Pension Adequacy in Cyprus

Article

The recent move by policy makers all over Europe to raise the retirement age is a testament to the correlation between the length of employment and financial wellbeing in retirement. It is no secret that the pensioners of the future cannot count on the social security system to provide them with a comfortable retirement. An (employer sponsored) supplementary retirement plan is paramount to close the gap between pre and post-retirement income, also known as the replacement rate.

It is suggested that through a combination of Pillar I, II and III offerings a pensioner should target a replacement rate of 80 to 90%. And while this takes a significant commitment it does not guarantee a comfortable retirement. The theoretical problem with the replacement rate is that it only measures pension adequacy as it relates to post retirement income. It does not take into consideration post retirement expenses, such as health care or post-employment transition costs. Naturally, a pensioner may have non-pension assets which could, if liquid, contribute to any shortfall but if the assets are insufficient there is a risk that old-age pensioners could fall below the poverty line (disposable income of less than 60% of mean income).

In October of this year the EU's Social Protection Committee issued the latest version of its tri-annual Pension Adequacy Report[1]. The report outlines, at EU level, the degree to which pensions provide people with a sufficient income in old age, protecting them against poverty and allowing them to enjoy a decent standard of living. And while the report did not reach any pivotal conclusions there are a few of data points that are important retirement planning considerations.

First the good news:

- Pensioners have been able to maintain their relative standard of living throughout the crisis
- The Theoretical Replacement Rate (TRR) for the Average EU-28 resident is very close to their working counterparts meaning that, on average, retirees in the EU are enjoying living standards close to the those close to retirement age and face lower risks of poverty than those of working age.

And now the bad news:

- Old age poverty continues to be a problem in some counties, especially in Cyprus where the risk of old-age poverty is among the highest at approximately 20%.
- Women end up with lower average pensions and are at greater risk of old age poverty; in Cyprus the pension gender gap stands at approximately 35%.
- While the TRR for the Average EU-28 resident is close to the pre-retirement income, Cypriots do not fare so well with post-retirement income below 80% of pre-retirement income.

The findings highlight, once again, the shortcomings of the replacement rate and the importance of a holistic approach to retirement planning. The findings also stress the importance of an uninterrupted career (in fact the data was based on that) a factor that contributed to the pension gender gap with other contributing factors being: lower income, a longer life span and the fact that more women tend to end up living alone thus making them reliant on a single income.

Earlier this year, Allianz insurance published a paper entitled: *Retirement Income Adequacy Indicator*[2] which aims to rank counties on their abilities to provide an adequate retirement income post Pillar I reforms.

The retirement adequacy index takes into consideration the contributions of the existing pension systems (Pillars I, II and III) as well as other factors such as the non-pension wealth, spending needs and transition from work. While Cyprus ranks 22nd out of the 49 countries represented in the report. Cyprus scores a dismal 33th place in terms adequacy of Pillar II and III and an even worse 44th place in terms of spending needs. Thus qualifying Cyprus' pension system as adequate but not sustainable. A worrying conclusion signaling the need for pension reform.

The data is not good: lower replacement rates, an above average risk of poverty, a large gender gap and an unsustainable pension system. And as we look to the future the Pension Adequacy Report highlights that it will be of increasing importance to have a complete working career with 40 to 45 years of pension contributions to receive a decent pension, a political hot potato and almost an impossibility given the high levels of (youth) unemployment prevalent in southern Europe.

And since political agendas cannot be relied upon it is incumbent on every Cypriot to take matters into their own hands and increase their contributions to private retirement plans and therein lies the hope; the Pension Adequacy report states that "In some Member States, future income maintenance after retirement will increasingly depend on private provision through occupational or personal pension schemes." and Cyprus has a head start, new Pillar II and III solutions have been introduced that provide employees with tax efficient savings schemes in an effort to get them a comfortable and adequate retirement.

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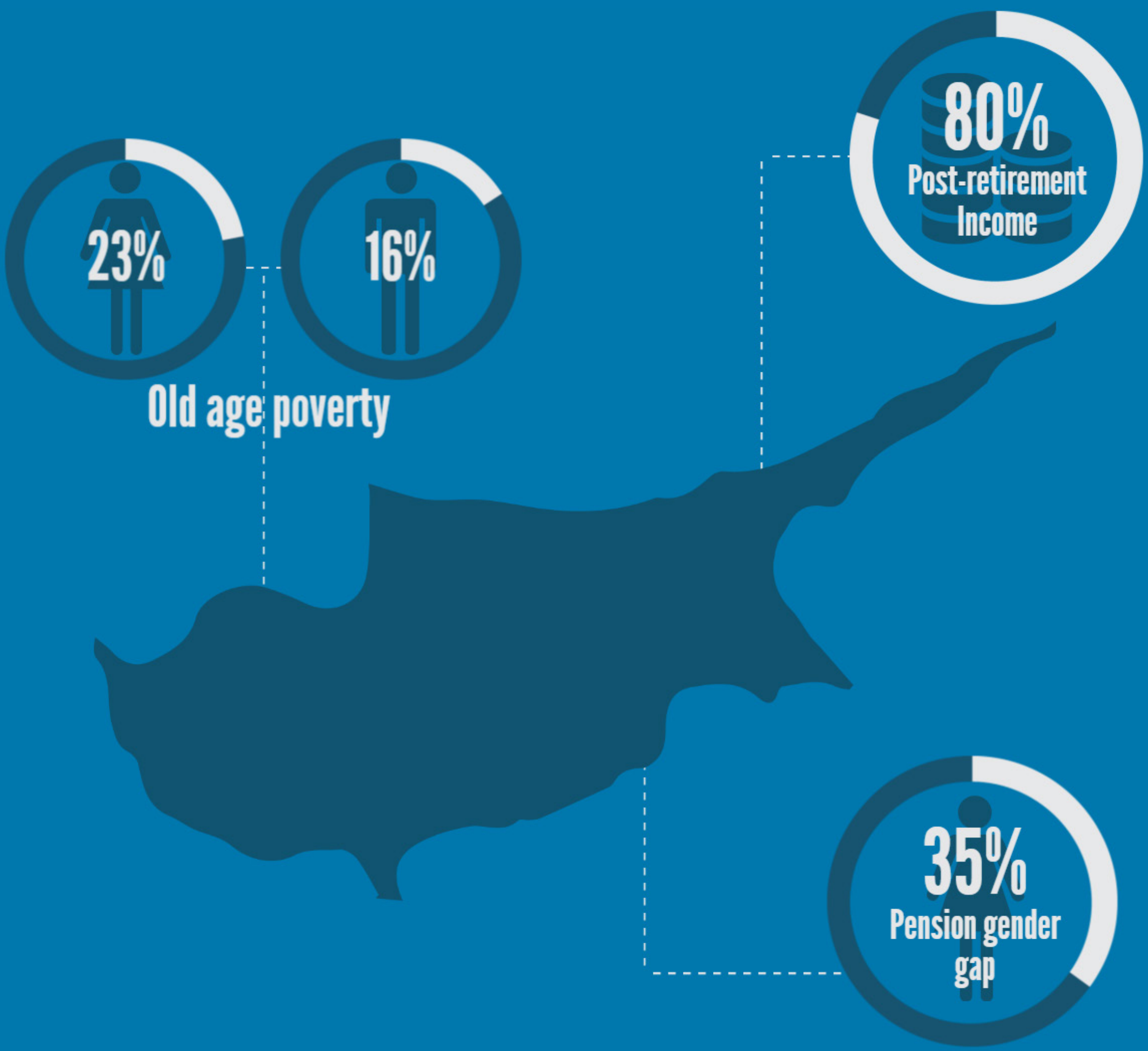
[1]The 2015 Pension Adequacy Report: current and future income adequacy in old age in the EU, Volume I, Joint Report prepared by the Social Protection Committee (SPC) and the European Commission (DG EMPL)
[2]Retirement Income Adequacy Indicator, Allianz International Pension Papers 1/2015



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