PRIVATE PENSION PLANS
JARGON BUSTER GUIDEBOOK

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Developed in collaboration with APS bank

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know, plan, act.

INTRODUCING THE PRIVATE PENSION PLANS JARGON BUSTER

Since 2004, reforms to the state pension system advocated that the Government should introduce pension legislation and regulation for the introduction of voluntary private pensions – which include personal (also referred to as Third Pillar pensions) and VORPS (also referred to as Voluntary Occupational Retirement Pension Schemes or Second Pillar pensions).

Private pension plans only made a return in Malta recently – Personal Pension Plans products were introduced in the market in late 2015, and VORPS pensions, more recently, in 2017.

These pension plans are voluntary. The Government's policy is to encourage savings in such pension plan products – either on an individual level or on an employer basis. The state pension is designed to provide a person with an adequate pension income that provides dignity in retirement. The state pension, however, is not designed to provide a pension income that provides a replacement rate that is close to the gross basic wage or income enjoyed in employment. This is particularly true for persons' whose wage or income exceeds the Maximum Pensionable Income Ceiling on which an individual's social security contribution is paid. This can be seen from the example presented in the Table below.

Table 01: Scenarios of State Pension Income for Persons Born on or After 1962

Gross Basic Wage or Income	€14,000	€16,000	€20,000	€25,000	€30,000	€35,000
Maximum Pensionable Income Ceiling	€25,258	€25,258	€25,258	€25,258	€25,258	€25,258
Maximum Pension Income	€9,333	€10,667	€16,839	€16,839	€16,839	€16,839
Replacement Rate	67%	67%	84%	67%	56%	48%

The Maximum Pensionable Income Ceiling for persons born on or after 1962 is €25,258. The Maximum Pension Income is 67% of that ceiling – €16,839. This means that persons who earn a gross basic wage or income which is less than €25,258 receive the full 2/3rds state pension – that is 67% of their gross basic wage or income that was originally established as the pension replacement rate for all state pensions when the Two-Thirds Pension was introduced in 1979.

THE GOVERNMENT'S POLICY IS TO ENCOURAGE SAVINGS IN PRIVATE PENSION PLAN – EITHER ON AN INDIVIDUAL LEVEL OR ON AN EMPLOYER BASIS

Between 1979 and 2004 the Maximum Pensionable Income Ceiling increased only by a total of €1,565 over a 27-year period – or €57.9 annually – from €13,380 to €15,728, whilst the average basic wage increased from €2,726 to €11,500 during the same period. This depressed the Maximum Pensionable Income Ceiling with regard to the average basic wage and the replacement state pension income rate for persons who earned an income or gross basic wage that is higher than the Ceiling.

To compensate for this depression in the Maximum Pension Income Ceiling, the 2007 pension reforms introduced an automatic annual indexation mechanism that is based on a formula which came into effect in 2014, made up of *70% Wage Inflation and 30% Retail Inflation*.

This has raised the Maximum Pensionable Income Ceiling for persons born on or after 1962 from €15,728 in 2004 to €25,258 in 2021. Nonetheless, as can be seen from Table 01 above, the replacement rate between the gross basic wage or income earned and Maximum Pension Income falls for persons whose gross basic wage or income is above the Maximum Pensionable Income Ceiling of €25,258: to 56% for persons who earn €30,000 and 48% for persons who earn €35,000.

TO NUDGE PERSONS TO INVEST IN SUCH PRIVATE PENSION PLANS, THE GOVERNMENT ESTABLISHED A FISCAL INCENTIVE FRAMEWORK

The introduction of voluntary private pension plans, be they Personal or VORPS pensions, is designed and directed to ensure that people are nudged to invest in such private retirement plans so that they complement their state pension with a private pension income. In doing so, they bridge somewhat the replacement rate between income earned in employment and people's retirement income.

To nudge persons to invest in such voluntary private pension plans, the Government established a fiscal incentive framework where:

- Investment by an individual: An annual tax credit of up to 25% of a maximum contribution ceiling of €3,000 on payment of the saving contribution is provided, and when the pension plan matures a person can withdraw tax free up to a maximum of 30% of the accumulated retirement fund as a lump sum.

- Payment of a contribution by the employer on behalf of an employee: An annual tax credit of up to 25% of a maximum contribution paid by the employee of up to €3,000 is provided to the employer, of which up to €2,000 of the contribution by the employer is treated as a profit and loss expenditure item.

ĠEMMA underlines the importance of complementing one's state pension with a further income to boost **one's disposable income during retirement. Investing in a voluntary pension plan is a decision that ĠEMMA strongly recommends.**

ĠEMMA recognises, however, that volunatary private pension plans are still new to Malta and the framework and terminology surrounding such plans is unfamiliar to most persons.

ĠEMMA emphasises that a financial decision should be an informed one – and one that fits an individual's personal financial and / or life cycle. This Private Pensions Plans Jargon Buster guidebook is designed to help you become somewhat more familiar with the technical terms of voluntary pension plans. The objective of this Guidebook is to assist a person who wants to invest in voluntary private pension plan to engage in an informed discussion with a Pension Plan Provider. It enables him or her to better understand how a particular product works and which product best suits your personal needs.

This Private Pensions Plans Jargon Buster seeks to omit the technical jargon used by Pension Plan Providers and seek to explain these in a simplified manner. ĠEMMA recognises that in certain instances this has not always been possible to achieve. ĠEMMA invites persons and Pension Plan Providers to present suggestions on how this Guidebook can be simplied further. Such suggestions are kindly to be sent to the attention of the ĠEMMA Team at gemma@gov.mt.

ĠEMMA thanks APS Bank for assisting it in the production of this Guidebook.

PENSIONS JARGON BUSTER

Accumulated Retirement Fund

This is the investment value of your Personal Pension Plan or Voluntary Occupational Retirement Pension Scheme which consists of the contributions paid and interest earned from the investment of the said contributions. The interest value of your Personal Pension Plan is compounded during the period of your Plan.

The total amount you are eligible to receive following the end of the investing period is referred to as the 'Maturity Benefit'.

Active Member

You pay contributions into your Personal Pension Plan or Voluntary Occupational Retirement Pension Scheme.

Annual Management Charge

This is the cost that your Pension Provider charges you annually. The charge covers the costs associated with the management of your Personal Pension Plan or Voluntary Occupational Retirement Pension Scheme. The charge is usually a percentage of the total fund value – and tends to vary between Providers.

The Annual Management Charge, or AMC, as it is known, is a cost that it is important that you know before deciding to invest in a Personal Pension Plan or Voluntary Occupational Retirement Pension Scheme. The higher the AMC charge, the higher is the cost of administration and the lower is the investment you will receive when you access you Personal Pension Plan.

Annuity

Purchasing an annuity at retirement provides protection against you outliving your assets accumulated in your Personal Pension Plan or Voluntary Occupational Retirement Pension Scheme.

If you opt for an annuity, on the commencement of your benefit you will receive a guaranteed income for the rest of your life. This, however, may be at a lower level than that which could be obtained by selecting the Programmed Withdrawal option.

Basis of Life Cover

A Personal Pension Plan or Voluntary Occupational Retirement Pension Scheme that is based on an insurance contract product offers only single life cover to the person contributing to the Personal Pension Plan.

On your death, such a Personal Pension Plan or Voluntary Occupational Retirement Pension Scheme will pay your heirs 101% of the value in your Plan and, in advance of the full settlement, may provide your heirs with a payment for the cost of funeral expenses to a certain limit as a partial pre-payment of the Death Benefit.

Beneficiary

You may nominate a Beneficiary or Beneficiaries who stand to receive your accumulated sum should you die before reaching retirement.

Commencement of Benefit (also referred to as the Vesting Age)

The MFSA regulations stipulate that to invest in a Personal Pension Plan or a Voluntary Occupational Retirement Plan Scheme you must be 18 years or older.

The regulations further establish that you can access your savings only between 61 and 70 years of age.

Contribution

You invest in your Personal Pension Plan or Voluntary Occupational Retirement Pension Scheme by means of a contribution which can be paid periodically. Your contributions constitute the investment upon which income or profits are generated. The contribution you pay benefits from a fiscal incentive, a tax credit of 25% on an annual maximum contribution ceiling of €3,000 or up to €750 annually.

Default Fund

A Personal Pension Plan or a Voluntary Occupational Retirement Pension Scheme is designed to protect your investment. Unless you specify otherwise, on enrolling into a Personal Pension Plan or a Voluntary Occupational Retirement Pension Scheme, the Pension Provider may place you in a Default Fund.

A Default Fund is a cautious investment that is directed towards low risk investments – mainly bonds, securities, etc. and reduced investments in shares.

The Default Fund is directed towards persons who do not understand investments and/or who have a low risk appetite and prefer to have a lower profit but desire their investment to be safe.

Diversification

The best way to protect your investment is by means of selecting a Personal Pension Plan or a Voluntary Occupational Retirement Pension Scheme which is highly diversified, that is, the investments are spread across different assets such as equities, bonds and property across different economic sectors in different regions such as the UK, US, Japan, etc.

Diversified growth fund

An actively managed fund designed by the Fund Provider to provide similar returns to equities, but with reduced volatility. The fund can invest in a very broad range of asset classes and countries to achieve this aim.

THE BEST WAY TO PROTECT YOUR INVESTMENT IS BY MEANS OF SELECTING A PERSONAL PENSION PLAN OR A VOLUNTARY OCCUPATIONAL RETIREMENT PENSION SCHEME

Draw Down of Personal Pension Plan Benefit

On commencement of the benefit you can choose to:

- take up to a maximum of 30% by means of a lump sum which is not taxable; and / or

- withdraw a minimum of 70% by means of an annuity or a programmed withdrawal on which tax is payable at your marginal tax rate.

Ethical Investing

Increasingly, more people are interested in investing ethically. Investing in sustainable products and technology has the potential to help the environment and obtain good returns as industries adapt and modernise.

Some Pension Providers offer the opportunity to invest ethically through their investment offerings which screen out investment into those companies which are deemed harmful to the enviroment and / or do not treat their employees and other stakeholders well.

Fees for managing the investment

Apart from the fees related to the Personal Pension Plan or Voluntary Occupational Retirement Pension Scheme itself, there is also another layer of fees at the investment level. This may be the management fee of the underlying fund or portfolio management fee of the Investment Strategy.

Fund Manager

This is the person who works with the Pension Provider to invest the money contained in a retirement fund.

Fiscal Incentive

As a person investing in a Personal Pension Plan or a Voluntary Occupational Retirement Pension Scheme you will receive a fiscal incentive from Government in the form of a tax credit.

The tax credit you will benefit from is 25% up to a maximum annual contribution of €3,000 – a maximum of €750.

If you invest in both a Personal Pension Plan and a Voluntary Occupational Retirement Pension Scheme you will benefit from the fiscal incentive attributed to each scheme: 25% up to a maximum of two annual contributions of €3,000 each – a maximum of €1,500.

You are eligible for a tax credit only if:

- you are 18 years of age when the pension scheme is set up;
- you are a resident of Malta for tax purposes;
- you have paid at least the amount of tax rebate in tax, except for non-working spouses.

Glide Path Investment Strategy

This is the formula applied by a Pension Provider that defines how your investment will be allocated from the time you invest in a Pension Plan to the target date you intend to commence your benefits. The Glide Path normally shifts your investment in your Pension Plan automatically over time in a manner that this becomes more conservative the closer your Pension Plan gets to the target date you commence benefitting from your Pension Plan.

Inflation Indexed

Some Pension Providers provide you with the opportunity to have contributions increased automatically to counter for inflation.

Investment Return

The benefit you will receive from a Personal Pension Plan or a Voluntary Occupational Retirement Pension Scheme depends on the number of years you invest, the amount you contribute, where you choose to invest and the rate of return of that investment. The length of investment is important as the more time you can give your investment to grow, the greater the potential for good returns. The earlier you start, the more time you have for your investment to grow.

The contribution you pay into your pension scheme is invested on your behalf by the Pension Provider. The objective is for your Personal Pension Plan or a Voluntary Occupational Retirement Pension Scheme to generate a positive rate of return, that is, your investments are generating a profit for you.

Your Pension Provider will guide you on the investment options available under their particualr schemes and should provide you with details on their associated potential risks and rewards.

Life styling / Target Funds

Life styling is an approach to investing that automatically switches your investments from riskier to safer assets as retirement approaches. Lifestyle funds begin to transition investments a number of years before retirement from 'growth' assets such as equities, which should provide long-term growth but an element of short-term risk, to safer investments such as government bonds and cash, which offer more short-term security.

Longevity risk

When drawing your benefits at retirement there is the risk that you may outlive your accumulated investment sum.

Lump Sum

A one-off cash payment representing up to a maximum of 30% of your investment and profits in your Personal Pension Plan or Voluntary Occupational Retirement Pension Scheme. You take this one-off benefit when you commence your benefit. This lump sum is tax free.

LIFE STYLING IS AN APPROACH TO INVESTING THAT AUTOMATICALLY SWITCHES YOUR INVESTMENTS FROM RISKIER TO SAFER ASSETS AS RETIREMENT APPROACHES

Managed Investment Strategy

Some Pension Providers offer the opportunity to invest in Managed Investment Strategies. These offer a pre-determined mix of investments which are actively managed by a professional team of investment experts in order to try to maximise returns while minimising risk.

A low, medium and high risk / reward option is usually offered together with more specilised strategies.

Marginal Tax Rate

This is the income tax band that you are classified in when all your income is calculated.

Minimum and Maximum Contribution Saved

There is no limit to the contribution you can pay into your Personal Pension Plan or Voluntary Occupational Retirement Pension Scheme. The limit placed is on the fiscal incentive that you can benefit from.

Certain Pension Providers establish a minimum contribution that you must pay in order to invest in their product.

On-going charge

A charge levied on your pension fund in relation to providing that pension scheme: includes any consultancy charges, initial and trail (the fee you may pay your financial advisor each year during the time you hold the said investment) commission, flat fees levied, etc.

Passive Investment Strategy

If you select a Default Fund you are selecting a passive investment strategy. This means that you will not be selling and buying investments yourself. The Pension Plan Provider will adopt a glide path investment strategy that will manage your investment over time.

Pension Provider

This is the financial services operator or institution from whom you buy the Personal Pension Plan or Voluntary Occupational Retirement Pension Scheme.

Personal Pension Plan

Also known as Third Pillar Pension plan, a Personal Pension Plan is a voluntary based private pension retirement plan which you may decide to join. The Government encourages you to join such a scheme so that when you retire, you have a pension income that is closer to the income you enjoyed whilst in employment. To nudge you to invest in such a scheme, the Government offers you a fiscal incentive.

The savings you invest in a Personal Pension Plan are locked until such time that you are allowed to access your pension scheme – that is, your commencement date. This results from the fact that such savings benefit from a Government fiscal incentive instrument directed to nudge you to save for your retirement.

Period of the Scheme

This is the minimum period you are obliged to invest in your Personal Pension Plan or Voluntary Occupational Retirement Pension Scheme. Different Pension Providers may establish different minimum periods.

Pledging of a Personal Retirement Pension Policy

A Personal Pension Plan or Voluntary Occupational Retirement Pension Scheme contract cannot be pledged as a hypothec or assigned to a third party.

Policy / Scheme Fee

A Pension Plan provider may include a policy or scheme fee charge paid either monthly or annually. Different Pension Providers may establish policy fees.

Portability

Your Personal Pension Plan or Voluntary Occupational Retirement Pension Scheme is portable. This means that you can, should you wish to do so, change your Pension Planner provider.

Programmed Withdrawal

If you opt for a programmed withdrawal once you access your investments in your Personal Pension Plan or Voluntary Occupational Retirement Pension Scheme, you will collect your benefit in periodic sums spread throughout the length of an estimated longevity.

Private Pension Schemes

Collectively, the Voluntary Occupational Retirement Pension Scheme and a Personal Pension Plan are referred to as Private Pension Schemes. The difference between the two is this:

(a) a Voluntary Occupational Retirement Pension Scheme (also referred to as a Second Pillar Pension) is a workplace pension; whilst

(b) a Personal Pension Plan (also referred to as a Third Pillar Pension) is an individual pension.

A Second and a Third Pillar Pension are both voluntary based.

Benefits from these private Pension Plans are paid out in addition to the Social Security Pension, or First Pillar Pension.

Benefits from these schemes are accessable between the ages of 61 and 70. Insurance contract products offer single life cover to the person contributing to the Pension Plan.

You can invest in either one or both of the private Pension Plans. If you invest in both Pension Plans you benefit from the fiscal incentive established under each of the schemes.

The Government offers you a fiscal incentive to nudge you to invest in a private Pension Plan. By investing in such a Private Pension plan you will benefit from:

- an annual fiscal incentive on the contribution made;
- tax efficient growth on your investment;
- the potential for long term investment growth which is either linked to the performance of the investment markets or provides annual interest which compounds over time.

A number of financial services operators and institutions offer private pension schemes and must be licensed to do so and comply with strict rules. Whilst Product Providers offer product differentiators to have a competitive edge, each scheme must meet certain criteria establised by the Malta Financial Services Authority.

Rate of Return

The income earned by holding an asset or portfolio over a specified time period.

Restarting Contributions

The regulations allow you to restart contributing into your Personal Pension Plan or Voluntary Occupational Retirement Pension Scheme following a suspension period.

Different Pension Products have different mechanisms of how such re-starting of contribution payments takes place. A product may be designed in a manner that allows you to start contributions at any time with no charges or it can set a period of time within which you are expected to start contributing again and, unless you do so, your scheme is frozen.

Retirement Fund

Retirement Funds are arrangements established for the principal purpose of holding and investing contributions made to one or more retirement schemes and / or overseas retirement schemes.

Risk Appetite

This is the level of risk you are ready to take with your investments in your Personal Pension Plan or Voluntary Occupational Retirement Pension Scheme. Pension Providers normally offer three types of risks:

- Cautious or default: mainly bonds, securities, etc. and reduced investments in shares (equity),

- Balanced: a balance of bonds, securities, etc. and shares (equity).

- Aggressive: mainly shares (equity) and reduced investment in bonds, security, etc.

Whilst an aggressive investment is likely to give you a higher return, it also has a relatively higher risk.

Social Security Contributory Pension – First Pillar Pension

This is the main pension in Malta and is provided by the State. On employment you pay a social security contribution: 10% on your basic wage if you are an employee and 15% on your income if you are self-employed. This contribution is paid up to a ceiling which is called the Maximum Pensionable Income Ceiling. It is also referred to as the pension, the basic state pension, social security contributory pension, the national insurance pension. To learn more about the Social Security Contributory pension you may wish to look at our Guidebook titled "Explaining the Social Security Contributory System in Simple Terms". Click here to download this Guidebook.

Stopping Contributions

There may be instances when circumstances force you into a position where you can no longer contribute further into your Personal Pension Plan or Voluntary Occupational Retirement Pension Scheme. The regulations allow you to suspend or terminate further contributions into your Personal Pension Plan or Voluntary Occupational Retirement Pension Scheme. Nevertheless, you cannot dip into or withdraw your savings and accumulated funds in your Pension Plan until you reach the age of 61 years.

This stems directly from the fact that the Government provided you with a fiscal incentive specifically to nudge you to save for your retirement.

Switching Investments

A Pension Provider offers you the opportunity to switch your investment fund or strategy. This is important as you may find that the selected initial investment is underperforming other similar types of investments or if it no longer matches your own risk appetite.

Different Pension Providers have different switching investment terms and fees.

Tax Paid on Personal Pension Plan

The tax paid on a Personal Pension Plan or Voluntary Occupational Retirement Pension Scheme is as follows:

- There is no tax paid on the contributions you pay into the pension plan. Rather, the Government offers you a tax incentive of 25% up to a maximum annual contribution of €3,000.

- There is no tax paid on the lump sum which you may withdraw from your Personal Pension Plan or Voluntary Occupational Retirement Pension Scheme when you are in a position to access your investments in the plan – the maximum lump sum being 30% of your investments and accumulated funds in the plan.

The remaining 70% of your investment and accumulated funds is taxed at your marginal tax rate – that is, the tax category you fall in when all your income is calculated.

Top-up Allocation Fee

Most Pension Plan providers charge a top-up fee if you decide to increase your contributions. The top-up fee can be in the form of a percentage or a one off fee. Providers have different forms of top-up fee configurations.

Top-up Contributions

A Pension Plan provider normally provides you with the opportunity to increase the monthly / annual contribution you pay so that you increase your pension savings – say, for example, to benefit from an increase in the fiscal incentive ceiling.

Transfer Value

The current investment value and projected future value of your Pension Plan are important to you, but the amount you receive when all charges and penalties have been deducted must be seriously considered before you make the investment or if you are thinking of changing your Pension Plan provider. This will provide you with the actual net investment income.

Third-party Administrator

An external organisation that is responsible for the day-to-day administration to process the pension scheme transfers on behalf of a Pension Plan provider.

A PENSION PROVIDER OFFERS YOU THE OPPORTUNITY TO SWITCH YOUR INVESTMENT FUND OR STRATEGY.

Transaction Costs

At a retirement fund level, transactions can be triggered for many reasons. The fund manager may make an active investment decision to buy or sell an investment.

If you are actively managing your own retirement fund, every time you make a change to your retirement investment portfolio you will incur a transaction cost.

Transfer charges when Changing a Pension Plan Provider

Your Pension Plan is portable – that is you can switch your Pension Plan provider. Nevertheless, a Pension Plan provider is likely to charge you a cost for such a transfer – though such cost cannot be so exorbitantly high that it prohibits you from making such a transfer.

This is an important consideration as you may wish to transfer your Personal Pension into your Company's Voluntary Occupational Retirement Pension Scheme in the future, should they offer you the opportunity.

Pension Plan providers offer different configurations of transfer based charges.

Trust Based Pension Plan

These are Pension Plans that are established under the Trusts and Trustees Act. Such a Pension Plan is governed by a Board of Trustees which is responsible for the management of the Pension Plan.

The trust structure offers a high level of fiduciary responsibilities to which the trustee is subject, and therefore the high level of protection that is awarded to the beneficiaries.

The Trust will offer different investment options similar to the unit linked retirement product.

Unit Linked Retirement Product

This is a Product that may be provided by a financial service operator, insurance company or institution which is licensed as an insurance principal or intermediary. In taking out a Unit Linked Retirement Plan (ULRP) you decide the type of investment funds you want to invest in.

These are important characteristics of a ULRP:

- Is a pool of assets, looked after by a fund manager, that many individuals invest in.

- Allows you to invest in a much larger spread of investments than you could buy yourself.

- A fund is divided into units of equal value. Each unit has an identical price. The unit price determines how many units you receive when you invest money in the fund and how much money you will receive when you cash in your unit.

- Every fund has a different mix of assets and different levels of risk.

- The value of your investment is equal to the number of units you own in each fund multiplied by the unit price for that fund.

ULRPs do not offer a guarantee but, given that you decide the investment mix, it provides you with the opportunity of higher returns.

Voluntary Occupational Retirement Pension Scheme

The Voluntary Occupational Retirement Pension Scheme (VORPS), also known as a Second Pillar Pension or a Workplace Pension, is a retirement scheme that *may* be offered to you by your employer. You are not compelled to become a member of such a pension scheme. Both the employer and the employee have the opportunity to contribute to this scheme. Although there might be additional conditions put on by the provider, the amount, the frequency and other conditions are decided by the company. An example of VORPS could be: the Employer contributes voluntarily an additional 5% of the wage of the employee in a VORPS scheme for all employees that have been with the company more than 2 years. The employee can top up further their pension pot by contributing from their end as well.

If offered, your company will select the Pension Plan provider, but you decide whether to contribute to the scheme or not. Contributions are collected via the regular payroll run. By offering staff the opportunity to join the company pension scheme, the employer is often seen as taking much of the hassle out of the process on behalf of their employees.

While the employer is not mandated to pay a contribution into your occupational retirement scheme, the Government does provide an employer with a tax incentive to nudge him to contribute to your occupational retirement scheme. Likewise, a fiscal incentive is also available for the employee, should they decide to top up their pension.

You can switch your Voluntary Occupational Retirement Pension Scheme provider. Pension Plan providers normally charge a transfer fee if you exercise your portability rights.

With-Profits Retirement Plans

This is a product that may be provided by a financial service operator or institution. The money you invest is pooled together with money from other people and invested in the insurance operator's with-profits fund. You get your share of profits in the form of annual bonuses added to your Personal Pension Plan or Voluntary Occupational Retirement Pension Scheme. Usually, once added, the bonuses cannot be taken away.

The Pension Plan provider usually seeks to avoid big changes in the size of the bonuses from one year to the next. It does this by holding back some of the profits from good years to boost the profits in bad years. This is called 'smoothing'.

The Pension Plan may provide a 'terminal bonus' when your policy matures.