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CHALLENGES OF THE CYPRUS PENSION SYSTEM

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Agenda

- **The components of the Cyprus Pension System**

- **Challenges of the System**
 - Ageing of the population
 - Financial sustainability
 - Adequacy of pensions

- **Recent Reform**

The components of the Cyprus Pension System

- **The Cyprus Pension System comprises:**
 - The General Social Insurance Scheme, universal coverage of the working population
 - The Social Pension Scheme providing non contributory pensions to residents without a pension income from any other source
 - The Occupational Pension Schemes of public and semi-public employees
 - The voluntary Provident Funds for employees in the private sector
 - The Special Allowance to Pensioners Scheme

Challenges of the System - Ageing

- The population is ageing as a result of the low birth rate and the increasing life expectancy
- The total fertility rate dropped from 2.5 in the mid 1980's to 1.4 in 2006, whilst life expectancy has increased from 72.3 in 1980 to 78.8 in 2006 for men and from 77.0 to 82.4, respectively, for women
- Life expectancy is projected to increase:

| | 2015 | 2020 | 2030 | 2040 | 2050 |
|-------|------|------|------|------|------|
| Men | 79.3 | 80.0 | 81.5 | 82.8 | 84 |
| Women | 82.8 | 83.5 | 84.9 | 86.2 | 87.5 |

Challenges of the System – Ageing (continued)

- Age-related dependency ratio (65+/15-64)

| Year | Age Dependency | System Dependency (No of pensioners/100 contributors) |
|------|----------------|--|
| 2004 | 17.5 | 26 |
| 2010 | 19.1 | 28 |
| 2030 | 32.9 | 47 |
| 2050 | 43.5 | 64 |

Challenges of the System – Financial Sustainability

- Public expenditure of pensions (GSIS pensions plus public employees pensions) in 2004 stood at 7% of GDP.
- It is projected to increase to 9% in 2015, 10% in 2020, 12% in 2030, 15% in 2040 and 20% in 2050.
- The impact on public finances expressed as the net cash flow to the GSIS will increase from 1.5% of GDP in 2007, to 2% in 2010, 2.7 in 2015 and 3.6% in 2020.
- In addition, the cost of public employees pensions (2% of GDP) will follow an increasing trend reaching 3% in the long term.

Challenges of the System

Financial Sustainability (continued)

- The reserve of the GSI fund as a multiple of the annual pension expenditure will evolve as follows:

| Year | Reserve |
|------|---------|
| 2007 | 8 |
| 2020 | 5 |
| 2030 | 0 |
| 2040 | -4 |
| 2050 | -8 |

Challenges of the System – Adequacy of Pensions

- Relative poverty, defined as 60% of the median net equivalised income, was 16% in 2005. For the population aged 65+ it was 52%.
- In absolute terms the poverty threshold was €8719. The relative median poverty gap for the population aged 65+ was 22%.
- The causes of the high risk of relative poverty amongst the aged are:
 - Older pensioners (75+) are still affected by the old flat- rate pension scheme
 - A considerable number of pensioners receive minimum pensions because of short insurance life or declaration of low incomes by the self- employed

Challenges of the System – Adequacy of Pensions (continued)

- The incomes of the active population increase at a faster rate than pensions due to high rates of growth of the economy. In 2005 the relative median income of the elderly (65+)/0-64 was only 57%.
- Second pillar pension provision for private sector workers is limited (only 35% have additional occupational protection), provided in the form of lump-sums (provident funds).
- Additional income support through the Special Allowance to Pensioners Scheme is not well targeted
- Need for more support to households of pensioners with low incomes

Recent Reforms

- Financial sustainability of the GSIS is being addressed chiefly by increasing its revenue and to a small extent by reducing expenditure.
- Increasing revenue will be achieved through a scaled increase in contributions, adding 1.3% to the contribution rate every 5 years, starting from 2009. Thus, the current contribution rate of 16.6% will reach 25.7% by 2039.
- In addition, efforts will be made to improve investment income through a change in the investment policy. Currently 98% of the GSIS assets are invested in Government treasury bills.

Recent Reforms (continued)

- Reducing expenditure will result from:
 - An increase in the minimum qualifying period for pension, from the current requirement of three years to ten years actual insurance.
 - Restricting credits for full time education to a maximum of six years

Improving Adequacy of Pensions

- Providing adequate income to pensioners and reducing relative poverty of the elderly will be pursued through the reform of the Special Allowance Scheme in order to make it more effective in reaching pensioners with incomes below the relative poverty threshold.
- Regular adjustment of pensions to the CPI and to the index of earnings will continue.
- With the maturity of the 1980 earnings related GSIS (2020 onwards) the replacement rate of pensions relative to earnings will increase, reaching 59% of gross average earnings , compared to 45% in 2006.

Impact of Reforms on Sustainability

- The reforms described before will improve the financial position of the GSIS. The reserve will be maintained at the current level relative to annual expenditure until about 2015 and although it will start declining thereafter, it will not be depleted until about 2055.
- The impact on public finances is also projected to be positive as the net cash flow from the Budget to GSIS will drop to about half by 2020.
- However, the current practice of investing the surplus of the Social Insurance Fund in non-marketable government securities effectively means financing the GSIS on a pay as you go basis.

Impact of Reforms on Sustainability (continued)

- The implications of this practice are:
 - financing pensions will depend more and more on the soundness of public finances
 - Intergenerational solidarity will work against future generations who will pay increased contributions and taxes to repay the government debt to GSIS.
- The Government has recognized the problem and is now about to change the investment policy and to create gradually a real fund for investing part of the GSIS assets outside the public sector.

Thoughts for further Reforms

- Addressing the need for reducing expenditure through an increase in the pension age. Effectively about 70% of social insurance pensioners receive pension at 63, though the pension age is fixed at 65.
- Improving and reforming the Provident Funds in order to become more effective in ensuring additional retirement income to more employees in the private sector and by providing annuities instead of lump-sums.
- Harmonizing the compulsory retirement age in the public and semi-public sector with the pension age under the GSIS.

Thoughts for further Reforms (continued)

- A radical reform would be the introduction of a universal social pension (demogrant) based on residence and the conversion the current GSIS into a second pillar provision for the working population.
- This change will address both the long-term financial sustainability and the adequacy of pensions.

Thank You!