The Pension System in Finland
Design and Challenges

Hannu Kahra
hkahra@gmail.com

Estonian Business School

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Pension system

- The pension system, in a unique way, combines a compulsory legislative basis, similar benefits for all, partial funding and private organization of the pension provision.
- It is a hybrid, fulfilling the functions of first and second pillar pensions within the same scheme.
- The main pension scheme is a legislated and compulsory earnings-related scheme, which is supplemented by the residence-based, flat-rate pension scheme.
- Pensions are partially financed (about 75%) by pay-go contributions, and partially by pre-funding (about 25%) contributions.
- The former flow through directly into pension payments; the latter are invested now, and paid out as pensions later.

Contributions & biggest players

- Average contribution 24.4%
- Employees pay
  - less than 53 years & over 63 years: 6,35%
  - 53–62 years: 7.85%
- Employers pay 17.75% (average)
- Assets under management 200 billion
- Private pension funds
  - Elo 23.651
  - Ilmarinen 46.975
  - Varma 46.936
  - Veritas 3.193
- Non-private pension funds
  - Keva (municipalities) 52.615
  - VER (state employees) 19.652

Melbourne Mercer Global Pension Index 2018

Grade	Index Value	Countries		Description
A	>80	Netherlands Denmark		A first class and robust retirement income system that delivers good benefits, is sustainable and has a high level of integrity.
B+	75–80	Nil		A system that has a sound structure, with many good features, but has some areas for improvement that differentiates it from an A-grade system.
B	65–75	Finland Australia Sweden Norway Singapore Chile New Zealand	Canada Switzerland Ireland Germany	

Source:
https://www.mercer.com.au/our-thinking/mmgpi.html

Melbourne Mercer Global Pension Index 2018

System	Overall Index Value	Sub-Index Values		
		Adequacy	Sustainability	Integrity
Argentina	39.2	40.8	33.8	44.1
Australia	72.6	63.4	73.8	85.7
Austria	54.0	68.1	21.5	76.7
Brazil	56.5	72.5	28.5	70.1
Canada	68.0	72.1	56.0	78.2
Chile	69.3	59.2	73.3	79.7
China	46.2	53.4	38.0	46.0
Colombia	62.6	68.4	50.1	70.9
Denmark	80.2	77.5	81.8	82.2
Finland	74.5	75.3	61.0	92.1
France	60.7	79.5	42.2	56.5
Germany	66.8	79.9	44.9	76.6

Source:
https://www.mercer.com.au/our-thinking/mmgpi.html

The overall index value for the Finnish system could be increased by:

- continuing to increase the minimum pension for low-income pensioners
- continuing to raise the level of mandatory contributions that are set aside for the future
- introducing arrangements to protect the pension interests of both parties in a divorce
- increasing the labour force participation rate at older ages as life expectancies rise

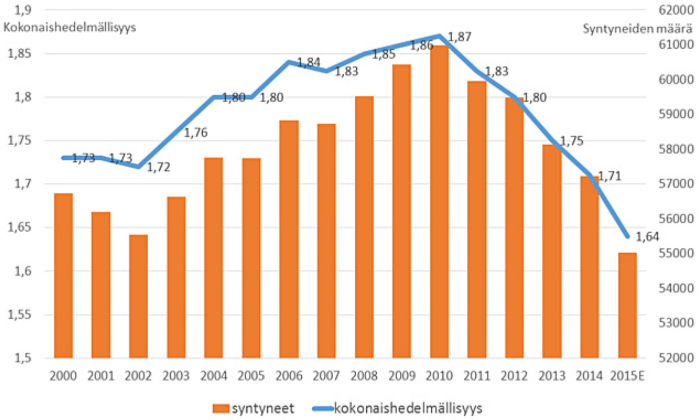
1. Later retirement but more flexible retirement
    - to preserve adequacy and sustainability simultaneously
2. Adjusting for changes in life expectancy
3. Adjusting for a delayed start to pension
    - a higher accrual rate of 4.5% on the flow of earnings after the age of 63
4. Individuals and families
    - in 2009 over 30% of single pensioners were poor, compared with 4.3% of couples
    - there is a good case for an option to transfer earnings-related pension rights between partners at divorce or retirement

1. Adjust retirement income system financing strategies?
   - the 75/25% split
2. Rethink role of pension assets and implications for investment policies?
   - are solvency requirements required -> more risk taking
3. Exploit significant 'economies of scale' opportunities in investments and benefit administration?
   - merge pension funds -> 400m cost benefit
4. Shift incentive structures in pension system from competition to collaboration basis?
5. Raise governance quality by combining representation and skills/experience requirements?
   - more expertise in boards
6. Accelerate 'looking outward' momentum in pension asset management?
   - reduce home bias

Challenges

- Low economic growth 2.9% -> 1.5%
    - low productivity growth
    - low population growth
- Aging population
- Low long-run investment returns
- Low birth rate

Less babies



Vuosi 2015 on ennakkotieto

Kuvio 2. Lähde: Tilastokeskus Väestönmuutokset; Väestöliitto Väestöntutkimuslaitos.

Väestöliitto

Problems that can be tackled

1. Governance: the role of employer and employee unions
2. Inter generations inequality
3. Pension fund management
   - principal/agent problem: asset owners vs. asset managers
4. Inefficient pension fund management
   - funds have lost to the benchmark about 2% annually
   - benchmark: 60% stocks and 40% bonds (ETFs)
5. Unrealistic assumptions
   - real return 3.5% -> 3% and 3.5% after 10 years
   - realistic assumption close to 2% or less

Pension reform

1. System: "the Two-Pension Fund" Theorem by Modigliani and Muralidhar ("the Ideal Model")
   - based on "modern portfolio" theory (Markowitz)
   - hybrid: both defined benefit (DB) and defined contribution (DC) plans
2. Pension fund management: adapt the Canadian model (Canada Pension Plan)
   - corporate finance theory and empirical data suggests that independent boards add the most value
   - the board is set up at "arm's length from governments"
   - investment expertise and relevant work experience are required
   - applies simple factor investing

References

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"Forget about me – save Social Security"

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