The World Bank and the European Union respectively are at the forefront to introduce pension institutional frameworks that will seek to ensure that the pensions nations will provide in the future will continue to ensure that old age is not and does not become synonymous with poverty.

The Stockholm European Council in March 2001 laid the groundwork for an open method of coordination on pensions - with the process finally launched by the Laeken European Council in December 2001 on the basis of a set number of common objectives under three headings referred to in the previous section. National strategy reports on pensions were submitted by member states to the Commission in September 2002, which were subsequently analysed by the Commission.

The report titled 'Joint Report by the Commission and the Council on Adequate and Sustainable Pensions' issued on 10th March 2003 states that the first comprehensive assessment of national pensions systems and policies at the EU levels shows that:

> *"… Member States are committed to ensuring the adequacy of their pension systems. At the same time, many Member States face very high expenditure increases in their pension systems under current policies and have yet to take measures … These expenditure increases could seriously undermine the sustainability of public finances in the long term. However, ensuring long term financial sustainability is not only important in its own right but is also a necessary precondition for an adequate provision of pensions in the future.*
>
> *Member states are fully aware of the interdependence between financial sustainability and adequacy in the context of an aging society: the financial sustainability of pensions systems is a necessary precondition for an adequate provision of pensions in the future, while ensuring adequacy is a precondition for obtaining political reform for the necessary reforms of the pension systems".*[14]

It is not the intention of this Discussion Paper to delve extensively into a detailed analysis of pension reforms overseas. Nevertheless, a short synopsis of work underway in a select number of Member States of the European Union is important as it presents in a clinical manner the span of policy options available and the measures adopted by other nations. This provides a yardstick against which the recommendations for a new national Pensions institutional framework can be measured.

01. Germany[15]

The general PAYG earnings related pension scheme covers around 82% of the employed population in Germany (33 million). The contribution rate stands at 19.5% paid equally by employers and employees. The contribution pays 63% of the expenditure on the pensions scheme with the remaining paid out of the federal public budget. First pillar schemes account for 78% of all incomes of people aged over 65. Second pillar provisions tend to be organised at company level in the private sector. Different financing models are possible, ranging from books reserves (internal funding guaranteed by compulsory insolvency insurance) to external funds and group insurances. Individual third pillar provision accounts for around 10% of total income in old age. Older people without sufficient incomes are entitled to means tested benefits.

The main challenge in Germany is seen to be maintaining financial sustainability in the face of an expected doubling of the old age dependency ratio over the coming decades.

In the new formula, increases in the contributions to old-age pension insurance and in the contributions to the voluntary private-funded pension schemes are deducted from the gross wage which constitutes the pensionable wage and the basis for the calculation of the adjustment index. Financial sustainability will also be strengthened by the fact that calculations of pensions and their annual adjustment are modified in such a way that the rise in total expenditure will be slowed.

The Government's strategy to cope with the financial challenge relies on increasing employment and productivity, in other words, strengthening the contribution base. There is scope for lowering the unemployment rate and raising labour market participation, in particular of women and older workers. The introduction of actuarial reductions for early pensions is likely to produce results in the coming years.

As private pension provision develops, it becomes increasingly important to ensure that individuals have sufficient information to be able to make the right choices, that occupational pensions provision is made widely accessible (notably through collective agreements) and that it does not exclude certain groups of workers (notably part-time and temporary workers) and discourage labour mobility.

The German pension system has been gradually adapted since the 1990s to the challenges of demographic aging. A major focus of the measures of 1992, 1997 and 2000 was to reduce the need for future increases in contribution rates, notably by raising the labour-force participation rate of older workers and hence the effective retirement age. The statutory retirement age is currently being raised to 65 years for all types of pensions except invalidity pensions. Early retirement is only possible at reduced pension levels. Thus, conditions for early retirement were tightened and financial incentives for working longer were introduced.

The latest reform also improved the protection of older people against the risk of poverty. Although there is no guaranteed minimum pension, the granting of social assistance to older people is no longer subject to a means-test against their children's income (even if they were to have sufficient resources to support their parents), nor is the income of household members other than the partner taken into account. In order to compensate for the planned reduction in replacement levels under the statutory scheme, massive support for the development of private pension provision has been made available not only in the form of tax deductibility, but also through direct grants for people on lower incomes and families with children who could not take advantage of the tax deductions.

The development of occupational pensions, which were traditionally voluntary benefits provided by the employer, will be boosted by the granting of the right to employees to demand that part of their earnings be converted into pension contributions. Such contributions are generally not subject to income tax nor, for a limited period, to social insurance contributions. Pension rights based on such employee contributions are vested immediately. This will be beneficial for people who interrupt their careers or change jobs and should improve occupational pension benefits for women. The 2001 pension reform also sought to further improve pension rights for women. In view of the fact that bringing up children often leads to reduced earnings (e.g. through part-time working or career breaks), pension entitlements are awarded by assuming average earnings during the first three years after the birth of a child. After that and up to the 10th year, low pension entitlements due to part-time working can be topped up.

02. France[16]

The French pension system is based on compulsory PAYG schemes, which cover 98% of total pension expenditure and are financed by social security contributions and taxes. The architecture of the schemes varies according to the sector of activity. Pension schemes for private sector employees cover 63% of total pension expenditure. Alongside a basic, general scheme with strong solidarity elements, mandatory supplementary pension schemes are established by collective agreements and financed on a PAYG basis. The benefit formula of these supplementary schemes is based on a point system and ensures a close link between contributions and benefits paid. Financial equalisation mechanisms exist between these different schemes.

A guarantee of a minimum level of resources for old people and the households to which they belong is provided through a means-tested complement to pensions received from other schemes. The extensive role of compulsory PAYG schemes in the French pension system leave little room for the development of other voluntary occupational or individual plans which nevertheless benefit from fiscal incentives.

In France, because of the early onset and the magnitude of the baby-boom, the number of new retirees will increase sooner and more significantly than in other Member States. Maintaining financial sustainability in the face of an expected rise of the old-age dependency ratio over the coming decades is seen as the main challenge.

Raising the effective age of withdrawal from the labour market (without increasing pension rights) is estimated to have a relatively large impact. Currently, the employment rate of older workers is still very low and the estimated labour-market exit age is, at 58.1 years, one of the lowest among EU countries. There is, therefore, large scope for increasing the labour supply of older people. The Government does not intend to raise the minimum legal age of retirement, which is now at 60, but rather aims to introduce incentives to postpone the effective withdrawal from the labour market.

The Government's strategy to cope with the financial challenge also relies on increasing employment among other groups, so as to strengthen the contribution base. There is scope for lowering unemployment and raising the employment rates of young people and women. A driving principle of the forthcoming reform is the safeguard of the compulsory schemes financed on a PAYG basis, which are regarded as an essential condition for inter-and intra-generational solidarity.

The pension adjustment is related to prices instead of wages, although leaving scope for some additional adjustments in the base of favourable economic performance. In order to reinforce the insurance character of the system, a 'solidarity fund' financed out of taxes was created with the purpose of funding certain solidarity elements (minimum old-age allowance, benefits awarded on the basis of the number of children, periods of national service, old-age contributions for the unemployed).

A pension reserve fund was created in 1999 with a view to smoothing contribution rates during the retirement of the baby-boom cohorts. However, assets of the reserve fund currently amount to less than 1% of GDP and will be difficult to boost, as aging will begin already from 2007 onwards.

03. Ireland[17]

The first pillar provides for flat rate payments and is financed through pay-related contributions from employers, employees and the self-employed. Supplements are payable for dependents, for those living alone and to pensioners over 80. Similarly, structured social assistance pensions are payable on a means-tested basis to those without a sufficient social insurance record.

The old-age (insurance-based) pension currently pays an amount equivalent to approximately 31% of gross average industrial earnings; the mean-tested pension pays slightly less. Rates of payment have increased significantly in recent years and the government has committed itself to a policy of ongoing real increases to the basic pension rates until 2007.

The second pillar consists of voluntary occupational pensions usually provided by individual employers. The third pillar is made up of individual pensions. The State facilitates and encourages second- and third-pillar pensions through favourable tax treatment of contributions and investment returns and by regulatory systems designed to safeguard pension entitlements.

Approximately 68% of members of occupational pension schemes are of the defined-benefit type with the remainder being defined-contribution schemes. The membership of second- and third-pillar schemes has been increasing by an average of 5% in each of the last five years as the workforce expanded rapidly. Currently, just over 50% of workers have supplementary pension coverage.

Aging presents challenges for Ireland of at least the same magnitude as for other Member States; the only difference is that this challenge, reinforced by increased longevity, will appear later.

The relative income situation of older people reflects notably the fact that Ireland is currently the only Member State without some form of compulsory income-related pension provision for a majority of workers. Moreover, the expansion of occupational pensions coverage - and employment in sectors that are well covered -

will take some time before producing its full impact on pensioner incomes.

As a means both to allow people to maintain an appropriate living standard in retirement and to contribute to spreading the future financial burden, raising the coverage of supplementary pensions is seen as crucial. Currently, occupational and private pension plans cover about 50% of employees and there are particularly low rates of coverage in certain sectors (eg 'hotels and restaurants' and 'wholesale and retail trades'). The government is seeking an increase in coverage to 70% of employees.

As a result of the progressive extension of compulsory insurance between the mid-1970s and the mid-1990s, 86% of pensions will be social-insurance-based by 2016. The absence of a means test and the fact that these contributory pensions are paid at a higher rate than social assistance pensions should reduce the number of pensioners on very low incomes. The Government has also set a target for supplementary pension coverage which should reach 70% of the workforce. To this end, the government will introduce personal retirement savings accounts (PRSA) from 2003 onwards as the main vehicle for increasing coverage. PSRAs will be subject to statutory limits on administrative charges, and pension entitlements can be maintained without penalty when an account holder changes or ceases employment. However, participation in a PRSA will be voluntary for an individual, but employers will be obliged to facilitate this unless they already operate an occupational pension schemes.

A key element of the Irish strategy is to build up a reserve fund to partially pre-finance public pensions to be paid out after 2025. The assets of the Reserve Fund will be drawn down by future Ministers for Finance commencing in 2025 until at least 2055.

04. United Kingdom[18]

The first pillar of the UK pension system consists of a flat-rate basic pension and an earnings-related additional pension, the State second pension that replaces the previous State earnings-related pension scheme (SERPS, introduced in 1978). These two tiers of the first pillar are financed through earnings related National Insurance contributions. The pensionable age is 65 for men and 60 for women. Legislation is in place to equalise State pension age at 65 by 2020. A full flat-rate pension requires 44 years of national insurance contributions for men and 39 for women. Pensions cannot be taken up before these ages, but may be deferred in return for higher benefits later (7.5% per year of deferral).

A unique feature of the UK pension system is the possibility to contract out of the earnings related tier of the PAYG financed first pillar. This requires coverage by an occupational or personal pension scheme providing equivalent or better benefits than the earnings related component of the statutory scheme. About 60% of the employed are in such contracted-out schemes and are entitled to a national insurance contribution rebate.

Occupational pension schemes tend to be established by a single employer and are generally of the defined-benefit type, providing pensions based on years of service and final pay. However, there is a trend towards defined-contribution schemes. Around 44% of the working population were contributing to an occupational or personal pension scheme in 2000/01 and 60% of pensioner households had income from an occupational pension scheme and 71% had investment income (including personal pensions).

Personal pensions were introduced in 1988 to offer a private second pension to people without access to an occupational scheme or who change jobs frequently. 12% of employees and 44% of the self-employed are building up personal pensions. To make private second pensions more attractive, stakeholder pensions were introduced in April 2001. The non-contributory minimum income guarantee provides means-tested support to people over 60, depending on their income and capital. Between 1979 and 1996, average net income of pensioner households rose by 64% while average earnings grew by 36%; however, the income of the poorest fifty of pensioners grew only by 30%.

Whereas adequacy had developed into a major challenge over the 1980s and 1990s, financial sustainability appears to be secured well into the future. Public pension expenditure was 5.5% of GDP in 2000 and was projected by the Economic Policy Committee to fall to 4.4% by 2050, reflecting a smaller increase in old-age dependency ratios than in the rest of the EU and, most of all, indexation of basic pensions to prices so that their value in relation to earnings will decline.

In view of the importance of private provision, the current diversity and complexity of private pension schemes pose particular challenges. Individuals are faced with a range of choices when they start or change employment. The large number of schemes raises issues of the feasibility of close supervision. Many pension schemes have significant holdings of equities which have produced high returns historically but do introduce an element of volatility. Many pension schemes and life insurers appear to have suffered badly from the recent downturn on world stock markets.

The introduction of the State second pension in April 2002 will enable people on lower earnings to build up more pension entitlements. In addition, individuals will be credited second pension rights for periods when they cannot work due to caring responsibilities or disability. From 2002, low and moderate earners who contract out in favour of an occupational scheme will receive a top-up to ensure that they will also benefit from the improvements resulting from the State second pension.

With regards to the employment of older workers, there is a policy of encouraging people to work beyond the pensionable age. People may delay claiming their pension or even 'de-retire' when they have claimed, and earn increments.

05. Sweden[19]

The new first-pillar scheme introduced in 1999 consists of an earnings-related (contributory) scheme and an old-age guarantee pension scheme (non-contributory). The income-related scheme is contribution-defined and financed from a contribution rate 18.5% pensionable earning during the entire career. Sixteen percentage points of the contribution are used for PAYG financing and are accumulated at a given interest rate as a notional pension capital (which accumulates roughly in line with earnings); 2.5 percentage points are invested in one or several funds chosen by the scheme member (the so-called premium pension scheme). The earnings-related pension system is separate from the government budget and financed only by contributions which are to be held constant at 18.5%. The notional PAYG capital and the capital accumulated under the premium pension scheme are converted at the time of retirement into a pension the amount of which depends on the average life expectancy at the age of retirement.

The old-age guarantee pension provides a minimum pension for people over 65 years after 40 years of residence in Sweden. It tops up the pension entitlements from the statutory earnings-related pension scheme to be guaranteed amount and is financed by taxes. A new form of means-tested support for elderly people not entitled to the guarantee pension (mainly immigrants) will be introduced in 2003. In addition, means-tested housing allowances contribute significantly to many pensioners' incomes.

The second pillar consists of large occupational pension schemes based on collective agreements and covering around 90% of employees. The contributions are typically between 2 and 5% of wages. Traditionally, these pensions were defined benefit, but are becoming increasingly defined-contribution schemes. In 2000, pensions paid out of these schemes accounted for 17% of total pension disbursements.

Third-pillar schemes contributed around 4% to total pension disbursements in 2000. Such voluntary individual pension insurance is tax deductible.

The projected increase in the old-age dependency ratio is much smaller in the case of Sweden than for the EU as a whole. Moreover, the design of the new pension system will limit the future growth of pensions expenditure. Spending on old-age pensions under the public scheme is expected to increase from 9% to GDP in 2000 to 11.4% in 2040, decreasing thereafter. This rise is comparatively small and is not expected to represent a major financial challenge.

The employment rate of older workers is the highest in the EU. Early retirement is not a major problem. However, the number of older workers on sick leave has been rapidly increasing during recent years, thus raising issues regarding the working environment of older workers.

As the guarantee pension is linked only to the price index, real income growth will lead to a rising income gap between wage earners and pensioners with earnings-related pensions above the guarantee level, on the one hand, and pensioners who are only entitled to the guarantee position on the other hand. In the long run, this could lead to increased relative poverty risks, unless dependence on the guarantee pension can be reduced by rising entitlements to earnings-related pensions. Women might be particularly affected by such an evolution as their earnings generally tend to remain lower than those of men. As survivors' benefits are being reduced, persons with low individual pension incomes will be particularly exposed to a sharp fall in their living standards upon the loss of their partner. However, at present older women are still entitled to widow's pensions under transitional rules.

The response to the challenge of ageing and certain inequitable aspects of the previous defined-benefit scheme (higher pensions for people with irregular earnings profiles, but the same contribution effort) was a comprehensive redesign of the pension system in 1999 which fully come into effect in 2003. The earnings-related scheme aims for actuarial neutrality. Redistributive elements include: pension credits for the unemployed or for parents during the first four years of their child; and the guarantee pension. Those mechanisms are financed out of the general budget.

The challenge of financial sustainability is addressed through an automatic balancing mechanism built into the earnings-related pension scheme. It is designed to maintain the contribution rate constant at 18.5% of earnings and operates through an adjustment of the index applied to the notional pension capital of the PAYG part. If the contribution base of the system deteriorates due an economic slowdown or unfavourable demographic developments, then the index is revised downwards. Moreover, the conversion of the notional pensions capital takes account of life expectancy at the age of retirement and, thus, neutralises a major cause of rising pensions expenditure.

Meeting the financial sustainability challenge will also be made easier thanks to the large buffer fund which was established as early as 1960 to smooth out fluctuations in the flow of pension contributions and disbursements. This buffer fund is expected to contribute to the long-term financing of the pension system. Its assets amounted to 26% of GDP in 2001.

All financial risks under the new earnings-related pension scheme (longevity, falling contribution base) are borne by beneficiaries. However, the systems provides for a high degree of flexibility, both in terms of the choice of retirement age and in terms of the possibility of combining income from work with a full or partial pension. Actuarial neutrality will allow individuals to play their working life in such a way as to obtain an adequate pension and, thus, offers strong incentives for increased labour-market participation of older workers (already the highest in the EU). This requires, however, that employability and the ability to work are maintained. Currently, the government tries to address the problem of a rise in sick leave through a comprehensive programme aimed at promoting better health in working life. If a large number of people are unable to earn adequate pension entitlements, financial risks are shifted to the general budget (through the guarantee pension).

[14] Pg 8, Joint Report by the Commission and the Council on adequate and sustainable pensions, ECOFIN 76, SOC 115, 7165/03, 10th March 2003, Brussels
[15] Pgs 120 – 124, ibid
[16] Pgs 134 – 138, ibid
[17] Pgs 139 – 142, ibid
[18] Pgs 178 – 182, ibid
[19] Pgs 174 – 176, ibid

APPENDIX XI

Countries with Mandatory Funded Second Pillar Pensions Schemes

XI

Country	Year of introduction
Chile	1981
Switzerland, The Netherlands	1985
Australia	1988
Denmark, Peru	1993
Argentina, Columbia	1994
Uruguay	1996
Bolivia, Hungary, Kazakhstan, Mexico	1997
El Salvador, Poland	1998
Sweden	1999
Hong Kong	2000
Latvia	2001
Dominican Republic	2003

Source: Table 7.2 – Pensions: Challenges and Choices, The First Report of the Pensions Commission, UK Pensions Commission

APPENDIX XII

Statutory Retirement Ages in Selected EU Member States

XII

	Early Retirement	Standard Retirement
Belgium	From 60 (subject to 28 years of employment to be raised to 35 by 2005).	Men: 65 Women: 62 (65 in 2009).
Denmark	No early pension under the public old- age pension scheme. Supplementary pension (ATP): from 65 (with actuarial reduction).	Public old-age pension scheme: 65. Supplementary pension (ATP): 67.
Germany	Under strict conditions until 2011 from 60, subject to 35 insured years from 63 with actuarial reduction of 0.3 % per month. 63 (severely disabled).	65 years (Severely disabled: 63 years).
Greece (persons insured after 1.1.1993)	Full pension: From 60 (arduous work). Reduced pension: From 60.	65 years.
Spain	Reduced pension: from 60 years (persons insured before 1.1.1967). From 61 years (persons with 30+years of contributions and non-voluntary unemployed)	65 years.
France	No early pension.	60 years
Ireland	No early pension.	Retirement pension: 65 years. Old-age contributory pension: 66 years.
Italy	After 37 years of contributions or at age 57 and 35 years of contributions (for private sector employees).	Old earnings-related system: Men: 65 years. Women: 60 years. New defined- contribution system: Actuarial benefits from age 57 for men and women.
Luxembourg	60 years (480 months insurance or assimilated periods) 57 years (480 months insurance).	65 years.
The Netherlands	No early pension.	65 years.
Austria	Men: 61.5. Women: 56.5 (61.5 by 2029).	Men: 65 years. Women: 60 years (65 by 2033).
Portugal	55 years(at reduced pension after 30 years of contributions). 60 (unemployed). 55 (unemployed, at reduced pension). 55 (unhealthy work in certain professions).	65 years.
Finland	60 years.	65 years.
Sweden	From 61 with actuarial reduction.	65 years but right to stay until 67 years.
United Kingdom	No early pension.	Men: 65. Women: 60 (65 by 2020).

Source: Table 7 - Joint Report by the Commission and the Council on Adequate and Sustainable Pensions, 10 March 2003

Deferred Retirement	Accumulation with earnings
No deferred pension.	Pension reduced if annual earnings exceed a certain amount which is higher after age 65.
Public old-age pension scheme: Supplementary pension (ATP): up to three years.	Gradual reduction beyond EUR 30 000 per year.
No upper limit; actuarial increase of the entitlement by 0.5 % per month.	Yes after age 65. Pensions reduced if annual earnings exceed a certain amount until age 65.
No deferred pension.	Reduced pension.
No upper limit.	Pension suspended in case of gainful activity. The combination of a partial pension and part-time work is possible from the age of 60. People over 65 can combine a pensions and earned income.
No upper limit.	Subject to condition. No pension if employment with last employer.
No deferred pension.	Yes after age 66.
No upper limit.	Possible after 40 contribution years or upon reaching the standard retirement age. Otherwise not possible (except for the self-employed with a reduced pension).
Until the age of 65.	Yes for normal old- age pension. Early retirement: earnings up to 1/3 of minimum wage.
No deferred pension.	Yes.
Unlimited possibility.	Standard retirement:Yes. Early retirement: Pension discontinued if monthly earnings exceed EUR 302.
Possible up to a maximum of five years.	Yes.
No upper age limit.	Yes.
No upper age limit.	Yes.
Maximum of five years. Deferment unlimited from 2010.	Yes.