Pension Reform in the Philippines ...

...in need of directions -

“a case-study”
The mandatory retirement programs

• For employees in the private sector: The Social Security System - SSS covering 22+ m covered employees

• For employees in the government sector: The Government Service Insurance System - GSIS covering 1.5 m employees
Mandatory programs for both private and govt. sectors:

• Defined contribution provident fund - HDMF (Home Development Mutual Fund) with 5 m employees covered to fund home building and ownership

• R.A. 7641 - law passed in 1992, defining minimum benefit obligation of employer to employee at retirement. Does not require pre-funding
Other schemes for special government units, which moved out of GSIS coverage

- A pension benefit retirement scheme for members of the military - AFP-RSBS paid out of the national budget
- Newly established defined-benefit retirement scheme for members of the police force
Other schemes for special government units...

- A monthly life pension benefit for members of the judiciary indexed to the increases in salary of the still-active justices, and funded from the national budget.
Voluntary Occupational Pension Plans

• Employers can set up tax-qualified retirement plans under trust arrangements to supplement mandatory retirement benefits. The enabling law RA 4917 was enacted in 1967.

• Other groups can establish tax-qualified retirement plans under mutual benefit schemes regulated by Insurance Commission.
Regulation

• Occupational pension plans established under RA 4917 are subject to approval for tax-exemption by the internal revenue (tax) authority.

• There are no rules and regulations governing investments of trust funds established under RA 4917.
Regulation...

- Insurance Commission has oversight functions over the GSIS life and non-life insurance operations.

- Insurance Commission has oversight function over SSS role as insurer of its own mortgage redemption insurance accounts. Law specifically restricts oversight function to this activity.
### Contributions, % of monthly wage

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<th>Private workers</th>
<th>Government workers</th>
<th>Self-employed</th>
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<td>TQOPP</td>
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<td><strong>Totals</strong></td>
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<td><strong>25</strong></td>
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STATUS OF THE PROGRAMS

• SSS reserves for private workers to run out by 2015

• AFP-RSBS: Armed Forces of the Philippines Retirement and Separation Benefit System is in danger of insolvency from failed investments of its reserves.
STATUS OF THE PROGRAMS

• Retired justices of the courts receive monthly pension indexed with pay levels of active justices and paid out of the national budget (which is already strained).
Causes of deficiency of SSS:

- Benefit increases were not accompanied by corresponding increases in contributions.
- Investments are with social and political considerations, sacrificing income and growth.
Causes of deficiency of SSS:

• Formula for benefits provide opportunity for employer to gain full benefits for employee with less contribution (corrected by adjusting benefit)
Causes of SSS deficiency, continued...

• Weak linkage in benefit formula allows increases in benefits due to inflation without increase in contributions

• Labor law, rules and regulations that protect workers’ economic security provides ways for employers to avoid the cost of social insurance, hence poor enrollment in SSS.
Pension Benefits seem small yet, hypothetical replacement rates vs final pay can exceed 100% -

• Partly due to low wage levels and need of workers for higher current income - sacrificing deferred income
### Retirement benefit replacement rates in % of final pay

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<td>54</td>
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<tr>
<td><strong>Totals</strong></td>
<td>132 {87}</td>
<td>108</td>
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Causes of the low actual replacement rates -

- No portability of benefits between schemes; worker leaving one plan may withdraw benefit from plan.

- Strong preference for lump sum benefits due to need for current consumption.
Causes of low actual replacement rates -

- Tax regime not favoring conversion of lump sum payments to monthly pension
- Living benefits from insurance and matured provident fund are paid before retirement from gainful employment
Causes of low actual replacement rates -

• Maximum level of salaries as basis of contribution not adjusted as often as needed by economic factors; adjustment has to be done by amending the law

• Inefficient system of collection; employers evade paying contributions (when they can)
Causes of low actual replacement rates -

- Mandatory programs have separate collection systems for the same individual covered worker
Needed:  
A Road Map for Reform

Some specific ideas for reform:

• There must be consistency and coordination between law protecting workers rights and law providing economic security

• There must be one integrated mandatory retirement system covering workers of all classes with supplementary schemes
Guideposts for reform:

• The levels of benefits and contributions must be linked to economic affordability

• There must be strong centralized regulatory system for pension and contractual savings schemes, whether government or private
Guideposts for reform:

- The tax policy must be consistent with an overall economic plan, which recognizes the fact that an efficient retirement system can improve economic growth and consequently higher wages.
General guideposts

• Social and economic factors to consider when making reforms.
Socio-economic guideposts...

- Easier for a high-level economy to assure social security benefits that are adequate for maintenance and still provide differentials above the maintenance minimum
Socio-economic guideposts ...

• The poor society faces many difficulties, and may have to forego some types of social security systems that are available to the richer society
Socio-economic guideposts ...

• Increase in the burden of social security financing on future generations cannot be avoided. The only way one generation can lighten the burden on future generations is to take action now, which will increase future productivity.
Socio-economic guideposts...

• Investments of the reserve funds is crucial. Unless the community is willing to take steps to ensure that the funds are productively invested, future generations will gain no advantage from an accumulation of reserves.
Setting Social Security Policy

• Forming social security policy is guided by the attainment of the best possible compromise between conflicting objectives.

• Compromise is not of “either-or” but of “the relatively more and the relatively less” - an application of the marginal principle.
Role for actuaries:

- Comprehensive involvement in planning and reforming the total pension system; not just quantifying solvency concerns.

- Stronger actuarial involvement in the regulation of contractual savings and pension schemes.
Role for actuaries

- Active involvement in the formulation of implementing rules to promote good governance practices