WELCOME

WELCOME TO THE SIXTH EDITION OF PENSION POINT OF VIEW, where you’ll find industry insights and ideas on pension trends and plan design.

This latest edition focuses on an increasingly popular yet controversial pension reform: increasing the retirement age. Does it work? Do older workers stay employed longer? And how are other benefit programs affected? These are some of the questions we tackle. Additionally, we bring you insights into longevity trends, seniors’ concerns—or lack thereof—over leaving an inheritance and the latest savings plan figures.

Once again, I welcome your emails with feedback and suggestions for further topics of interest.

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FEATURE

(At times surprising) evidence from five different countries on the impact of reforms that raise the retirement age. Can it give pension plan administrators a new perspective? READ HERE

FACTUAL SNIPPETS

The old-age dependency ratio is doubling in some regions over the next twenty years; an illustrated graph speaks louder than words. Elsewhere, find out which is the happiest retirement year. READ HERE

STATS AT A GLANCE

The use and appeal of RRSPs and TFSAs has not only fluctuated over time, it’s distinctly different for various age groups and income classes in Canada. READ HERE
FEATURE

Through Bismarck’s lens: raising the retirement age

In 1889, Germany became the first modern nation to officially implement an old-age social insurance program. A myth persists that it adopted age 65 as the standard retirement age because that was the age of the program’s designer, Chancellor Otto von Bismarck. Truth be told, Bismarck was already 74 and the retirement age was set at 70. It wasn’t until 1916 (27 years later) that it was lowered to 65. By then, Bismarck had been dead 18 years.

Fast forward a century to August 2016. Calls to raise Germany’s retirement age by two more years to 69 (following the government’s earlier decision to raise the age from 65 to 67) received a swift and frosty response. Yet, we are likely to hear more proposals such as this as aging populations put pressure on pension systems and attempts are made to restore financial balance.

But it begs the question: how well does raising the retirement age actually work? Does it change people’s retirement behaviour? Increase the length of time older workers remain in their jobs? Or does it simply shift the financial burden from one social security program to another?

Specifically, will unemployment insurance (UI) and disability insurance (DI) become pathways to early retirement?

This article pulls together evidence from five countries that have put in place pension reforms to increase either the normal retirement age (NRA) or the earliest retirement age (ERA). More specifically, we look at workers’ behavioural response to retirement, employment, UI and DI as a result of these reforms.

In a nutshell, here’s what we found. Reforms to increase the retirement age:

- greatly impact retirement behaviour
- lengthen employment in case of either NRA or ERA increases
- have mixed impacts on other social security programs

To be sure, there are some limitations that affect the interpretation of the five country studies’ results, and a few words on how they were obtained are in order.

Grains of salt—methodology & limitations

Are “univariate volatility” and “heteroskedasticity” part of your everyday vocabulary? If so, then we invite you to dive headfirst into the source documents listed at the end of this article. For the rest of us, suffice it to say the country studies typically used a difference-in-difference approach to generate estimates and forecasts. This approach compares groups of people who are affected by the reform to those who aren’t.

In an attempt to measure the impact of the retirement age reform (as opposed to other factors) on workers’ behaviour, the studies typically controlled for relevant variables such as age, education, marital status, state of residency, household size and, to some degree, reforms to other relevant programs.

Why it matters

Knowing whether pension reforms, such as raising the retirement age, are effective and to what degree (if any) they may influence related social benefit programs is relevant not only to governments (and thus taxpayers) who finance these programs. Administrators of public and private pension plans also need to look at the broader implications of pension reforms, particularly where the effects may spill over to other areas, most notably disability benefit provisions administered by the same plan administrator.

It’s important, when planning and implementing changes to pension plans’ NRA or ERA, to consider whether the changes should coincide with reforms of related provisions.

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1 Different countries use different terms to mark the age when workers are eligible to retire with unreduced benefits, such as full retirement age and statutory pension age. For simplicity, this article uses NRA throughout.

2 Empirical studies control for other influential factors (variables) by attributing a certain value to each variable’s coefficient in the formula used to calculate the impact of the variable in question (in this case, “increase in retirement age”).
However, there are limitations; other relevant factors may not have been accounted for that undoubtedly influenced behaviour. For example, state pensions across countries may differ considerably in terms of their importance, making up a significant fraction of total retirement resources for some individuals but not for others.

Similarly, we don’t always know what other features of each country’s tax and benefit system might also have changed that could offer incentives to remain in paid work. As well, different replacement rates of UI and DI benefits may influence the response to pension reforms.

Another consideration is the reform’s lead time—the time between legislation and implementation. Take the United States, for example. It legislated reforms in 1983, yet gradual implementation didn’t begin until 17 years later and remains incomplete to date. At the other end of the spectrum is Austria, with its one-year lead time (though implementation took place gradually, as it did in all cases). A longer lead time gives workers time to adjust (for example, savings behaviour) to lessen the impact of the reform on their net pension wealth; this, in turn, may affect their retirement behaviour.  

And finally, a word about Germany’s recently implemented reform (from 2012 onwards). At present, the only available data is based on workers’ surveyed expectations rather than actual behaviour, which makes this study different from the other four. While the German study doesn’t provide insights into the reform’s spillover effects, which is hardly surprising since most people don’t expect to receive UI or DI benefits, it can increase our understanding of how retirement age reforms affect societal norms.

It will be obvious by now that a strict side-by-side comparison of country results needs to be taken with a grain of salt; it’ll be more useful to look at the results with a view to obtaining a broader picture based on a multi-country scope.

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3 All other things equal, raising the NRA will decrease affected workers’ net pension wealth as there are consequently fewer years to collect a pension.
Pension systems and reforms—a country overview
Ordered by reform legislation year, the following table features each country's key state pension system characteristics and reform highlights. Two reforms target women only (Australia and the UK), one increases the ERA (Austria) and the remaining four increase the NRA.

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<td>Retirement benefits at all ages are closely linked to a person's earnings history and provisions that calculate the benefits they receive. Individuals who choose to collect benefits before their NRA are subjected to an earnings test. If they exceed a certain threshold, part or all of the retirement benefits will be withheld.</td>
<td>Two-step NRA increase • men and women, from 65 to 67 • 2000–2005 and 2012–2025 implementation Penalty for claiming ERA increased, though age 62 remains unchanged.</td>
<td>Non-contributory scheme. Eligibility does not require prior employment, and benefit levels do not depend on prior earnings. Instead, eligibility is subject to residency and age conditions. No compulsory retirement age. Individuals can draw retirement benefits and continue working.</td>
<td>Two-tier system. The basic state pension is based on the number of years (but not the level) of contributions made. The second-tier pension is related to earnings across the whole of the working life and replaces 20 per cent of earnings within a certain band. Most opt out of this second-tier pension for a government contribution to a private pension scheme. There is no earnings test, and claiming pensions and stopping work are largely separate decisions (i.e., individuals can draw state retirement benefits and continue working). No early retirement option (reduced or otherwise).</td>
<td>Two-step NRA increase • women only, from 60 to 65 • 1995–2014 implementation Men's NRA of 65 unchanged. NRA for both women and men to increase to age 67, 2017–2024.</td>
<td>NRA increase • women, from 55 to 60 • 2001–2017 implementation</td>
<td>Contributors earn pension points per year, depending on their wage. The total is multiplied by the &quot;pension value&quot; (calculated every year), which is indexed and accounts for changes in the system's dependency ratio. Changes in the pension value affect all pensioners equally—a crucial difference with other countries' pension systems where reforms often only affect younger pensioner cohorts while maintaining the status of older pensioners. Individuals with at least 45 years' work history are eligible for early retirement at age 63 (no penalty/reduction).</td>
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<td>Pension entitlements are subject to individual lifetime earnings, with a maximum benefit of 80 per cent of average earnings where there are 45 insurance years at the NRA of 65 years. Survivor and disability pensions add up to a considerable portion (about one-third) of total pension benefits.</td>
<td>ERA increase • men, from 60 to 65 • women, from 55 to 60 • 2010–2018 implementation NRA for both men and women to increase to 67, 2020–2028, and linked to life expectancy after that.</td>
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Results

The following results are based on data for the first year of each country’s pension reform increase only, unless indicated otherwise.4

1. Effect on retirement behaviour and employment

Key takeaways

- Whether the NRA or ERA was increased for women only or men as well, all reforms had a significant impact on retirement behaviour.
- Both NRA and ERA increases extend the length of time older workers remain employed.
- Longer reform lead times don’t necessarily diminish female workers’ response to continued employment.
- Increasing women’s retirement age may affect their partners’ employment as well.

The details

The studies show the country with the greatest impact on retirement behaviour is Germany. Survey respondents expected an almost two-year retirement delay as a result of the two-year NRA increase. Keep in mind, however, these results reflect anticipated behaviour rather than estimated behaviour based on actual occurrences; German reality down the road may look different. However, we can say with some certainty that the German reform has greatly affected social norms and individual attitudes.

Several U.S. studies found the initial year of the NRA increase led to a significant delay in claiming retirement benefits by as much as one month for every two-month increase in the NRA. In other words, the reform delayed actual retirement by 50 per cent of the NRA increase.

In the UK, where women’s NRA was increased by five years, the effects on women’s retirement behaviour were considerably lower though still significant—the retirement age increased by about one month for the initial first year of the NRA increase, and employment rates rose 7.3 percentage points. This seems to contradict the commonly held theory that longer reform lead times lessen the impact of the reduced net pension wealth and, in turn, lessen the impact on employment among older workers. One explanation may be that many affected women were unaware of the UK reform (implemented with a 15-year lead time), forcing some to adjust their behaviour sharply over a short period of time. Of note, the employment rate of male partners also increased by 4.2 percentage points. This apparent “knock-on effect” may be due to

- couples seeking to align their leisure time, and/or
- couples choosing to adjust the husband’s employment to compensate for the policy change and cushion the impact of the woman’s higher NRA through a combination of both partners working longer.

Results in Australia, where women’s NRA also increased from 60 to 65, are not far off the UK’s—employment rates rose by 8 percentage points for all women. However, the corresponding figure for single women was 13 points. It may be that credit constraints for single women were a factor.

Finally, in the case of Austria, which raised the ERA for both men and women, employment results were marginally higher.

When the ERA was raised by 26 months from age 60 to 62.2 for men and age 55 to 57.2 for women between 2001 and 2006, employment rose 9.8 percentage points and 11.0 points, respectively.

As for retirement behaviour, the policy reduced retirement by 19 percentage points for affected men and 25 points for affected women.

4 Note: because the German country study is based on surveyed expectations rather than actual, measured behaviour, the German results are a reflection of the entire NRA increase.
2. Spillover effects: DI and UI programs

Key takeaways

■ The spillover effects of pension reforms are correlated to countries’ existing social programs and the role they have traditionally played in transitioning to retirement.

■ Preliminary evidence indicates spillover effects are more pronounced among women; however, overall, the results are mixed, requiring further investigation to support sound conclusions.

The details

Austria, which raised the ERA for both men and women, shows only modest spillover effects into its DI program. Depending on the subgroup, disability enrolment increased 0.1 to 1.1 percentage points among men and 0.5 to 1.8 percentage points among women during the reform’s initial 26-month ERA increase. This relatively insignificant impact may be explained in part by survivor and disability pensions historically adding up to a considerable proportion (about one-third) of total pension benefits in Austria, where medical criteria for disability classifications are significantly relaxed at age 57.5 In other words, the incidence of DI claims was already relatively common before the ERA reform. Interestingly, the ERA reform appears to have caused a substantial 12.5 percentage point increase in benefit payouts under Austria’s UI program during the initial 26-month increase. For comparison, UI payouts among women in the UK increased only 1.3 percentage points. Keep in mind, though, the UK results reflect the initial 12-month NRA increase only.

Significant spillover effects occurred in Australia, which increased women’s NRA by five years from 60 to 65. On average, DI support increased about 12 percentage points. Among single females, the reported increase was no less than 21 points. These results suggest a more modest NRA increase with (consequently) less significant reduction in net pension wealth might have put less stress on the country’s entire social security program.

Evidence on spillover effects in the United States is rather mixed. Numerous studies report significant DI spillover effects, though these studies may not have controlled for the effects of a concurrent reform that eased the DI program’s eligibility criteria. We can, therefore, place greater confidence in a more conservative assessment, claiming DI benefits among 45- to 64-year-old male recipients increased by 1.6 percentage points, with the corresponding figure for women being significantly higher at 3.4 points.

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5 Below the age 57 threshold, an individual is generally considered disabled if the capacity to work is reduced by more than 50 per cent in any occupation. After 57, the definition changes to own occupation. As a consequence, disability enrolment begins rising significantly at the age threshold.
Matters of fairness

Establishing that retirement age reforms do work (albeit at the expense of other social programs) is one thing. Whether they are fair is another.

The recent Guardian article “Women’s state pension rise: an unfair burden or a necessary reform?” alleged that several hundred thousand women have had their retirement plans “shattered” because they may have to wait up to six years longer than originally expected before being able to claim their pension.

Another common objection over raising the retirement age is that such reforms are unfair because longer lifespans don’t affect us all equally; they are mostly enjoyed by individuals with higher income levels who are likely to be in better health to continue working and may have more employment opportunities than low-income workers.

Such allegations are not easily dismissed and warrant additional expert insights. We can only speculate where Bismarck would stand on the question of “unfair burden or necessary reform,” though his nickname, The Iron Chancellor, might give us an idea.

Establishing that retirement age reforms do work is one thing.

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References


FACTUAL SNIPPETS

It’s raining seniors

Once more, we return to matters of longevity, but is that a surprise? It’s a fascinating topic with as many implications as there are pages in the Income Tax Act.

Did you know, for example, that half of all humans who have ever been over 65 are alive today? That said, at 8 per cent, the age group’s share of the total population is remarkably similar to what it was a few decades ago. That’s about to change, however; by 2035, that share is forecasted to climb to 13 per cent. What’s more, the “old-age dependency ratio”—the ratio of people over the age of 65 to those of working age—will grow even faster. In China that ratio is expected to more than double between now and 2035!

Old-age dependency ratio, population aged 65 and over to those aged 15-64 per 100 people, 2014

We don’t need to tell you that this isn’t particularly good news. Having a larger proportion of older people is believed to slow economic growth or possibly even cause persistent stagnation as a smaller workforce diminishes companies’ incentives to invest.


Breaking news: retirement may be good for you!

Media coverage on how working late in life is allegedly good for us is—let’s be honest—not always welcome news. For those needing justification for sticking to their original retirement goals, here’s help.

A 2016 study followed over 27,000 Australian men and women for a three-year period and compared retirees with their peers who were still working. Overall, retirees had a larger reduction in the “lifestyle risk index score” than non-retirees. More specifically, retirees reported a significantly larger increase in time spent walking—33 versus 16 minutes per week (though, frankly, both numbers seem rather low). Retirees also considerably raised the time spent doing moderate-intensity exercise (59 versus 24 minutes per week). However, there was little change in vigorous-intensity physical activity by retirement status (one versus four minutes per week).

The most dramatic change reported concerned sitting time—40 minutes less per day among retirees compared to their working peers. To be sure, all that extra non-sitting time wasn’t spent sleeping. In fact, sleep duration increased only about 15 minutes per night.

Completing the picture of a healthier lifestyle is the finding that women retirees were more likely to quit smoking than their still-working peers. Interestingly, there was no significant association between retirement status and alcohol use or fruit and vegetable consumption.

Seniors say “no” to sacrifices
The vast majority (86 per cent) of Canadian seniors don’t plan on giving up their own needs and desires so they can leave a larger inheritance to their children. This position only strengthens with age; more than 9 in 10 seniors (94 per cent) aged 75+ years say “no” to making any sacrifices. Similarly, most are unconcerned about what they’ll leave to their children after having supported their own needs and desires. Again, this is particularly true for older seniors.

We may safely assume that Canadian seniors aren’t uncaring about the financial well-being of their offspring. Rather, the lack of concern is likely to reflect the fact that most children are no longer financially dependent on them. That said, possibly the most curious finding is that seniors with a post-secondary (26 per cent) or university (24 per cent) education are more likely to have a financially dependent child, compared to seniors with high school (13 per cent) or less (7 per cent) education.

“9” is the magic number
U.S. octogenarians say their financial well-being was among the most important factors (68 per cent) when deciding when to retire, more so than health (53 per cent) or age (42 per cent). The 500 surveyed seniors in their 80s reported an average retirement age of 64, with just over 18 per cent retiring before turning 60, while nearly a quarter waited until their 70s or 80s.

Nearly half (49 per cent) say their best and happiest year of retirement was within five years of retirement. Interestingly, nearly one-third reported their best year was over 10 years after they stopped working. On average, the ninth year was the best, though attitudes vary depending on age at retirement.

86% of Canadian seniors don’t plan on giving up their own needs and desires to increase their children’s inheritance

Source: Ipsos, September 28, 2016.
Savings plans—coverage in Canada

Most of us are aware that registered pension plan (RPP) coverage in the public and private sectors has moved in opposite directions over the past decade, slowly but steadily increasing for the former and decreasing for the latter. In 2014, 88 per cent of public sector employees had RPP coverage compared to 24 per cent of private sector employees. Overall, only 37 per cent of employees in Canada had RPP coverage in 2014.

Two saving plans outside of occupational pension plans are the registered retirement savings plans (RRSP) and the tax-free savings account (TFSA). Here, we take a closer look at how participation under each has changed over the years.

RRSP

From 2004 to 2014, there has been a decrease in tax filers contributing to an RRSP among the younger age groups but a slight increase for tax filers 55 years and over. When looking at income classes, the numbers declined for all but one class and most notably for the highest income class ($80,000 or more). The exception here is the middle-class group ($60,000–80,000), which saw a proportional increase of tax filers making RRSP contributions between 2004 and 2014.

Proportion of Canadian tax filers who contributed to a RRSP, 2004 vs. 2014, percentage

<table>
<thead>
<tr>
<th>Income Class</th>
<th>2004</th>
<th>2014</th>
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<tr>
<td>Less than $20,000</td>
<td>3</td>
<td>5</td>
</tr>
<tr>
<td>$20–40,000</td>
<td>14</td>
<td>39</td>
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<tr>
<td>$40–60,000</td>
<td>34</td>
<td>39</td>
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<tr>
<td>$60–80,000</td>
<td>39</td>
<td>46</td>
</tr>
<tr>
<td>$80,000 or more</td>
<td>58</td>
<td>75</td>
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<tr>
<td>Total</td>
<td>23</td>
<td>26</td>
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Note: before 2007, the three middle-income classes ($20,000–80,000) were grouped together.
TFSA
Since 2009, Canadians have had the option to contribute to a TFSA. Between then and 2014, the proportion of tax filers contributing to a TFSA has increased across all age groups, most notably those under 35 years of age, whose proportion doubled. Interestingly, the increase in the proportion of tax filers contributing to a TFSA was very similar (between 8 and 10 percentage points) across all income classes.

Proportion of Canadian tax filers who contributed to a TFSA, 2009 vs. 2014, percentage

Proportion of tax filers who contributed to a TFSA by total income class, 2009 vs. 2014, percentage

Source: Office of the Superintendent of Financial Institutions Canada