HANDBOOKS

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The Finnish Pension System

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INTRODUCTION

This is a publication which describes the Finnish pension system. The book presents the structure and functioning of Finnish pension provision from different viewpoints. The emphasis is on statutory pension provision, but the publication also describes occupational and personal pension provision, which are used to complement statutory pension provision. In addition to describing the system, the book also strives to evaluate future prospects and present data on the effects of the pension system based on studies, statistics and calculations. The book includes in part very detailed information on the pension system, but despite that we hope that it gives a useful overview of the system.

At the beginning of 2007 changes related to technical legislative procedure were made especially to the private-sector pension acts, as three pension acts for employees were combined into one Employees Pensions Act. In 2007 some changes in content were also made to the features of statutory pension provision overall, and these changes have been taken into account in this book.

Except for one, all the authors work at the Finnish Centre for Pensions. Chapter 1 on the scope of pension provision was written by Mika Vidlund and Seija Lehtonen. Chapter 2 on the pension benefits was written by Arto Laesvuori and Kalle Elo. The main input in writing chapter 3 on the administration and supervision was provided by Mika Vidlund and Suvi Ritola as well as Mari Rehn-Kiukkonen. Chapter 4 on pension financing was written by Christina Lindell, Seija Lehtonen and Eliisa Ryynänen. The authors of chapter 5 on investment operations in the earnings-related pension scheme are Reijo Vanne from the Finnish Pension Alliance Tela and Ismo Risku. Chapter 6 on supplementary pension provision was written by Kati Ahonen and Juha Knuuti. Chapter 7 on taxation was written by Suvi Ritola and chapter 8 on pensioners' income level by Marjukka Hietaniemi. Chapter 9 on the future prospects of pension provision was written by Ismo Risku. The author of chapter 10 on the history of pension provision in Finland is Kimmo Kontio. Appendix 1 was compiled by Marjukka Hietaniemi and the statistics in appendix 2 by Marja Kiviniemi. The book was prepared for publication by Merja Raunis. The book was translated into English by Janina Gröndahl.

The book is also published in Finnish. The publication is available in both languages on the website of the Finnish Centre for Pensions at www.etk.fi. Under the navigation Pension system there is also further information related to the chapters of the book, including links to other relevant publications.

We wish to thank the authors and the persons who have given their comments on the book for their valuable input.

Helsinki, June 2007
The editors

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The Finnish Pension Scheme in Brief

Finnish pension provision consists mainly of the employment-based earnings-related pension and the residence-based national pension, which provides a minimum income. Employer-specific pension provision or pension provision based on labour market agreements as well as pension provision based on personal insurance policies are not very common in Finland compared to many other European countries. The reason for this is, among other things, that the statutory earnings-related pension scheme has no upper limit in euros for the pensionable earnings or for the pension.

From the beginning of 2005 the largest pension reform since the initial years of the scheme took effect. The most important changes of the extensive pension reform was the taking into account of the earnings of the whole work history in the pensionable earnings, introduction of the flexible retirement age for the old-age pension between ages 63 and 68, raising of the age limits for pre-retirement pensions, total abolishment of the unemployment and individual early retirement pensions as well as taking into account of increased longevity in the pension amount. In addition the calculation rules of the different pension acts were harmonised further.

The reform was continued through an overall reform, which took effect from the beginning of 2007 and which unifies three private-sector pension acts for employees into one Employees Pensions Act (TyEL). This reform will not affect the contents of pension provision almost at all.

In Finland, almost all gainful employment is covered by pension provision. Self-employed persons, farmers, seamen and public-sector employees have their own pension acts. The acts offer pension provision which more or less corresponds to that of the Employees Pensions Act (TyEL). The extensions introduced from the beginning of 2005 as regards the taking into account of unpaid periods improve pension provision especially for women.

The benefits of the earnings-related and the national pension schemes are largely the same. The national pension guarantees a minimum pension, if the person receives no earnings-related pension or if the earnings-related pension is small. The schemes secure subsistence in old age, in the event of incapacity for work, death of the family breadwinner or the ageing person becoming unemployed.

The earnings-related pension acts make it possible to work part-time and receive a part-time pension instead of the reduction in income.

The administration of the earnings-related pension scheme is decentralised. In the private sector earnings-related pension provision is handled by pension insurance companies, company pension funds and industry-wide pension funds as well as the seamen's and the farmers' specialised pension providers, and their activities are coordinated by the Finnish Centre for Pensions and supervised by the Ministry of Social Affairs and Health and by the Insurance Supervisory Authority. In addition the public sector has its own authorised pension providers. The national pension scheme is administered by the Social Insurance Institution (Kansaneläkelaitos Kela) under the auspices of Parliament.

The earnings-related pensions are financed jointly by the employers and the employees. In addition the State participates in the financing of the self-employed persons' and seamen's pensions. The national pensions are financed solely through employer contributions as well as tax revenues.

The private-sector earnings-related pension scheme has already from its beginning in the 1960s used partial funding. This means that about one-quarter of the pension contributions are funded to cover future pensions. The remaining three-quarters are used to finance pensions in current payment.

The State, the employees and the employers as well as the entrepreneurs all influence the development of the legislation on the earnings-related pensions. Earnings-related pension provision is based on law, but the principles are mainly agreed on in negotiations between the labour market organisations. In the beginning the establishment of the earnings-related pension scheme was carried out with the participation of the labour market organisations, and earnings-related pension provision is still a special focus of interest for the labour market organisations.

Population ageing poses challenges also for the Finnish pension system. The large age groups of post-war baby-boomers are nearing retirement age and in the next few decades the age groups that enter the labour market are smaller than the age groups that exit the labour market. The share of total pension expenditure in GDP will increase from approximately 11 per cent in 2005 to a good 14 per cent in the 2030s.

Efforts have been made to stave the growth in pension expenditure especially through the 2005 pension reform. The life expectancy coefficient, which will affect pensions from 2010, will adjust pension expenditure according to the changes in life expectancy. In the long term the life expectancy coefficient will significantly diminish the effects of population ageing on pension expenditure.

The relation of new old-age pensions to the average wage is currently approximately 50 per cent. This proportion will remain at more or less the same level until it towards the end of the next decade decreases slightly mainly due to the life expectancy coefficient.

1 Scope of Pension Schemes

In Finland almost all gainful employment, public and private, as well as self-employment, accrue, with minor restrictions, pension rights based on earnings or income and the time in employment. Since the 1960s the scope of statutory pension provision has broadened as new pension acts have been enacted and the criteria for being covered by pension insurance have become less strict. The newest act is the Employees Pensions Act (TyEL), which took effect from the beginning of 2007 and which unifies the former pension acts for employees, TEL, LEL and TaEL into one single act.

After the 2005 pension reform ever fewer persons than before remain outside pension provision. Pension rights do still not accrue for periods of military service or civilian service, or for periods of unpaid domestic work, except periods of child home care allowance to care for a child aged less than 3 years at home. Periods of basic unemployment allowance and labour market support do also not accrue earnings-related pension rights. Recipients of grants are also still outside the scope of earnings-related pension provision.

1.1 Pension acts

The first earnings-related pensions act in Finland was the Seamen's Pensions Act (MEL), which was enacted in 1956, and after that the Employees' Pensions Act (TEL) and the Temporary Employees' Pensions Act (LEL) took effect in 1962. In 1964 the Local Government Employees' Pensions Act (KVTEL) entered into force, and in 2003 it was changed into the Local Government Pensions Act (KuEL). In 1966 the Evangelical-Lutheran Church received its own act (the Evangelical-Lutheran Church Pensions Act KiEL), and the following year the State Employees' Pensions Act (VEL, from 1 January 2007 VaEL) took effect. Self-employed persons and farmers received their own pension acts (the Self-Employed Persons' Pensions Act YEL and the Farmers' Pensions Act MYEL) in 1970. The last act to enter into force was the Pensions Act for Performing Artists and Certain Groups of Employees (TaEL) in 1986. In addition the coverage of pension provision has been improved also later as sportsmen became covered by mandatory pension provision. Pension provision for sportsmen was arranged in 2000 under a separate act on accident insurance and pension provision for sportsmen (575/2000).

State and local government officials and employees were already covered by pension provision, but only after the enactment of these acts did the public-sector pension acts cover practically all public-sector employees. Furthermore the employees of the Bank of Finland and the Social Insurance Institution (Kansaneläkelaitos Kela) and the employees of the regional government of Åland have their own pension regulations, which correspond to the State Employees' Pensions Act (VaEL) as to the benefits provided.

Earnings-related pension rights also accrue for certain unpaid periods stated in the earnings-related pension acts, such as periods of earnings-related unemployment, rehabilitation and training benefits as well as for periods of parental allowance and sickness allowance. In addition pension rights accrue under a separate act for parents receiving child home care allowance to care for a child aged less than 3 years at home as well as for students for periods of study which end in the taking of a degree or qualification (VEKL). The extensions implemented from the beginning of 2005 as regards the taking into account of unpaid periods for the earnings-related pension give especially women improved pension coverage compared to the previous situation.

In addition to the aforementioned acts on earnings-based pension provision Finland also has a National Pensions Act (KEL), which guarantees a minimum pension, and the related national Survivors' Pensions Act (PEL). Persons resident in the country who have reached the age of 16 are insured under the National Pensions Act. Finnish citizens and citizens of other EU/EEA countries are entitled to the national pension when they have lived in the country at least 3 years after reaching the age of 16. In the period of residence, time of residence in other EU/EEA countries is also taken into account. However, a period of residence or employment of at least one year in Finland is always required. A residence period of five years is required for citizens of countries other than those mentioned above.

The national pension is a pension which covers the whole population and is thus the broadest pension scheme measured by the number of insured. However, the national pension is in its entirety dependent on other pension income, so those completely without an earnings-related pension or with a small earnings-related pension are entitled to it. The national pension also includes different increments, which on certain conditions also can be awarded to persons who only receive an earnings-related pension. In 2005 the number of recipients of a national pension was approximately 50 per cent of all pension recipients. Of the new pension recipients the corresponding percentage is approximately 44.

1.2 Insured in the private sector

The pension acts for private-sector wage earners as of 1 January 2007 are TyEL and MEL, and for self-employed persons YEL and MYEL. The number of persons insured in the private sector at the end of 2005 is shown in Table 1.1. The person may be simultaneously insured under several pension acts.

At the end of 2005, 60 per cent of those insured in the private sector were men and 40 per cent were women.

The persons insured under the Employees Pensions Act (TyEL) are employees aged 18–68 who work under an employment contract and whose earnings amount to at least the minimum amount prescribed by law (46.08 euros per month in 2007).

Table 1.1. *Insured in the private sector at the end of 2005.*

Pensions act	Insured
Employees	
TEL [1]	1,223,000
LEL [1] [2]	98,000
TaEL [1]	74,000
MEL	5,000
Entrepreneurs	
YEL	175,000
MYEL	89,000
Total	1,609,000

[1] TEL, LEL and TaEL have been unified into TyEL from the beginning of 2007.
[2] Since we observe a cross section at the turn of the year, the number of persons insured under LEL is unusually low. During the calendar year the number of persons insured under LEL is approximately the double.

The Seamen's Pensions Act (MEL) covers sailors and other personnel working on board Finnish commercial vessels in international traffic and on board saving and fishing vessels with a commercial purpose sailing in open sea and on board icebreakers. On the other hand, those working in coastal and inland waterway traffic are covered by TyEL and the officers on board icebreakers are covered by VaEL. MEL is also not applied to fishing carried out solely in the Baltic Sea.

The Self-Employed Persons' Pensions Act (YEL) covers independent entrepreneurs aged 18–68 who are resident in Finland and whose self-employment activity continues at least four months after the person reached the age of 18 and whose earnings from self-employment amount to at least 6,054.55 euros a year (in 2007). The self-employed person's family member is also an entrepreneur, if the family member works in the company without being covered by an employment contract. The partner in a general partnership and the responsible partner in a limited partnership are considered as entrepreneurs.

The Farmers' Pensions Act (MYEL) covers farmers aged 18–68 who are resident in Finland and their family members who work on the farm. The farmer should have at least five hectares of land and work on the farm himself or herself. When assessing the size of the farm a certain proportion of the forestland, depending on the municipality, is also taken into account as agricultural land. Other criteria for insurance under MYEL is that self-employment has continued for at least four months after the person reached the age of 18 and that the reported income is at least 3,027.28 euros per year (in 2007). Farmers covered by MYEL also include fishermen who pursue professional fishery without being employees as well as reindeer owners who pursue reindeer husbandry on their own, a family member's or the reindeer owners' association's account.

1.3 Insured in the public sector

The public-sector pension acts and pension regulations as well as their coverage at the end of 2005 are shown in Table 1.2. Approximately 30 per cent of those insured in the public sector were men and 70 per cent women at the end of 2005.

Table 1.2. *Insured in the public sector in 2005.*

Pensions act	Insured
KuEL	480,000
VEL	175,000
KiEL	16,000
Others	8,000

The Local Government Pensions Act (KuEL) covers officials and employees of the municipalities and federations of municipalities, and foster parents and care-giving relatives who have an assignment contract with a municipality or municipal federation. KuEL can also cover limited liability companies where the municipalities own at least 90 per cent of the shares. In KuEL the age limits are the same as under TyEL, but there is no lower limit for the earnings.

The State Employees' Pensions Act (VaEL as of 1 January 2007, before that VEL) covers state officials and employees. Of the comprehensive school and upper secondary school personnel, those who were working on 31 December 1998 are insured, whereas those who started working on 1 January 1999 or later and who were born after 31 December 1969 are covered by the pension act relevant to the party arranging the education (KuEL or TyEL). VaEL also covers some of the personnel of the private organisations subsidised by the State.

In the State Employees' Pensions Act (VaEL) the age limits are the same as under TyEL, but there is no lower limit for the earnings. The act on arranging pension provision in employment contracts shorter than a month (LYVEL) took effect at the beginning of 1998, and thus short-term state employment became covered for pension benefits. VaEL, which entered into force from the beginning of 2007, includes rules also regarding pension provision for short-term employments. The pensions for Members of Parliament are determined according to a separate act, and also the pension benefits of the representatives elected to the European Parliament from Finland are determined according to this act as far as appropriate. The pensions for members of the Government are based on a separate act.

The Evangelical-Lutheran Church Pensions Act (KiEL) covers officials and employees of the Evangelical-Lutheran Church, a parish, a federation of parishes or other association of parishes. In addition priests and lectors employed by certain other institutions with the permission of the cathedral chapter and a deaconess performing teaching duties in a deaconesses' institution are insured under KiEL. Also people who have spent a long time in missionary work abroad can be included in the insurance policy under KiEL as decided by the Church Council. The same criteria apply in KiEL as in VaEL as applicable.

The highest chiefs, archbishop, bishops, legally-trained assessors and officials of the Church Council of the Orthodox Church are covered for pension benefits according to VaEL. The pensions for priests, deacons and cantors who started work before 1 January 1994 are determined according to the rules of the pension fund of the Orthodox Church, which are similar to VaEL as applicable. Those who started work on 1 January 1994 or later are insured under TyEL.

The group ”others” includes the pension regulations for the personnel of the Bank of Finland and the Social Insurance Institution (Kela) as well as the pension schemes of the regional government of Åland and the Orthodox Church.

2 Pension Benefits

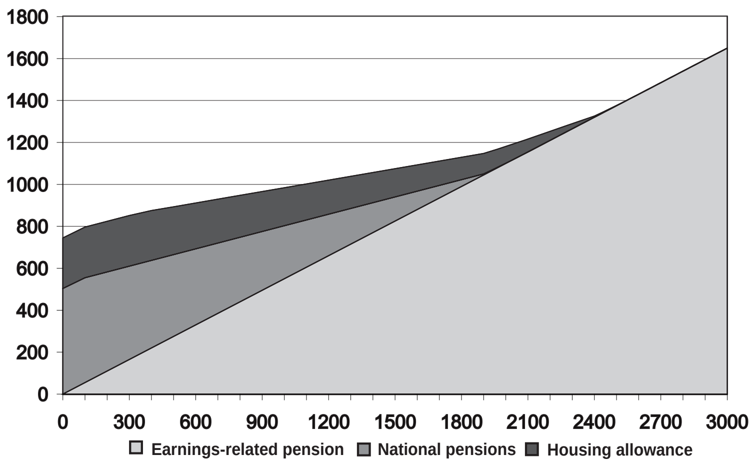
2.1 Entity of pension provision

Statutory pension provision consists of the earnings-related pension and the residence-based national pension. The earnings-related pension strives to secure the level of consumption achieved while in active employment to a reasonable extent upon retirement and during the time in retirement. The national pension should secure a minimum pension for pension recipients whose earnings-related pension is small due to a short work history or low earnings, or who are not entitled to any earnings-related pension.

Figure 2.1 shows the pension recipient's total pension consisting of the earnings-related pension and the national pension according to the wage during the working career. The national pension has been calculated on the assumption that the pensioner is single and lives in the second, that is, cheaper category of municipalities (see section 2.3).

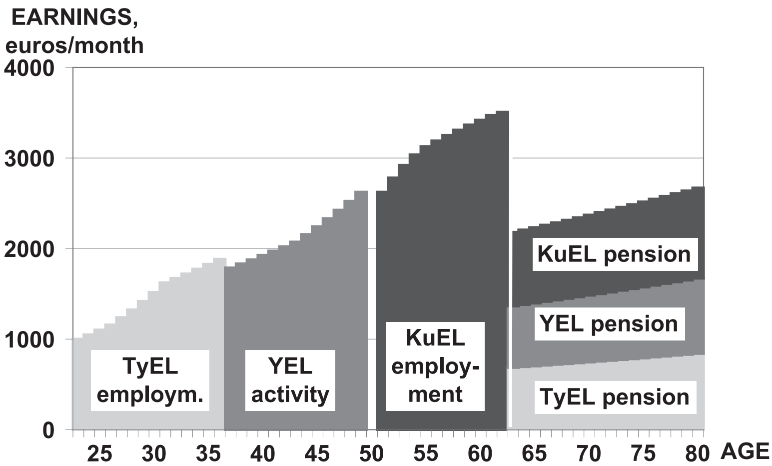
The pension under the national pension scheme and the earnings-related pension scheme in the figure is supplemented by the pensioner's housing allowance paid by the Social Insurance Institution, which is calculated on housing costs corresponding to 328 euros per month.

Figure 2.1. *Total pension in 2007 according to income level during the work history, euros/month.*



The amount of the statutory earnings-related pension is affected by the amounts of the annual wages and self-employed persons' incomes during the work history as well as the accrual rate, which again depends on, for instance, the person's age. The accrued earnings-related pension is calculated separately for each calendar year and for the employment under each pensions act. The pensions accrued from employment under the different acts are added together. Figure 2.2 shows the general principles for determining the earnings-related pension.

Figure 2.2. *Determining of the earnings-related pension.*



The earnings-related pension consists of pension components accrued from the annual earnings of different employment contracts and periods of self-employment. In the figure the annual earnings are expressed in nominal terms, the initial amount of the pension adjusted by the wage coefficient and the earnings-related pension payable after that adjusted by the earnings-related pension index (further information in the section 2.2.4 Regular revaluation).

2.2 Earnings-related pension benefits

The earnings-related pension benefits under the acts on the earnings-related pension which took effect from the beginning of 2005 are old-age pension, early and deferred old-age pension, part-time pension, disability pension, partial disability pension, cash rehabilitation benefit, partial cash rehabilitation benefit, rehabilitation assistance and survivors' pension (surviving spouse's pension and orphan's pension) and for farmers also farmers' early retirement aid. All pension benefits are continuous and payable once a month. However, very small monthly pensions may on certain conditions be paid as lump sums.

Main principles of earnings-related pension provision:

All gainful employment has to be insured in some pension scheme* and accrues a pension (earnings principle). To receive a pension there are no qualifying criteria dependent on the length of the work history.

Accrued pension rights are maintained after the employment ends or the employer is changed (vesting principle).

Pensions accrued during the work history and pensions in payment after retirement are automatically revalued in line with an index which is determined on the basis of changes in the earnings level and consumer prices.

The time from the onset of disability to the age of 63 accrues a pension, if the person has during the 10 years preceding the disability had earnings of at least 13,824 euros (in 2007).

There is no upper limit in euros for the amount of the pension or the pensionable earnings (no pension ceiling)**.

The total amount of pensions accrued from different employment contracts are integrated with benefits from statutory workers compensation, motor liability and military accident insurance (so-called LITA reduction). They are primary in relation to the earnings-related pension, so the earnings-related pension only becomes payable to the extent that it is larger than these benefits.

The pension accrued during the working career is, as a rule, paid by the pension provider where the insured person's last employment contract was insured (last institution principle).

* Remunerations of less than 46 euros do not have to be insured for pension benefits. Self-employment which lasts for less than four months or where the earned income is small does also not have to be insured.
** The earned income under the Self-Employed Persons' Pensions Act (YEL) cannot be confirmed to a higher amount than 137,500 euros a year (in 2007), however.

The acts on the earnings-related pension which were in force before 2005 also included as pension benefits the unemployment pension and the individual early retirement pension. Long-term unemployment provision is transferred from the pension scheme to the unemployment security scheme, so the unemployment pension scheme is gradually abolished. The individual early retirement pension was also abolished as a benefit type. However, unemployment pensions and in the public sector also individual early retirement pensions may still be awarded during the transition periods defined in the different acts.

2.2.1 Determining the pension and entitlement to a pension

The amount of the pension depends on the total amount of the annual earnings during the work history. In addition, as regards disability pensions the earnings for projected pensionable service, i.e. the period from pension contingency to the age of 63, are taken into account. Further, pension rights also accrue for so-called unpaid periods on the basis of the earnings that the insured's social security benefits are based on.

Pension rights accrue at the rate of 1.5 per cent on the earnings for each year in employment between the ages of 18 and 53. After this the accrual rate is 1.9 per cent until the age of 63, after which the accrual rate is 4.5 per cent on the earnings until the age of 68. This accrual rate of 4.5 per cent is called the accelerated accrual rate and it strives to induce the insured to extend their working careers.

On the earnings of the projected pensionable service connected to the disability pension, insofar as the projected pensionable service includes time before the age of 50, pension rights accrue at the annual rate of 1.5 per cent. From the age of 50 pension rights accrue on the earnings for projected pensionable service at the rate of 1.3 per cent until the end of the calendar month when the insured reaches the age of 63.

On the earnings which the social security benefits are based on (for unpaid periods) pension rights accrue at the rate of 1.5 per cent. Pension rights also accrue for employment contracts and periods of self-employment which are parallel with the pension. In that case the accrual rate is 1.5 per cent regardless of the insured person's age.

The pension is determined on the basis of the insured's earnings for each year of the working career, adjusted by the wage coefficient to the level of the year of the start of the pension. However, the employee pension contribution for each year is deducted from the employees' annual earnings.

The earnings-related pensions are integrated with benefits from statutory workers compensation, motor liability and military accident insurance. These benefits are primary in relation to the earnings-related pension, so the earnings-related pension is only paid out to the extent that it is larger than these benefits. Until 2004 the earnings-related pensions were also integrated with each other so that they did not exceed 60 per cent of the highest wage of the working career. From 2005 the integration of earnings-related pensions was discontinued, so that for instance the pensions accrued during the aforementioned period of accelerated accrual rates (ages 63–68) are not obliterated due to the integration of pensions.

The disability pension or the cash rehabilitation benefit are increased by a lump sum when the pension has continued for five full calendar years. The amount of the lump-sum increase depends on the pension recipient's age at the beginning of the year of the increase. The increase is 21 per cent for those who are aged 24-26. The increase is reduced by 0.7 percentage points for each year of age. Persons who are aged over 55 at the beginning of the year of the increase do not receive a lump-sum increase. The lump-sum increase took effect from the beginning of 2005 and it also concerns pensions which had started before 2005, but the lump-sum increase is carried out for the first time at the beginning of 2010.

When the old-age pension starts or when the disability pension is changed to an old-age pension the pension amount is adjusted by the life expectancy coefficient, through which new old-age pensions are automatically adjusted to changes in life expectancy. The accrued pension or the pension in payment when the old-age pension starts is multiplied with the life expectancy coefficient, which reduces the monthly payable pension in circumstances of increasing life expectancy, but does not reduce the accumulated pension payable over the pension recipient's whole time in retirement if the pension recipient reaches the age foreseen by the increase in life expectancy. The comparison level for the life expectancy concerns the year 2009, when the life expectancy coefficient has the value one (1.000). The life expectancy coefficient is determined for each age group at the age of 62. The life expectancy coefficient will be applied for the first time to old-age pensions which start in 2010.

Old-age pension

The insured can take the old-age pension according to his or her own choice between the ages of 63 and 68. A further requirement is that the employee no longer continues the employment contract from which he or she retires.[1] The pension that the insured has accrued up to the start of the pension is paid as the old-age pension. The insured may also take the old-age pension early after having reached the age of 62. The early old-age pension is permanently lower than the normal old-age pension. It amounts to the pension accrued up to the start of the pension, reduced by 0.6 per cent for each month that the pension is taken early before the age of 63. Correspondingly the pension may be deferred beyond the age of 68. The deferred old-age pension is increased by 0.4 per cent for each month that the start of the pension is postponed beyond the age of 68.

Part-time pension

A part-time pension can be granted to an insured aged 58–67 who has been permanently in active employment in the past few years and who does not receive any other pension based on the insured's own work history and who changes from full-time to part-time work. The working hours should be reduced so that the earnings from the part-time work amount to 35–70 per cent of the stabilised earnings for the full-time work. The amount of the part-time pension is 50 per cent of the difference between the full-time and part-time earnings (earnings reduction), but still at the most 75 per cent of the old-age pension accrued up to the start of the part-time pension.

Unemployment pension

The unemployment pension may still be awarded to a long-term unemployed person born before 1949 after the person has reached the age of 60, if he or she has received unemployment allowance for the maximum period of time, that is, for at least 500 days. A further criterion is that the applicant has been gainfully employed for at least 5 years during the past 15 years. Another requirement is that it has not been possible to assign the applicant a job where a refusal to take on the job would have meant loss of the right to unemployment allowance.

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[1] Self-employed persons who have retired on an old-age pension may continue their self-employment activity.

Disability pension

Disability pensions may be granted to insured persons who have reached the age of 18 but not yet 63 and who have some illness, handicap or injury that reduce their work ability and where the incapacity for work can be assumed to last for at least a year.

Besides medical factors the person's earnings capacity through such available work that he or she can manage reasonably well when considering his or her education, earlier activity, age, place of residence and other comparable factors are taken into account.

Depending on the reduction in work ability and earnings level the disability pension is paid either as a full pension or as a partial pension. A full disability pension is paid if the work ability is reduced by at least three-fifths, and a partial disability pension if the work ability is reduced by less than three-fifths but by at least two-fifths. The partial disability pension is half of the insured's full disability pension. If the recipient of a disability pension participates in vocational rehabilitation, a rehabilitation increment of 33 per cent is awarded to the disability pension for the duration of the vocational rehabilitation.

The disability pension consists of the pension accrued during the work history and the accrued pension for the projected pensionable service, which is calculated from the beginning of the year of the start of the pension to the age of 63. The requirement for entitlement to a pension for projected pensionable service is that the insured has earnings totalling at least the amount specified in the act (13,823.37 euros in 2007) during the 10 calendar years preceding the start of the pension. The wage for projected pensionable service is determined on the basis of the earnings from employment and the earnings that the social security benefits received by the insured are based on for the five calendar years preceding the year of the pension contingency, revalued in line with the wage coefficient. If the insured has no earnings from employment during the five-year observation period, he or she is not entitled to a pension for projected pensionable service.

The individual early retirement pension may still be awarded in the public sector to persons aged less than 63 and born before 1948, on certain conditions. The individual early retirement pension has the character of a disability pension, but when granting the pension the role of the medical factors when assessing the work ability is smaller than in the usual disability pension. Besides the person's state of health, also for instance a long work history and factors due to ageing are taken into account when assessing the work ability.

Awarding of the pension presupposes that the insured is entitled to a pension for projected pensionable service, i.e. that employment ended less than a year before. The amount of the pension corresponds to a full disability pension. If the pension recipient's income from work exceeds 252.27 euros per month (in 2007) but is less than 60 per cent of the pensionable wage, the pension is paid to the amount of a partial disability pension. If the income from work exceeds 60 per cent, the pension is suspended for as long as the work continues.

Cash rehabilitation benefit is paid to a person incapable of work whose handicap or illness is expected to improve through rehabilitation. Awarding the benefit presupposes that the applicant is incapable of work in a way which entitles to a disability pension and that the incapacity for work can be estimated to last for at least a year. A further requirement is that a treatment or rehabilitation plan has been drawn up for the applicant. The cash rehabilitation benefit, which amounts to the disability pension, is always granted for a specified period of time, during which the insured is assumed to be unable to work due to the disability.

Rehabilitation allowance can be paid to an insured who is working but who is threatened by incapacity for work due to illness and for whom the pension provider arranges vocational rehabilitation. The amount of the rehabilitation allowance is the full disability pension increased by 33 per cent. It is paid for the period when the insured is unable to work due to rehabilitation. If the employee during the vocational rehabilitation earns more than half of the stabilised earnings, the rehabilitation allowance is paid as a partial rehabilitation allowance, amounting to half of the full rehabilitation allowance.

Discretionary rehabilitation assistance may be granted to the amount of the disability pension for the periods between the issuing of the rehabilitation decision and the start of the rehabilitation measures and between the rehabilitation periods. As a rule, rehabilitation allowance is paid at the most for three months per calendar year separately for the time between the issuing of the rehabilitation decision and the start of the rehabilitation measures and the time between the rehabilitation periods.

Survivors' pension

The survivors' pension can be paid to the surviving spouse, the former spouse as well as the children of a deceased who was insured under the earnings-related pension acts before his or her death. The pension is divided into the surviving spouse's pension and the orphan's pension.

The right to a surviving spouse's pension is determined through the marriage and through the children. A registered partnership between persons of the same sex is considered as a marriage, but the parties to the registered partnership cannot have any children together when assessing the entitlement to a pension. The surviving spouse is entitled to a pension if

1) the surviving spouse has or has had a child (own or adopted) together with the deceased; or
2) the surviving spouse had reached the age of 50 at the time of death of the insured or had been receiving a disability pension for at least three years, and if the marriage had been contracted before the surviving spouse reached the age of 50 and the deceased the age of 65 and the marriage had lasted for at least five years.

The former spouse's right to a surviving spouse's pension is determined in the same way as for the surviving spouse, if the deceased was liable to pay alimony to the former spouse under a legally valid decision.

A child who was aged under 18 at the time of death of the deceased is entitled to an orphan's pension. A child is always paid an orphan's pension after his or her own parents. An adopted child is entitled to a pension after his or her adoptive parents. The surviving spouse's child or adopted child may be entitled to an orphan's pension after the deceased, if the child lived in the same household as the surviving spouse and the deceased. However, the child is entitled to an orphan's pension only after two primary beneficiaries simultaneously.

The surviving spouse's pension ends if the surviving spouse remarries before reaching the age of 50. The child's pension ends when he or she reaches the age of 18 or if he or she is adopted by someone else than the surviving spouse or his or her spouse.

The basis for the survivors' pension is the deceased person's old-age, early old-age, full disability, individual early retirement or unemployment pension. If the deceased was not yet retired, or he or she received a partial disability or a part-time pension, the basis for the survivors' pension is the pension that the deceased would have received if he or she had become incapable of work at the time of death.

The total amount of the surviving spouse's pension and the orphan's pensions before integration is shown in table 2.1 as a share of the deceased person's pension.

Table 2.1. *The surviving spouse's and children's shares of the survivors' pension.*

	Number of children				
	0	1	2	3	4–
Surviving spouse's pension	6/12	6/12	5/12	3/12	2/12
Orphan's pensions	–	4/12	7/12	9/12	10/12
Total	6/12	10/12	12/12	12/12	12/12

Thus the total amount of the surviving spouse's pension and the orphan's pensions is at the most that of the deceased person's pension. If the surviving spouse is the sole beneficiary, the surviving spouse's pension is half of the deceased person's pension.

The amount of the surviving spouse's pension may be reduced by the surviving spouse's own pensions. The reduction is made when the youngest child reaches the age of 18. If there are no children as beneficiaries, the reduction is made after the initial pension of six months if the surviving spouse is aged under 65, or immediately if the surviving spouse was retired at the time of death of the deceased.

The aim of the reduction is to adjust the surviving spouse's income to the level prevailing before the death of the deceased. The surviving spouse's own pensions are taken into account when assessing this, or if the surviving spouse was not yet retired at the time of death of the deceased, the calculated disability pension that he or she would receive if he or she had become incapable of work at the time of death of the deceased. The surviving spouse's pension is reduced if the surviving spouse's own earnings-related pensions exceed the limit of 714.66 euros per month (in 2007) as stated in the act.

Farmers' early retirement aid

Farmers' early retirement aid may be granted, depending on the way and year of giving up farming, to a farmer aged 56–60 but less than 63 who permanently gives up farming and transfers the farm lands to the person who continues farming or rents them as additional land to some other recipient. The farmers' early retirement aid can be granted to the owner of the farm, his or her spouse or surviving spouse who has marital right to property regarding the farm. The spouse of the person giving up farming may be entitled to farmers' early retirement aid alongside his or her spouse at the most five years before reaching the minimum age, but in that case the payment of the benefit does not start until he or she has reached the required age.

The farmers' early retirement aid consists of a basic amount and a supplementary component. The basic amount of the farmers' early retirement aid corresponds to a disability pension payable to the farmer on his or her MYEL income. The supplementary component of the farmers' early retirement aid amounts to the national pension that the person giving up farming would have been granted if he or she at the time of giving up farming had had the right to a national pension awarded in the form of a disability pension.

2.2.2 Pension accrual for unpaid periods

Besides earnings from employment an earnings-related pension also accrues for unpaid periods during which the insured has received social security benefits as defined by law or completed studies that end with the taking of a degree or qualification. Thus a pension accrues for periods of earnings-related unemployment benefits and certain periods of rehabilitation and adult training. Likewise pension rights also accrue for periods of maternity, paternity and parent's allowance as well as sickness allowance. Periods that entitle to a pension as financed by the State are periods of child home care allowance and periods of study that end with the taking of a degree or qualification.

The pension accruals for unpaid periods are calculated on the basis of the earnings that the social security benefits are based on, and of these earnings 65–117 per cent are taken into account, depending on the benefit. The pension accrued for the periods of child home care allowance and periods of study which end in the taking of a degree or qualification are calculated on the basis of a fixed earnings basis.

2.2.3 Maintaining pension rights when gainful employment ends before the pension contingency

If the insured person's employment contract or self-employment under the earnings-related pension acts ends before pension contingency, the person retains the accrued pension rights. On the basis of previous earnings the insured is entitled to an old-age or a disability pension and the beneficiaries to a survivors' pension.

Pension provision for different employment contracts may still be different, for instance, as to retirement age. When the pension is awarded the pension rights from previous employment contracts and periods of self-employment are then adjusted to correspond to the conditions of the last employment contract so that the capital values of the pension rights are maintained. The Ministry of Social Affairs and Health has confirmed the conditions for vested pensions which are common for all pension providers and the coefficients for adjusting the pension.

2.2.4 Regular revaluation

When determining the pension the pension rights accrued before 2005, i.e. vested pensions[2] and the earnings during the working career are revalued in line with the wage coefficient to the level of the year of the start of the pension, where the wage coefficient is determined with a weighting of 0.8 for the annual change in earnings level and a weighting of 0.2 for the annual change in consumer prices. The wage coefficient is also used to revalue annually the money amounts mentioned in the earnings-related pension acts, which determine, for instance, the conditions for insurance and accrual under the pension acts.

Pensions in payment are revalued annually at the beginning of January in line with the earnings-related pension index, where the change in earnings level has the weighting 0.2 and the change in consumer prices the weighting 0.8.

The wage coefficient and the earnings-related pension index are determined on the basis of the official time series of the earnings level and consumer price indices calculated by Statistics Finland. The earnings level index measures the

[2] From the beginning of 2005 the so-called annual technique was introduced in the earnings-related pension scheme for pension calculation, which means that the pension is determined separately for each year, whereas previously the pensions were determined separately for each employment contract and period of self-employment activity. The pensions accrued before 2005 were converted into vested pensions in the register.

development of earnings from regular work of all wage earners and includes both overall increases and wage drifts and to some extent the effects of structural changes in the economy on the earnings level. When calculating the wage coefficient and the earnings-related pension index the share of the increase in the pension contribution for employees aged less than 53 is deducted from the change in the earnings level index. The price index used is the national consumer price index, which has a somewhat broader scope than the EU harmonised consumer price index.

The Ministry of Social Affairs and Health confirms the wage coefficient and the earnings-related pension index annually by the end of October, i.e. two months before they are taken into use. When calculating them the realised annual change in the earnings level and the consumer prices is measured from the third quarter of the year to the third quarter of the year, i.e. almost to the date when the Ministry confirms the figures for the wage coefficient and the earnings-related pension index to be applied from the beginning of the following year.

2.3 Benefits in the national pension scheme

The national pension scheme guarantees a minimum pension if the person's own earnings-based pensions are small. The benefits include old-age, disability and unemployment pensions as well as the national survivors' pension payable to the surviving spouse and the children. Furthermore, housing allowance and pensioners' care allowance and an increase for a child can also be paid. War veterans with a service badge can be paid regular and additional front-veterans' supplements. Housing allowance can also be paid to the survivors' pension paid to the surviving spouse. The national pension is usually awarded at the same time as the earnings-related pension. The amount of the national pension is reduced by the amount of the earnings-related pension.

Entitlement to the national pension is based on residence. The national pension may be awarded to a Finnish citizen resident in Finland, if he or she has lived in Finland for at least three years after reaching the age of 16. Citizens of the countries with which Finland has concluded a social security agreement and the EU/EEA countries are subject to the same time limits as Finnish citizens. Citizens of other countries are entitled to the national pension if they after reaching the age of 16 have lived in Finland without interruption for five years immediately before the start of the pension.

When calculating the period of residence time of residence in the EU/EEA and agreement countries is also taken into account. However, the right to a pension requires at least one year of residence in Finland.

The significance of the national pension for the pension recipient's income has diminished over the years as the earnings-related pension scheme has developed. After the 1996 reform national pensions are no longer paid to all pension recipients, instead they supplement the pension only when the other pensions fall below a certain limit. In 2005 the number of recipients of a national pension was approximately 50 per cent of all pension recipients. Of the new pension recipients the corresponding percentage is approximately 40. The level of the full national pension is about 20 per cent of the average earnings of Finnish wage earners.

2.3.1 Pension benefits

The national pension and the national survivors' pension include the same types of benefits as the statutory earnings-related pension scheme, i.e. pensions on the basis of old age, incapacity for work and unemployment as well as surviving spouse's pensions and orphan's pensions. Also the entitlement criteria for the pensions are very similar in the earnings-related and the national pension schemes. However, partial pensions (partial disability pension and part-time pension) are not paid from the national pension scheme, and the national survivors' pension is only paid to a surviving spouse who is aged less than 65 and who does not receive a national pension.

The reform of the legislation on the earnings-related pension from the beginning of 2005 did not affect the general age limit for the old-age pension in the national pension scheme, as the age limit still remained at 65 years. However, the amount of the national pension is not reduced by the earnings-related pension accrual from employment from the age of 63. The increase to the disability pension from the earnings-related pension scheme made on the basis of the person's age after five years of payment as well as the benefit paid for periods of childcare and periods of study are also not taken into account when determining the national pension.

The age limit for the early old-age pension was increased to 62 years, i.e. to correspond to the age limit for the early old-age pension in the earnings-related pension scheme. However, the abate for early retirement is still 0.4 per cent for each month that the pension is taken early before the age of 65.

If the applicant wants to postpone the old-age pension to start later than the beginning of the month following the person's 65th birthday, the pension is increased by 0.6 per cent. The increase is calculated for each month that the pension is postponed and it has no upper limit. However, the national pension is not increased for the months for which the applicant is not entitled to a national pension after reaching the age of 65 (for instance due to residence abroad).

In the national pension scheme only persons born before 1950 are entitled to the unemployment pension between the ages of 60 and 64. In addition persons born in 1941–1947 who were long-term unemployed at the end of 2004 may on certain conditions be awarded so-called pension assistance for long-term unemployed, where those who are entitled to this may receive the old-age pension from the beginning of the month following the person's 62nd birthday without any abate for early retirement from both the earnings-related and the national pension scheme.

Those born in 1950 are thus the first age group that are left outside the scope of the unemployment pension. Their income is in the future secured through income security for the unemployed. However, persons born in 1950 and later who receive continued unemployment allowance under the act on income security for the unemployed are entitled to the national pension and the earnings-related pension without any abate for early retirement from the age of 62.

The person is entitled to continued unemployment allowance if the he or she has reached the age of 59 before the maximum period of 500 days for the unemployment allowance has ended. Unemployment allowance is then paid until the pension starts or until the age of 65. The Social Insurance Institution can only grant the unemployment pension when the applicant is or has been resident in Finland and fulfils the criteria regarding time of residence.

Disability pensions may be applied for by persons aged 16–64, and the pension is awarded until further notice or as cash rehabilitation benefit for a specified period of time. Income during short-term illness and rehabilitation for a person aged more than 65 who is gainfully employed is secured through sickness allowance and rehabilitation allowance until the age of 68.

2.3.2 Amounts of national pension benefits in 2007

The amount of the national pension depends on the pension recipient's earnings-based pension income, family ties and municipality of residence. A full national pension is granted on the basis of 40 years of residence. The national pension decreases as the earnings-based pension income increases so that it is reduced by half of the pension recipient's employment-based pension that exceeds the lower earnings limit. When the earnings-based pension exceeds a certain limit, no national pension is paid (table 2.2).

A voluntary supplementary pension based on an employment contract or self-employment is comparable to a statutory earnings-related pension and affects thus the determining of the pension according to the national pension scheme. The same applies to pensions awarded on the basis of workers compensation and motor liability insurance.

On certain conditions the applicant's pensions and compensations from abroad reduce the national pension. However, statutory pensions from the EU/EEA countries which are covered by EC Regulation 1408/71 on social security and which correspond to the person's own earnings-related and national pension do not, as a rule, reduce the national pension.[3]

Until 1995 the national pension included a fixed basic amount and an additional amount, which was dependent on the person's other pension income. The basic amount of the national pension was paid to everyone who was entitled to it, regardless of the size of the earnings-related pension. From 1996 new retirees no longer receive a national pension if the earnings-related pension exceeds a certain limit (table 2.2). For persons who had retired before 1996 and who received only the basic amount, the basic amount was gradually abolished by 2001. However, the abolition of the basic amount was partly compensated through the earnings-related pension scheme in October 2003, because before 1996 the basic amount was deducted form the maximum amount of the earnings-related pension when restricting the earnings-related pension to the 60 per cent limit.

[3] The national pension only takes into account pensions based on the spouse's insurance periods, own pensions and pensions based on the spouse's insurance periods from the agreement countries and those supplementary pensions from the EU/EEA countries which are not covered by Regulation 1408/71 as well as, for instance, benefits from statutory workers compensation, motor liability and military accident insurance (LITA compensations).

The national pension is taxable income. Due to the pension income deduction granted in the taxation, taxes are not levied on pension income amounting to a full national pension, however. Some supplements paid by the Social Insurance Institution, such as child increases, pensioners' housing allowance, pensioners' care allowance, regular and additional front-veterans' supplement, are benefits that are exempt from tax.

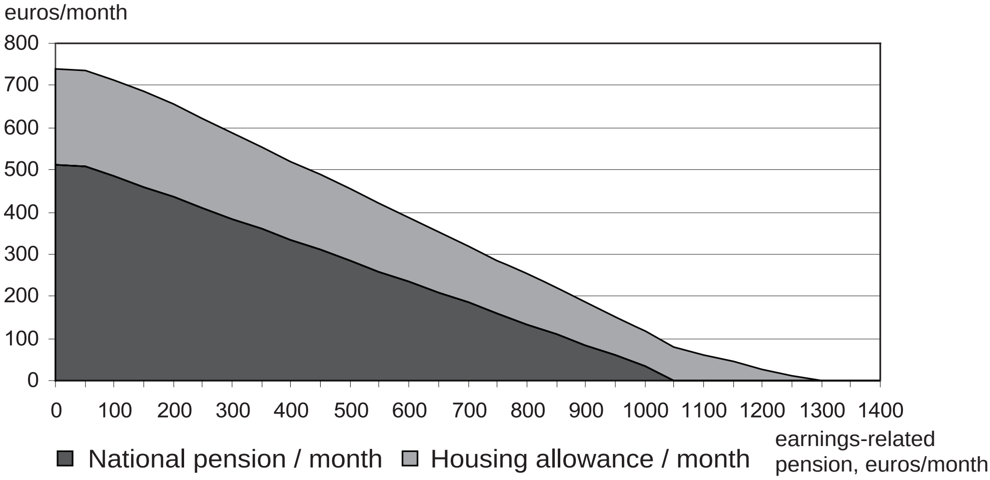
Table 2.2. *Amount of the national pension 1 January 2007, euros/month. The smallest payable national pension amount in 2007 is 11.58 euros a month.*

Family ties and municipality category	Full amount of the national pension	Earnings-related pensions which entitle to a full national pension (lower earnings limit)	Earnings-related pensions which no longer entitle to a national pension
Single			
1st category	524.85	48.12	1,074.63
2nd category	503.53	48.12	1,031.96
Married			
1st category	463.28	48.12	951.46
2nd category	445.12	48.12	915.21

Source: Social Insurance Institution.

Figure 2.3 describes how the national pension depends on the amount of the earnings-related pension in 2006. The figure shows the situation of a childless single pension recipient who lives in the first municipality category. A pension recipient who receives no earnings-related pension or whose earnings-related pension is very small gets a full national pension. If the earnings-related pension is at least a good 1,000 euros per month, the pension recipient is no longer entitled to the national pension. Figure 2.3 also shows the amount of the housing allowance paid from the national pension scheme when the assumed housing costs are 310 euros per month (amount of the average housing costs in 2005 for pension recipients who receive housing allowance). Pension recipients can also be paid other supplements.

Figure 2.3. *Amount of the national pension in proportion to the amount of the earnings-related pension.*



The surviving spouse's pension is paid to a widow or widower aged less than 65 who is resident in Finland after the death of his or her spouse who was resident in Finland. The surviving spouse's pension consists of a starting pension and a continuing pension. The person entitled to a national survivors' pension receives a starting pension for six months after the death of the spouse. The starting pension consists of a fixed-amount share regardless of the surviving spouse's earnings and wealth, and in addition a surviving spouse with low income may receive the earnings-related component of the starting pension. However, at the most the starting pension payable to the surviving spouse amounts to the full national pension. In addition the surviving spouse can apply for housing allowance.

After the starting pension a surviving spouse who is eligible for a national survivors' pension can receive the surviving spouse's continuing pension, if he or she cares for his or her own or the deceased spouse's child who is aged under 18. Then the continuing pension amounts to at least the basic amount, i.e. about 17 per cent of the full national pension, and it can also include, depending on the surviving spouse's earnings, an additional amount (in total at the most amounting to the full national pension) and housing allowance. If the surviving spouse no longer has to care for children aged under 18, he or she can receive a continuing pension only on the basis of a lack of means. Then the continuing pension only includes a component based on the surviving spouse's own earnings (at the most approximately 83% of the full national pension) and possible housing allowance.

Table 2.3. *Supplements to the national pension in 2006.*

Front-veterans' supplement To persons who were at the front during the war as soldiers or in other service as well as persons who participated in mine clearing operations after the war.	42.57 euros/month
Additional front-veterans' supplement To pension recipients resident in Finland who receive front-veterans' supplement and a national pension, 25-45 per cent of the pension recipient's national pension which exceeds 88.02 euros a month.	196.57–160.70 euros/month maximum
Housing allowance 85 per cent of the pension recipient's acceptable housing costs which exceed the deductible, if the hou-sing costs exceed a certain amount. Besides the earnings the entitlement to and amount of the housing allowance is affected by the applicant's housing costs, family ties and wealth.	378.90 euros/month maximum to childless person
Pensioners' care allowance Different in size depending on the applicant's need of assistance, need of guidance and supervision as well as the amount of special costs. The care allowance is not affected by the pension recipient's and his or her family's income and wealth.	Care allowance 53.47 euros/month Increased care allowance 133.11 euros/month Special care allowance 281.46 euros/month
Pensioners' child increase If the pension recipient has to provide for a child aged less than 16, awarded to pension recipients who receive a national pension, an earnings-related pension or pensions under workers compensation and motor liability insurance.	19.00 euros/month per child

The orphan's pension can be paid to the deceased person's own child, adopted child or a child who at the time of death of the deceased lived in the same household and who was cared for by the deceased, as long as the child is aged under 18. The orphan's pension includes a basic amount regardless of the child's earnings, amounting to approximately 10 per cent of the full national pension. If the child's both parents or guardians are dead (full orphan), an orphan's pension is paid after them both separately, i.e. two basic amounts. If the child studies, the pension can be paid until the age of 21. In all, the orphan's pension after one parent can amount to approximately 23 per cent of the full national pension.

2.3.3 Regular revaluation

All benefits and earnings limits in the national pension scheme are linked to the cost-of-living index. The cost-of-living index (basic year 1951=100) is a long time series calculated according to the newest consumer price index (at the moment basic year 2005=100). Thus it develops in the same manner as the consumer price index (see above on regular revaluation of the earnings-related pensions). The national pensions are revalued annually in January. A benefit from the national pension scheme that has once been determined is not recalculated due to revaluation of the earnings-related pension; instead the amount to be paid is only revalued in line with the index of the national pension scheme.

From time to time an overall increase to the national pensions is made by decision of Parliament, so that the level of national pensions would not lag too much behind the development in the earnings-related pensions. The latest overall increase of this kind was carried out in September 2006.

2.3.4 Reforming the national pension scheme

The reform of the legislation on the national pension takes effect 1 January 2008. The new legislation is part of the overall reform aimed at modernising and clarifying the legislation as regards income security.

Previously survivors' pensions were regulated in a separate act and the pensioners' care allowance in the National Pensions Act. The new National Pensions Act covers national pensions, survivors' pensions and the increase for a child, whereas the pensioners' care allowance are covered by the new act on benefits for the disabled.

The second cost-of-living category of municipalities will be abolished by the new act for the national pension, surviving spouse's pension and other benefits whose amount is linked to the cost-of-living category of municipalities. This means a rise in the benefit level for recipients of a national pension who live in the second cost-of-living category of municipalities, that is, for a large share of the recipients of a national pension.

3 Administration and Supervision of the Pension Scheme

3.1 Main features of the administration and supervision of the earnings-related pension scheme

3.1.1 Active parties within the earnings-related pension scheme

Statutory earnings-related pension insurance is in the private sector handled by pension insurance companies, company pension funds and industry-wide pension funds, which are independent insurance providers. Separate pension providers established by law for certain groups of people are the Farmers' Social Insurance Institution and the Seamen's Pension Fund. Until 2007 pension provision for persons insured under LEL and TaEL was arranged with a separate pension provider. From the beginning of 2007 the pension acts for employees (TEL, LEL and TaEL) were unified into one act, the Employees Pensions Act (TyEL). Then also the arranging of insurance under LEL and TaEL with the separate monopoly pension provider ended and the provider will function as the other pension insurance companies. The private-sector pension providers are supervised by the Ministry of Social Affairs and Health as well as the Insurance Supervisory Authority, which functions under the auspices of the Ministry.

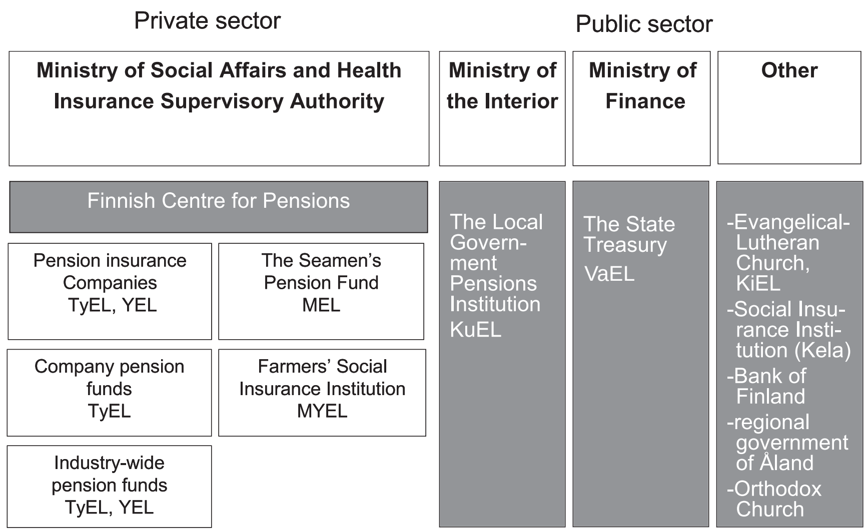
With certain exceptions, earnings-related pension provision for local government personnel is handled by the Local Government Pensions Institution, which is an independent institution under public law. The Institution is supervised by the Ministry of the Interior. The State Treasury handles state earnings-related pension matters and is supervised by the Ministry of Finance. The Church Council, under the auspices of the Synod and the Ministry of Education, handles the KiEL pensions for the Finnish Evangelical-Lutheran Church. However, the investment activities of these public-sector pension providers are supervised by the Insurance Supervisory Authority.

In addition pension provision for the employees of the Bank of Finland and the Social Insurance Institution (Kela) and those covered by the pension scheme for the regional government of Åland is arranged with their own pension providers.

One significant special feature of Finnish social security and the Finnish insurance market is that private insurance providers handle private sector earnings-related pension insurance and workers' compensation, which are part of statutory social insurance. While the administration of the earnings-related pension scheme is decentralised to several pension providers, some functions are handled centrally at the liaison body of the earnings-related pension scheme, the Finnish Centre for Pensions.

Figure 3.1 shows the administrative organisation of the earnings-related pension scheme separately for the private and the public sector.

Figure 3.1. *Administration of private-sector and public-sector earnings-related pensions from the beginning of 2007.*



3.1.2 Tripartite administration

In Finland the contents of the statutory earnings-related pension scheme are regulated by statute but the principles of the scheme are largely agreed in connection with the negotiations between the labour market organisations. The earnings-related pension scheme follows a so-called tripartite administrative model. The State, the employees and the employers as well as the entrepreneurs all influence the development of the legislation on the earnings-related pensions.

The coordination and preparation of the earnings-related pension legislation is the responsibility of the Ministry of Social Affairs and Health. The Finnish Centre for Pensions, the pension providers and the labour market organisations participate in the preparation of legislation. Formally the pension providers are then represented by the Finnish Pension Alliance TELA. The final handling of changes to the earnings-related pension acts occurs in Parliament, which issues and changes the acts on the earnings-related pensions. The President of the Republic confirms the acts with his or her signature.

In the beginning the establishment of earnings-related pension provision was carried out with the participation of the labour market organisations, and earnings-related pension provision is still a special focus of interest for the labour market organisations. This shows in their representation in the administration of the pension providers and the Finnish Centre for Pensions and in the participation in the development of the scheme. At the liaison body of the earnings-related pension scheme, the Finnish Centre for Pensions, the labour market organisations have their own quotas. Likewise the labour market organisations are represented in the decision-making bodies of the pension companies. Some of the pension providers are industry-specific. Thus the expertise and representation of the employers', employees' and self-employed persons' organisations are a natural part of the activities of these institutions.

3.2 Authorised pension providers

The obligations of the pension providers include awarding and paying the pension recipients' pensions. The pension providers also mainly give advice to the insured as regards pension matters. The employers pay the pension contributions to the pension providers. The pension providers invest the funded components of the pension contributions, which are not used to pay current pensions. Together with the Finnish Centre for Pensions the pension providers participate in the preparation of guidelines and legislation.

Despite the decentralised administration one application is enough when applying for an earnings-related pension and a possible national pension. The application form can be handed in at or sent to any of the pension providers, the local offices of the Social Insurance Institution (Kela) or the Finnish Centre for Pensions.

The earnings-related pension for employees and for entrepreneurs is awarded and paid by the pension provider where the person's last employment contract or self-employment was insured (so-called principle of the last institution). The pension provider which insured the employee's last employment contract calculates the total amount of the pensions accrued from different employment contracts, handles the payment of the pension to the pension recipient and levies the other pension providers' shares of the pension through the cost clearing handled by the Finnish Centre for Pensions. The last provider (private-sector or public-sector pension provider) handles the payment of the whole pension, which may have accrued from different sectors.

The supervision system for the private-sector pension providers, as for other insurance activities, consists of the administration, internal supervision systems and auditing of the insurance provider as well as public insurance supervision. Decisions and regulations by the Ministry of Social Affairs and Health and the Insurance Supervisory Authority are binding on the insurance providers and steer their activities.

Although the contents of the statutory earnings-related pension scheme are regulated by law, in the decentralised scheme the pension providers decide independently, within certain limits, on for instance the investment of pension assets. The actuarial and other principles confirmed by the Ministry strive to secure the safeguarding aspects of the pension providers' activities.

A TyEL employer may choose with which pension provider earnings-related pension insurance is arranged for the employees. Insurance can be taken out with one of the current six pension insurance companies, who have a concession from the Government to handle statutory earnings-related pension insurance, or a company pension fund or an industry-wide pension fund. The pension insurance companies are often part of a company group which also handles other types of insurance. The local offices of the company group thus also provide service to the pension insurance company's insured throughout the country.

Company pension funds usually function within one company or company group. An industry-wide pension fund usually covers several companies in the same industry. At the end of 2005 there were 30 company pension funds and eight industry-wide pension funds. When considering the different types of pension provider, the estimated distribution of those insured under the Employees' Pensions Act (TEL) at the end of 2005 was the following: 85 per cent were insured with a pension insurance company, 12 per cent with a company pension fund and three per cent with an industry-wide pension fund.

Entrepreneurs insured under the Self-Employed Persons' Pensions Act (YEL) arrange their personal earnings-related pension with a pension insurance company or a pension fund. In 2005 approximately 99 per cent of the entrepreneurs had arranged their earnings-related pensions with a pension insurance company and approximately one per cent with a pension fund.

In 2005, the administrative costs of the private-sector pension providers amounted to 382 million euros, i.e. slightly less than 0.01 per cent of the wage bill of these pension providers.

3.2.1 Pension insurance company

The acts applied to the pension insurance company are the Act on Pension Insurance Companies (354/1997) and the Insurance Companies Act (1062/1979).

In Finland a pension insurance company can be founded by one or several natural or legal persons (e.g. company or corporation). At least half of the founders have to be resident (for legal persons domiciled) in the European Economic Area, unless the Ministry of Social Affairs and Health grants an exemption from this.

A pension insurance company can be a limited company or a mutual insurance company. The pension insurance company can also be a public insurance company mentioned in the Finnish Companies Act. The basic capital required for a pension insurance company is 5 million euros, minimum. A pension insurance company's articles of association and changes to them have to be confirmed by the Insurance Supervisory Authority.

A pension insurance company handling statutory earnings-related pension insurance has to have a concession granted by the Government. The Government may include conditions in its concession which are necessary in order to safeguard the interests of the policyholders and the insured, to ensure the stable functioning of the company and to promote the healthy development of the earnings-related pension insurance business.

The EU Life Insurance Directive is not applied to Finnish pension insurance companies, and therefore statutory earnings-related pension insurance has to be kept legally separate from the company group's other insurance activities. The pension insurance company cannot handle any other type of insurance than insurance under the Employee's Pensions Act (TyEL) and the Self-Employed Person's Pensions Act (YEL) and related reinsurance.

The assets of the pension insurance company have to be kept separate from the assets of companies that belong to the same company group as the pension insurance company. The annual accounts of the pension insurance company may not be included in the consolidated accounts of another company. In addition, the financial management and payments traffic of the pension insurance company must be arranged so that assets are not used for arranging the financial management or payments traffic of another company which belongs to the same company group as the pension insurance company.

Foreign insurance companies may not directly engage in statutory pension insurance in Finland, but a foreign corporation or natural person may establish a pension insurance company in Finland. The company is subject to the same restrictions as regards line of industry and concessions as a pension insurance company established by Finns. So far, no foreign insurance company is engaged in earnings-related pension insurance business in Finland.

The stipulations as regards the administration of pension insurance companies have been reformed in the beginning of 2007. The rules regarding the administration of pension insurance companies have been made clearer and revised so that they correspond to other legislation regarding companies. The aim is also to emphasise the independence and autonomy of the pension insurance companies in respect to companies pursuing other business activities.

The administrative structure of the companies follows the normal model for companies. At the annual general meeting power of decision is exercised by the company's shareholders in accordance with the Insurance Companies Act. The Supervisory Board is elected at the general meeting and the obligations of the Supervisory Board are determined according to the legislation on limited companies. The Supervisory Board nominates the members of the Board of Directors.

The Supervisory Board and the Board of Directors have to have representatives for the policyholders and the insured chosen from the persons suggested by the central labour market organisations representing the employers and the employees. There has to be an equal number of such representatives for the employees and for the employers, and their total number has to be at least half of the total number of members in the Supervisory Board and Board of Directors, respectively.

The pension insurance company must have a separate nominating committee, consisting of persons suggested half by representatives of the policyholders and half by representatives of the insured. The nominating committee makes proposals as concerns the remuneration and nomination of the members of the Supervisory Board to the general meeting and proposals as concerns the remuneration and nomination of the members of the Board of Directors to the Supervisory Board.

The Board of Directors elects the managing director following normal practices in limited companies and supervises the managing director's activities. The managing director of a pension insurance company may not function as managing director of a credit institution or investment services company in the same company group or financial and insurance conglomerate as the insurance company. The managing director may also not be a member of the Supervisory Board or of the Board of Directors of the company.

3.2.2 Industry-wide pension fund

The industry-wide pension fund is regulated by the Act on Insurance Funds (1164/1992). According to the Act on Insurance Funds, an industry-wide pension fund can have one or several founders. The founder has to be a Finnish citizen or a citizen of another EEA country, or a corporation or foundation domiciled in Finland or another EEA country. A general partnership or limited partnership can be the founder on certain conditions.

The purpose of the industry-wide pension fund is to grant pensions to the members of the fund and to others who are insured with the fund. The scope of the industry-wide pension fund may consist of, for instance, the employees of one or several employers who have a financial or functional connection or the employees of employers who belong to the same company group. At the fund meeting, decision-making power in fund matters is exercised by the members of the fund (employees) and the partners (employers). The minimum number of members for an industry-wide pension fund handling statutory pension insurance is 300.

Engaging in activities in the form of an industry-wide pension fund requires that confirmation is obtained from the Insurance Supervisory Authority for the rules of the fund and changes to them and that the fund is reported for registering to the insurance funds register within the prescribed time. As a requirement for confirmation of the rules and their changes the Insurance Supervisory Authority can request a sufficient guarantee capital or basic capital.

Establishing a new industry-wide pension fund is from 1 July 2003 possible also so that a pension insurance company transfers some employer or partner-specific part of the TyEL insurance portfolio with assets and a certain solvency margin to a new industry-wide pension fund.

3.2.3 Company pension fund

The company pension fund is regulated by the Act on Company Pension Funds (1774/1995). The company pension fund is a fund established by one or several employers with the aim of awarding pensions to the persons insured with the company pension fund. Establishing a company pension fund presupposes at least 300 insured. On the basis of a stipulation in the rules of the company pension fund, the fund's sphere of activities may include also certain other persons. The company pension fund is a legally separate unit, where the employer is represented in the administration.

The company pension fund can grant both voluntary supplementary pensions (A pension funds and departments) and statutory pensions (B pension funds and departments) or both (AB pension fund).

Being engaged in activities through a company pension fund requires that the rules of the company pension fund and amendments to them are confirmed by the Insurance Supervisory Authority, and also that the pension fund is reported for registering with the register of company pension funds within the prescribed time.

As for a new industry-wide pension fund, establishing a new company pension fund has from 1 July 2003 been possible also so that a pension insurance company transfers some employer or partner-specific part of the TyEL insurance portfolio with assets and a certain solvency margin to a new industry-wide pension fund.

3.2.4 Transfer of insurance portfolio of pension providers

In order to achieve a sufficient number of pension providers in the decentralised earnings-related pension scheme the legislation has to secure the transfer of the employer's insurance portfolio from one pension provider to another on conforming grounds.

The insurance portfolio under the Employees' Pensions Act (TEL) may be transferred to a fully new industry-wide pension fund or company pension fund to be established, or from a pension insurance company to an already existing company pension fund or industry-wide pension fund and from an industry-wide pension fund to a company pension fund.

By law solvency margin is transferred in connection with the transfer of the insurance portfolio, that is, assets which exceed the liabilities, to the amount which enables an investment distribution in the receiving pension provider through which a yield corresponding to the calculated interest rate can be expected in the long term.

The level of the solvency margin to be transferred has been changed a number of times. From 1 July 2003 the level was 12.4 per cent of the technical provisions to be transferred and 1 April 2005 the level was reduced to 11.8 per cent. This level was too low and led to speculative insurance portfolio transfers when the employer which maintained the company pension fund could himself keep the part which exceeded the solvency margin to be transferred when he discontinued the insurance business. On the other hand, a policyholder who established a new pension provider did not have equal possibilities to compete with the profitability of the pension provider transferring insurance business.

In April 2006 the rules were changed so that the level of solvency margin to be transferred increased. The change concerns transfers of the insurance portfolio agreed on 7 October 2005 and later. Defined in more detail, the amount of the solvency margin to be transferred is double the median of the solvency borders of pension providers handling statutory pension insurance. The Ministry of Social Affairs and Health confirms the level of solvency margin to be transferred twice a year through decree as proposed by the Finnish Centre for Pensions. In December 2006 the level was confirmed as 22.5 per cent.

The objective of increasing the level is to ensure that the legislation does not unnecessarily hinder the flexible changing of pension provider. The immediate aim is to lessen companies' willingness to dissolve their own company pension funds and industry-wide pension funds.

The determining of the level of solvency margin to be transferred strives to discourage speculative insurance portfolio transfers and simultaneously also that the level of solvency margin to be transferred safeguards the equal treatment of the receiving pension provider in respect of the other pension providers. In view of a well-functioning decentralised scheme it is important that there is a sufficient number of pension providers within the scheme and that the different pension providers are competitive in relation to each other.

3.3 Role of the Finnish Centre for Pensions in the administration and activities of the earnings-related pension scheme

The Finnish Centre for Pensions acts as the liaison body of the private-sector earnings-related pension scheme in an otherwise decentralised scheme. It aims at promoting the implementation and development of the pension scheme. The Finnish Centre for Pensions handles responsibilities which it is useful to handle centrally. Such tasks include for instance maintaining the nationwide pensions register, division of liability for pension costs between the pension providers, decisions on the application of the acts, drawing up statistics and conducting research, and tasks related to the development of earnings-related pension provision. In addition the Finnish Centre for Pensions acts as liaison body in international connections, also on behalf of the public-sector pension providers.

Until 2007 the Finnish Centre for Pensions has maintained the nationwide employment register. From 2007 onwards a separate company owned by the Finnish Centre for Pensions and the pension providers, AREK, has been established to register earnings data. The register data are used when awarding pensions. To complement its own register data, the pension provider gets the other data needed to calculate the pension from AREK and the Finnish Centre for Pensions.

Centrally administered registers make it possible to provide service to the insured already before the pension contingency. Every year a large number of insured automatically receive information on their registered employment contracts and accrued pension rights. The Finnish Centre for Pensions annually sends about 400,000–500,000 employees a pension record and in addition the pension providers send pension records to their own insured. The insured can also at any time request his or her employment data or view them over the Internet. Thus the insured can verify that their register data are correct. This is also important for supervising the obligation to take out insurance. From 2008 onwards the pension providers will send register data to all employees annually for checking.

One of the obligations of the Finnish Centre for Pensions is to supervise that the employers take out pension insurance for their employees and the self-employed persons for themselves. If an employer or a self-employed person refuses to take out insurance, the Finnish Centre for Pensions takes out insurance at the employer's or the self-employed person's expense with a pension company (forced insurance).

The Finnish Centre for Pensions also gives application guidelines to the pension providers and makes decisions concerning interpretation of the pension acts. The application guidelines provide interpretations and specify the principles laid down by law so that all the pension providers act in the same way when granting statutory pensions. The application guidelines are often prepared together with the pension providers and sometimes also with the labour market organisations.

One important responsibility of the Finnish Centre for Pensions is to divide the costs for the pensions between the pension providers. This centralised clearing and division of costs makes possible the functioning of the decentralised scheme. In addition the Finnish Centre for Pensions participates together with the pension providers and the labour market organisations in the preparation and development of legislation.

The Finnish Centre for Pensions is not a government agency but a unique institution, which is part of the indirect state administration, as are the public-sector pension providers (the State Treasury and the Local Government Pensions Institution). However, the Finnish Centre for Pensions does not handle insurance for the private-sector employees, nor does it grant or pay pensions, which the public-sector pension providers do.

3.4 The Insurance Supervisory Authority

Supervision and inspection of the authorised pension providers is the responsibility of the Insurance Supervisory Authority, which functions under the auspices of the Ministry of Social Affairs and Health. The supervisory right of the Insurance Supervisory Authority also extends to the specialised pension providers, the Finnish Centre for Pensions and the investment activities of the public-sector pension providers.

The Insurance Supervisory Authority supervises and checks that the pension providers follow the law and good insurance practices as well as use appropriate procedures in their activities. The Authority especially supervises the development in the finances and solvency of the pension providers. The Insurance Supervisory Authority also confirms the rules of the company pension funds and industry-wide pension funds as well as maintains the register of company pension funds and industry-wide pension funds and the concessions register of insurance companies.

The Insurance Supervisory Authority can give the pension provider an admonition, ask it to correct its actions within a prescribed time, or prohibit the company from continuing its erroneous actions. To ensure compliance, the Insurance Supervisory Authority may impose a fine. The Government may impose restrictions on the concession of the pension insurance company or withdraw it.

The pension provider is obliged to report annually to the Insurance Supervisory Authority its financial statements data, a report in accordance with the regulations of the Insurance Supervisory Authority on its activities and state as well as any other necessary information. The Insurance Supervisory Authority has the right to inspect the premises of the pension provider and participate in the meetings where power of decision is executed. However, it may not participate in the decision-making.

Independence of the Insurance Supervisory Authority in relation to the Ministry of Social Affairs and Health has been increased from the beginning of 2007. This has meant loosening the administrative and financial connection between the Insurance Supervisory Authority and the Ministry of Social Affairs and Health.

3.5 Regulatory mechanisms in pension provision

3.5.1 Acts, principles and guidelines governing pension insurance

The contents of statutory pension provision are determined in the relevant pension acts, and thus there are no differences between the pension providers as to the contents of private-sector pension provision. In addition, the insurance terms and conditions as well as the actuarial principles have to be confirmed by the Ministry of Social Affairs and Health.

The principles regulate the calculation of the insurance contributions and technical provisions, vested pensions and surrender, the consequences in case of neglect in paying insurance contributions as well as the rights of the policyholder in cases where the insurance policy is terminated before the agreed time or the insurance company is freed of its obligations otherwise.

The principles for calculating the insurance contributions and technical provisions have to be drawn up keeping in mind especially the safeguarding of the interests of the insured, i.e. secure the pension company's ability to handle its future pension payments (principle of solidity). When drawing up other principles mentioned above, attention should be paid especially to achieving reasonable principles (principle of moderation).

The responsibilities of the Ministry of Social Affairs and Health include preparation of legislation on insurance providers and insurance activities and a significant proportion of the issuing of provisions on a lower level. The Insurance Supervisory Authority gives the pension providers more detailed regulations and instructions as regards for instance bookkeeping and the annual accounts, coverage and calculation of the technical provisions as well as the solvency requirements.

As a rule, the pension insurance companies, company pension funds and industry-wide pension funds are also covered by the legislation on competition, because they pursue economic activities as intended by the legislation on competition. However, when applying the legislation on competition the pension providers have an exceptional status, because they implement mandatory and statutory pension provision, which is mostly based on the principle of joint liability.

In TyEL the pension providers are obliged to cooperate in the preparation of the insurance terms and conditions and of the actuarial principles as well as in the gathering of statistical data and in other matters related to the implementation and development of the earnings-related pension acts.

The legislation on competition applicable to authorised pension providers is primarily the stipulations of the Treaty Establishing the European Union and secondarily the national Act on restriction of competition. The aim has been to harmonise the latter with EU law.

The application guidelines are recommendations of the Finnish Centre for Pensions to the pension providers as regards the application of the earnings-related pension acts. The Finnish Centre for Pensions draws them up together with the pension providers and other cooperation partners. The guidelines state for instance how the earnings-related pension acts and the principles used in the division of costs as well as other regulations which affect the implementation of earnings-related pension provision are to be applied.

The cooperation between the pension providers and the Finnish Centre for Pensions as regards the application guidelines and the arranging of courses about the guidelines is permitted also from the competition legislation point of view. However, the cooperation as regards the guidelines must not extend to issues concerning the pension provider's customer service or internal processing procedures.

The rights of persons who move between different countries to social security and the countries' liability for the arranging of provision are determined in social security agreements concluded between the countries. In the European Union social security for persons moving between the member states is governed by Regulation 1408/71. The stipulations of this Regulation are observed in the EU countries, the EEA countries and Switzerland. In addition Finland has concluded bilateral social security agreements with Israel, Canada, Quebec and the United States.

The aim of the agreements and the EC Regulation is to secure the continuation of social security coverage when moving from one country to another and to prevent situations where the person has double social security coverage or has to pay double social insurance contributions. On the other hand, they remove restrictions on the entitlement to social security.

3.5.2 Stipulations on the financial management of the pension providers

The stipulations in the legislation and the regulations and instructions issued by the Ministry and the Insurance Supervisory Authority strive to secure the pension providers' ability to meet their insurance commitments. According to the Act, the pension provider's assets are to be invested productively and safely (further information in chapter 5).

Another way of striving to secure the meeting of the solidity requirement is the Ministry's advance confirmation of the pension providers' actuarial principles. The actuarial principles govern the calculation of the contribution and the technical provisions as well as the common calculated interest rate, i.e. the return requirement.

The pension insurance companies, industry-wide pension funds, company pension funds and specialised pension providers have their own actuarial principles. The insurance company or the industry-wide pension fund has to apply for confirmation of the actuarial principles with the Ministry of Social Affairs and Health, whereas for company pension funds the Ministry of Social Affairs and Health issues the principles through decree. The pension providers have to cooperate in the preparation of the insurance terms and conditions and the actuarial principles. The principles must not contain differences between the pension providers which would hamper the handling of common matters in accordance with the earnings-related pension acts.

The investment plans are regulated by law. The pension providers' Boards of Directors approve the investment plans, which have to be sent to the Insurance Supervisory Authority. The intention is to secure the safety, yield, realization, diversity and sufficient diversification of the investments. The investment activities of the authorised pension providers should be autonomous and independent of other parties.

As a buffer against investment risks the pension provider has a solvency margin, which means the difference between assets and liabilities. The solvency margin enables increased investment in instruments with higher yield expectations but also higher risk. The solvency margin maintains solidity and its supervisory limits act as supervision mechanism.

From the beginning of 2007, the risks related to the investment of earnings-related pension assets are taken into account more exactly than before when calculating the solvency border of the pension providers. In addition the possibility of investing the assets productively and safely in line with the development in the investment activities has been improved. To calculate the solvency border the investments are divided into groups according to their real risks and the solvency border is calculated using values which describe the risks of the investments.

In addition to the solvency margin mechanism, i.e. the rules on solvency, the investment activities of the pension providers are governed by the rules on coverage of the technical provisions. Coverage of technical provisions implies ensuring the security of assets, their return and convertibility into money as well as the diversification of assets. The rules regarding the investment of assets used to cover the technical provisions have been reformed from the beginning of 2007.

3.6 Administration and supervision of the national pension scheme

The administration of the national pension scheme is handled by an independent institution under public law, the Social Insurance Institution of Finland (Kansaneläkelaitos Kela). The Social Insurance Institution handles both national pension and other basic provision, such as health insurance, income security for the unemployed, family benefits and financial aid for students.

According to the Act on the Social Insurance Institution of Finland (731/2001), the administration and activities of the Social Insurance Institution are supervised by the 12 Trustees appointed by Parliament. The eight auditors elected by the Trustees carry out the audit of the Social Insurance Institution. The activities of the Social Insurance Institution are directed and developed by the Board, which has 10 members. Eight members of the Board are elected by the Trustees. In addition to them the Board includes the Director General of the Social Insurance Institution and his or her deputy. The Director General of the Social Insurance Institution is nominated by the President.

The decision-making on social security benefits has been decentralised to the local district offices, numbering 263 in total in 2005. They make the decisions on almost all benefits. Disability pensions are decided on centrally at the central administration. The national pension is awarded and paid by the Social Insurance Institution.

The employer's national pension contribution is paid to the tax authorities, who forward the payment to the Social Insurance Institution.

The Social Insurance Institution is also the liaison body for pension claims coming to Finland from abroad, whereas the Finnish Centre for Pensions is responsible for the processing and forwarding of the pension claims of persons resident in Finland to other countries. The Social Insurance Institution and the Finnish Centre for Pensions cooperate closely and they use each other's register data when processing pension claims.

3.7 Legal protection of the insured

The system of appeals is twofold. The aim of preventive modes of appeal is to ensure that issues are solved correctly and according to law at the earliest possible stage. The intention of retroactive modes of appeal is to enable the correction of an erroneous decision and ensure that the procedure is according to law.

The most important guarantee of preventive modes of appeal is the fact that the administrative procedure is governed by law. Preventive modes of appeal include for instance the processing of the cases adhering to the proper form, rules on disqualification, hearing of the party involved and providing reasons for the decision. Retroactive modes of appeal are divided into ordinary modes of appeal and extraordinary modes of appeal.

3.7.1 Modes of appeal in earnings-related pension matters

The ordinary mode of appeal in insurance and pension matters is appeal and in insurance contribution matters the mode of appeal is material appeal. When the period of appeal has expired (the decision has become legally valid), the decision may be appealed through extraordinary appeal. Extraordinary modes of appeal are correction of error in the decision, amendment of a legally valid decision on the basis of new clarification, removal of a legally valid decision and annulling a decision of the Insurance Court.

The person whose right, interest or obligation the matter concerns may appeal the appealable decision or summary of decisions which he or she has received from the pension provider or the Finnish Centre for Pension by appealing to the Pension Appeals Court. The decision of the Pension Appeals Court may be appealed to the Insurance Court. On the other hand, the decision of the Insurance Court may no longer be appealed. The same appeals process also applies to debiting imposed by the pension provider or the Finnish Centre for Pensions and the employer’s withholding of the employee’s pension contribution.

The State Pension Appeals Board and the Local Government Pension Appeals Board have been merged with the Pension Appeals Court from the beginning of 2007. The Pension Appeals Court is thus the first appellate body for both private-sector earnings-related pension matters and those public-sector earnings-related pension matters which before 2007 were appealed to the Local Government Pension Appeals Board and the State Pension Appeals Board. There are separate rules regarding appeals in pension matters of the employees of the Bank of Finland and the regional government of Åland.

The appeals have to be made in writing within 30 days of being served the decision. Material appeals concerning debiting and the withholding of the employee's pension contribution must be made to the Pension Appeals Court within two years of the beginning of the year following the debiting or levying of the amount.

The appeals are handed in to the pension provider which issued the appealable decision, or to the Finnish Centre for Pensions if the appeals concern a decision by the Finnish Centre for Pensions. The pension provider or the Finnish Centre for Pensions investigates whether it can itself correct its own decision. If the pension provider or the Finnish Centre for Pensions accepts the claims in the appeals in full, it issues an appealable amendment of the decision. If the decision is amended only partially, a provisional decision is issued, and this decision cannot be appealed.

If the pension provider or the Finnish Centre for Pensions does not accept the claims in the appeals in full, it has to forward the appeals and its statement regarding the appeals to the appellate body.

A person who has been insured in two or more EU countries may appeal the pension decision after having received the summary of the pension decisions of all the relevant EU countries. However, a decision regarding the entitlement criteria for a disability pension may be appealed immediately.

3.7.2 Appeals in national pension matters

A decision by the Social Insurance Institution concerning the national pension is appealed to the Social Security Appeal Board as the first appellate body. The decision of the Social Security Appeal Board may be appealed to the Insurance Court.

4 Pension Financing

Pensions are usually financed through pension contributions paid by the employer and the employee. The extremes of pension financing systems are the pay-as-you-go (PAYG) system and the funded system. In a *pay-as-you-go system* the pension contributions are used to cover the annual pension expenditure and related administrative costs. In this way each generation in the labour market pays the pensions of those who are retired. Alongside the PAYG system a separate buffer fund may also be gathered to prepare for fluctuations in premium income. In a pure *funded system* pension contributions are levied annually to an amount that corresponds to the accrued pension and this amount is funded to await retirement. In a funded system each generation thus pays its own pensions and the employee in a way saves part of the wage (into the fund) for the future pension.

Pension funding directs the cost constituted by pensions to the generation which receives a pension and through pension funding the continuous payment of pensions can be secured. Funding makes it possible to use investment returns to finance pensions, which reduces the contribution level. Funding can be realised either at a collective or an individual level. In many countries pension contributions are funded into the employee's personal pension account.

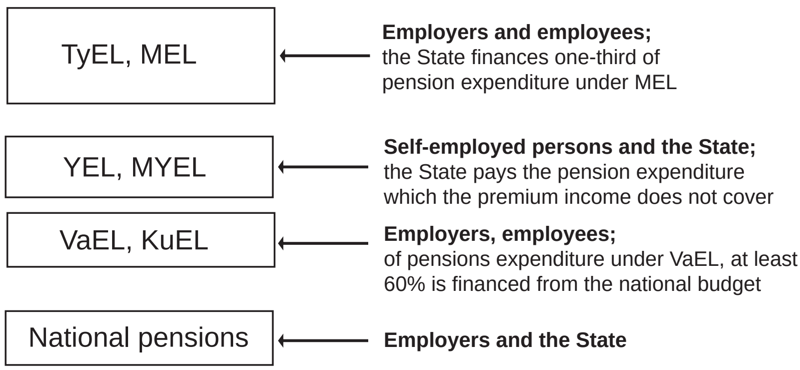
The Finnish statutory earnings-related pension scheme includes several different pension acts. The grounds for determining the pension are mainly the same for all insured, but the pensions under the different acts are financed differently. Earnings-related pensions are mainly financed through pension contributions paid by the employers and the employees. The State partly finances the pension expenditure under some of the pension acts.

One of the special features of the Finnish earnings-related pension scheme is the system of partial funding, which is applied to the financing of pensions under the pension acts for private-sector employees. As regards these pension acts, the financing has been carried out at the individual level since the inception of the scheme, but not through personal pension accounts, however. The objective of the financing at the individual level is to link the liability for the financing of the pension to the pension provider which has funded the contribution.

Pensions under the pension acts for self-employed persons (YEL and MYEL) are financed according to the PAYG principle. The financing of public-sector pensions is mainly based on the PAYG principle. In the public sector funds are nowadays collected also into collective buffer funds.

National pensions are fully financed on the basis of the PAYG principle; slightly less than half of the national pension expenditure is financed through the employers' national pension contributions. The other half is made up of State money and income from VAT.

Figure 4.1. *Financing sources of the Finnish earnings-related pension scheme.*



The employers and the insured are the main pension financers (figure 4.1). The earnings-related pension contribution is determined in proportion to the insured's earnings and the contribution is levied separately from each insured person. The insured are employees and self-employed persons aged 18–68.

The employees have paid part of the pension contribution since 1993. The employees' contribution share depends on the insured person's age, except for seamen. The possible annual adjustment to the pension contribution is divided in half between the employer and the employee.

Table 4.1. *Pension contributions on average in 2007.*

	Total contribution, per cent of wage / earned income	Employee's share, per cent
TyEL[1)]	21.1	4.3 / 5.4 (aged under 53 / aged 53–>)
MEL[2)]	22.0	11.0
VaEL[2)]	24.8	4.3 / 5.4
KuEL[3)]	21.1	4.3 / 5.4 Self-employed person's share on average (estimate)
YEL[2)]	20.8 / 21.9 (aged under 53 / aged 53–>) (1st time setting up in business 48 months 25% reduction)	19.6
MYEL[2)]	10.19–20.8 (aged under 53) 10.73–21.9 (aged 53–>)	10.7

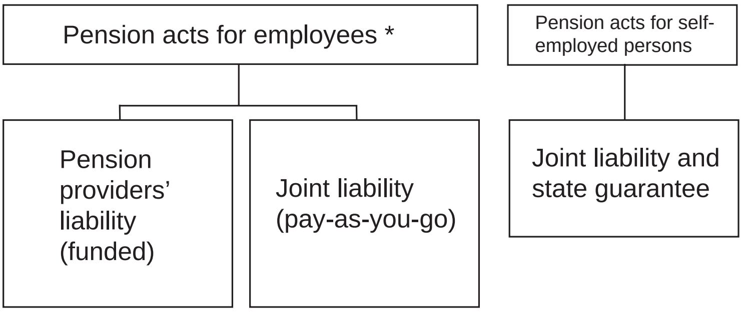
1) Including temporary rebates.
2) The contribution percentages do not include the share of self-employed persons', seamen's and state employees' pensions financed from the national budget.
3) Part of the KuEL contribution is levied from the employers on the basis of pension expenditure. The total contribution accumulated corresponds to an estimated 28.5 per cent of the wage bill under KuEL.

4.1 Pension financing in the private sector

The private-sector pension acts are divided into the pension acts for employees and for self-employed persons (figure 4.2). Even though the pension accrues in the same way, the pensions under the different pension acts are financed differently. The Employees Pensions Act (TyEL) and the Seamen's Pensions Act (MEL) regulate the financing of pensions at the level of the pension provider, the determining of the employee's pension contribution and the principles for the employer's contribution and liabilities.

Pensions under the pension acts for private-sector employees are financed through partial funding, which means that part of the pension to be paid out is funded in advance and part is financed from the pension contribution for the year of pension payment. The financing of pensions under the pension acts for self-employed persons is purely based on the PAYG principle. The self-employed persons' pension contributions, reduced by administrative costs, are used to cover the pension expenditure for the year in question and the State finances the remaining portion.

Figure 4.2. *Pension financing in the private sector.*



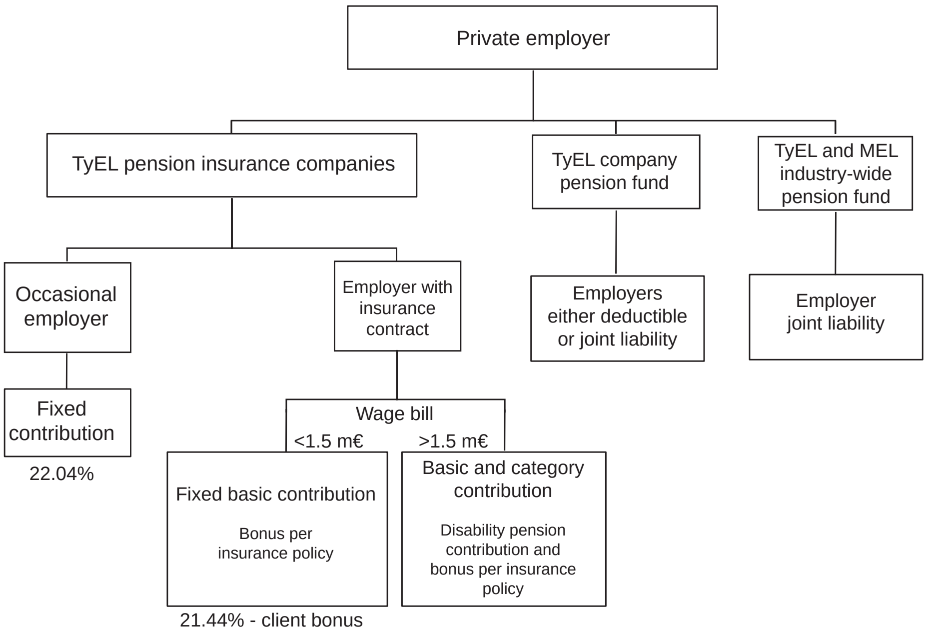
* In addition the State finances one-third of pension expenditure under MEL.

The employer whose business is covered by TyEL can arrange pension provision for the employees by taking out insurance with a pension insurance company (employer with insurance contract), by joining an industry-wide pension fund or by arranging pension insurance through a company pension fund (further information in chapter 3). In addition an occasional employer, who does not have any permanently employed staff and who pays wages to an amount of less than 6,600 euros (level of 2007) over a 6-month period, may arrange pension provision for the employees with a pension insurance company without filing an insurance application. The Seamen's Pension Fund handles pensions for seamen. Self-employed persons can take out insurance with a pension insurance company or with a pension fund providing pension cover under YEL. Pensions for farmers are handled by the Farmers' Social Insurance Institution (MELA).

4.1.1 Employee pension contributions

The main principle when determining the pension contribution under the Employees Pensions Act is the same regardless of the type of pension provider: an amount is levied as pension contribution which together with the pension provider's other income is enough to cover the financial year's pension expenditure, funded pension liability, administrative costs and premium losses due to unpaid contributions. However, the contribution under TyEL varies both between pension providers and between employers within the same pension provider. Figure 3 describes the main principles for the determining of the employer contribution for different types of pension provider.

Figure 4.3. *Financing of the employees' pensions as of 2007.*



In the pension insurance companies the TyEL contribution and the technical provisions accumulated for future pension payments are determined according to the bases approved by the Ministry of Social Affairs and Health. The average TyEL contribution in 2007 is 21.6 per cent of earnings without temporary rebates for 2007, and including temporary rebates 21.1 of earnings. The employee's share for employees aged under 53 is 4.3 percentage points and for employees having reached the age of 53 years 5.4 percentage points. The pension provider levies the pension contribution from the employer as one whole and the employer withholds the employees' share from the wage. The components of the pension contribution are specified in table 4.2. The components of the pension contribution are not separately divided into the employer's and the employee's share.

In the insurance company handling TyEL insurance the contribution is determined according to the size of the employer company. The pension contribution is reduced by an employer-specific bonus, which depends on the pension provider's investment returns and the client relationship. The average bonus in 2007 is 0.4 per cent of earnings.

The company pension fund levies as contribution from the employers an amount which together with returns from investment operations is enough to cover the relevant year's pension expenditure, funded pension liability and other expenses. If the pension fund has separate accounts for each employer, each employer pays its own expenses. If the pension fund keeps so-called equalising accounts, the pension fund's expenses are divided between the employers in proportion to insured earnings or pension liabilities. The mode of accounting is determined in the pension fund's regulations. *The industry-wide pension fund's* contribution levied from the employers is determined as for company pension funds. The pension contribution is divided between the employers in proportion to insured earnings.

Employers covered by the *Seamen's Pensions Act (MEL)* pay a flat-rate contribution proportional to earnings. In contrast to TyEL, the employer and the employee covered by MEL both pay half each of the pension contribution. In 2007 both the employer's and the employee's contribution is 11 per cent of earnings.

The act lays down a principle of joint and several liability, which concerns pension providers which insure business covered by TyEL and MEL. According to the principle, the pension providers are jointly liable for the pension recipient's benefits, which in case of the pension provider's bankruptcy would otherwise be fully or partially unsecured.

4.1.2 Self-employed persons' pension contributions

Pension contributions under YEL and MYEL are determined on the basis of the average TyEL contribution and the confirmed income. The contribution for persons aged under 53 corresponds to the average TyEL contribution without the contribution increase for employees having reached the age of 53. The pension contribution for self-employed persons covered by YEL and MYEL who have reached the age of 53 corresponds to the pension contribution for persons aged under 53 increased by a percentage point corresponding to the contribution increase for employees having reached the age of 53. In 2007 the confirmed contribution percentages are 20.8 per cent for entrepreneurs aged under 53 and 21.9 per cent for entrepreneurs who have reached the age of 53.

A new self-employed person covered by YEL is during the first four years entitled to a reduction of 25 per cent on the pension contribution. After the initial years the self-employed person may make use of the possibility of flexible payment of contributions. By paying additional contributions of at least 10 per cent some years the entrepreneur can improve the pension accrual for the year in question. It is also possible to pay reduced contributions, which reduces pension accrual correspondingly. Flexible payment of contributions does not change the confirmed income.

It is considered inapproriate to levy full pension contributions from low-income farmers. Only when the reported income exceeds a certain limit a contribution corresponding to the average TyEL contribution is levied. The average MYEL contribution in 2007 is an estimated 10.7 per cent.

The State participates in the financing of pension provision for self-employed persons and farmers insofar as the pension contributions are insufficient. Due to the age structure of the persons insured under YEL the State has participated in the financing of YEL pensions since 1979, except in 1990. In recent years the State's share of the pension expenditure under YEL has been slightly less than 10 per cent, in some years even 5 per cent and at the most in the 1990s slightly less than 20 per cent. Due to the farmers' low contribution rate compared to the benefits the State has always to a significant extent participated in the costs for pensions under MYEL. In recent years the State has financed slightly less than 80 per cent of the pension expenditure for farmers.

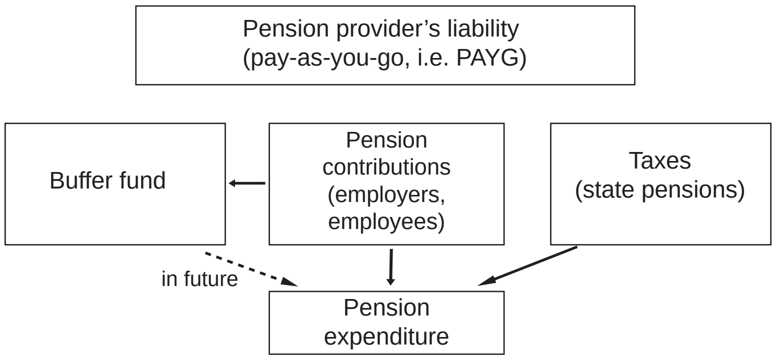
4.1.3 Pension financing in the public sector

Up to the turn of the 1990s the financing of local government and state employees' pensions was based on a PAYG system, i.e. the amount levied as pension contributions or taxes corresponded to the amount needed to finance the pensions in payment. Since the end of the 1980s the public sector has funded part of the pension contribution in order to reduce the pressure to increase the contribution in future as the post-war baby-boomers are in retirement in 2010–2050. The funding targets have been specified over the years.

The aim of the State Pension Fund is nowadays to accumulate funds until the amount corresponds to 25 per cent of the State's pension liabilities. In 2007 almost half of the target has been achieved. Due to the funding target the proportion of the State's pension expenditure which is to be financed from the national budget is determined annually. In 2007 the proportion of pension expenditure to be covered from the national budget is 60 per cent, minimum.

Through funding and investment operations the Local Government Pensions Institution strives to stabilise the pension contribution rate at slightly under 30 per cent of wages, provided that the number of persons covered by the local government pension scheme remains stable.

Figure 4.4. *Pension financing in the public sector.*



The premium income under KuEL consists of the salary-based employer and employee pension contributions as well as the employer's pension contribution based on pension expenditure and on preretirement pensions. The total contribution accumulation corresponds in 2007 to an estimated 28.5 per cent of the wage bill under KuEL.

Under the State Employees' Pensions Act pension contributions are levied according to the general contribution category, except military personnel and persons who chose the specific retirement age (55, 58 or 60 years or the compulsory retirement age) by the end of 1999. When taking into account all pension contributions and payers the total contribution accumulation in 2007 corresponds to an estimated 24.8 per cent of the wage bill under VaEL. In addition at least 60 per cent of pension expenditure is financed from the national budget.

The pension contribution levied from Church employers is determined according to the size of the employer. In addition the employers pay a deductible component on the basis of realised disability pensions, likewise according to the size of the employer. The total contribution accumulation in 2007 corresponds to an estimated 31.5 per cent of the wage bill under KiEL.

4.2 Partial funding in the private sector

Since the introduction of the pension act the principle of partial funding has been applied to the financing of pensions under the pension acts for private-sector employees. Pensions under the pension acts for employees (TyEL and MEL) are funded at the individual level with the pension provider where the employment contract is insured.

In the partially funded system the pension to be paid is divided into two components depending on how the pension is financed. The pension includes a funded component, if the assets to finance it are accumulated in advance. The assets are dissolved when the pension is paid out. The part of the pension which has not been funded in advance is the pooled component. The assets to cover the pooled components are collected according to the PAYG principle through the pension contribution in the year of pension payment. Benefits which are partly funded in advance are old-age, disability and unemployment pensions. Survivors' pensions and part-time pensions are financed fully according to the PAYG system.

The future old-age pension is funded as the pension accrues based on earned income. Disability and unemployment pensions are funded when the pension starts. The act regulates for each type of pension the funding principles, and the technique is determined in more detail in the calculation bases.

The pension insurance companies' pension contribution includes the old-age, disability and unemployment pension components, through which accumulated assets are funded for future pensions. In addition to the aforementioned components the levied contribution includes a pooled component, which is used to accumulate assets to finance for each year the other pension components than the funded components, i.e. the pooled components of the pensions and the fully unfunded pensions.

Table 4.2. *Average components of the TyEL contribution in 2007, per cent.*

Funded old-age pension component	3.0
Funded disability pension component	2.0
Funded unemployment pension component	0.0
Pooled component	16.1
Other expenses	0.9
Bonuses	-0.4
Temporary contribution rebates *)	-0.5
Total contribution	21.1

*) The temporary contribution rebates include the reduction in the disability pension component, 0.4 percentage points, which reduces the surplus accumulated in previous years from the disability pension contributions. In addition the employers' share of the contribution has been reduced by 0.1 percentage points of payroll. The reduction is due to the sale of the shares owned by the Finnish Centre for Pensions in the company Garantia and the repayment of the money from this sale to the employers.

The funded component of the individual pension is the responsibility of each pension provider insofar as the pension provider has collected contributions in advance for this pension. The pension liability of the individual pension is the money amount which on average suffices to finance the funded component of the pension in question from the starting point of the future pension or, as regards a pension already in payment, from the calculation point of the pension liability to the end of pension payment. The pension provider calculates actuarially the commitment related to the pension liability, i.e. the amount of technical provisions, for each insured person, whose future pension it has funded in advance. When calculating technical provisions a discount rate of three per cent is taken into account, which is the technical interest rate used when calculating the capital value of the pension.

The pension provider invests the funded pension components independently, productively and safely. A certain minimum rate of return is expected on them. In previous years the minimum return requirement on the pension providers' investments consisted of the sum of the discount rate and the supplementary factor. A rate of return corresponding to the discount rate (3 per cent) was used to annually adjust the amount of old-age, disability and unemployment pension liabilities. The amount of old-age pension liability was increased with a return on old-age, disability and unemployment pension funds corresponding to the supplementary factor.

From 2007 the pension providers' so-called minimum return requirement is replaced by the fund transfer obligation. The fund transfer obligation consists of three components: discount rate, supplementary factor and equity linked provision. The supplementary factor is determined on the basis of the pension providers' solvency. After the transition period the factor is 18 per cent of average solvency of the pension provision under TyEL and MEL weighted by pension liabilities and calculated under certain restrictions. The rate of return on old-age, disability and unemployment pension funds which corresponds to the supplementary factor is also in future used to annually increase the pension providers' old-age pension liabilities. The aim is that the funded old-age pensions better follow the development in prices and wages.

One component in the new fund transfer obligation is also the transfer obligation to the buffer fund called collective equity linked buffer fund. This transfer obligation is proportional to the technical provisions and corresponds to one-tenth of the equity linked factor. The equity linked factor is determined on the basis of the weighted average return on the pension providers' investments in listed shares. The pension providers adjust the equity linked buffer fund annually so that the buffer fund in proportion to the pension provider's technical provisions is of the same size for all pension providers. The minimum for the equity linked buffer fund is -10 per cent and the maximum +5 per cent of technical provisions. If the buffer fund falls below the limit of -10 per cent, the pension providers have to increase the fund from the solvency margin, and if the buffer fund exceeds the limit of 5 per cent, the excess amount is transferred to old-age pension liabilities. Through the collective equity linked buffer fund earnings-related pension investments aim at higher rates of return than at present by increasing investment risk in a controlled way.

4.2.1 Financing old-age pensions

Depending on the employee's age an old-age pension accrues at the annual rate of 1.5 per cent, after reaching the age of 53 at the rate of 1.9 per cent and after reaching the age of 63 at the rate of 4.5 per cent of earnings. An old-age pension also accrues for the time on a disability, an unemployment or a part-time pension. The pensionable earnings are adjusted in line with the wage coefficient to the level of the year of the start of the pension.

During their active years the future old-age pensions of employees aged 18–54 are funded per individual, i.e. the funding period covers about four-fifths of a full work history. The funded old-age pension accrues at the rate of 0.5 per cent of the insured person's earnings for the year in question without index adjustments. Due to inflation and real-term increase in earnings level the proportion of the funded pension of the total pension has remained pretty low. In 2005 only approximately 13 per cent of the old-age pensions paid had been funded in advance.

In order to maintain the real-term values of funded pensions and correspondingly to reduce the pressure to increase the pooled component of the contribution, the financing of old-age pensions has been strengthened since 2000 by transferring annually to the old-age pension liability the return on old-age, disability and unemployment pension funds which exceeds 3 per cent. As of 2007 old-age pension funds are annually enhanced correspondingly by an amount determined by the supplementary factor under TyEL, but on the basis of the return on shares only when the equity linked buffer fund exceeds the upper limit laid down in the act.

In order to alleviate the pressure to increase the pension contribution caused by the post-war baby-boomers, old-age pension funding has been increased since 2003 with a view to additional funding by 2013 which corresponds to 7.5 per cent of wages. Since 2005 old-age pension funding has been further increased by an amount which corresponds to contributions received as an increase to the employee contribution for insured persons who have reached the age of 53.

The old-age pension component included in the pension contribution is determined so that the accumulated assets on average are enough to pay the funded components accrued in the year in question (0.5 per cent of earnings) from the age of 65 to the person's death. When determining the contribution, factors that are taken into account are mortality and the discount rate of 3 per cent. Mortality varies according to gender, age and year of birth.

At the individual level the old-age pension contribution is estimated so that the assets received as contributions in a certain year, the discount rate on them and the so-called inheritance gain (the dissolved old-age pension liability of deceased persons) together suffice to finance the funded component of the employee's old-age pension accrued in the relevant year. In 2007 the funded share for a 18-year-old woman is 2.18 per cent of earnings and for a 54-year-old woman 5.95 per cent. For men of the same ages 1.77 per cent and 4.77 per cent of earnings are funded, respectively.

The average old-age pension contribution to be funded is 3 per cent of wages and it is estimated to stay at the same level also in future. On the other hand, the cost for the old-age pension component financed according to the PAYG principle in 2007 is an estimated good 10 per cent of wages and the cost for this component is estimated to increase strongly in future. In 2025 it is estimated to be 19 per cent of wages.

The pensions are funded with the pension provider with which the employee's activities covered by TyEL are insured. However, the pension provider which insured the last employment contract pays the old-age pension to the pension recipient in full, also insofar as the pension has been funded with other pension providers. The resulting differences to the pension provider's real cost liability are adjusted through the pooling mechanism by applying a collective procedure developed for this purpose.

4.2.2 Financing disability pensions

In principle disability pensions are not funded until the pension starts. However, due to the change in legislation, future disability pensions have since 2005 been prepared for by arranging so that at the end of the financial year an amount has been funded in advance which on average suffices to fund the new disability pensions which are estimated to start within the following 18 months. Through advance funding a situation is avoided where the employer would incur expenses for disability pensions which do not start until about two years after the employment contract has ended.

The disability pension is funded, if the employee's earnings under the pension acts for employees for the two years preceding the onset of disability, i.e. the pension contingency, exceeds the limit of 13,823.37 euros (in 2007). Otherwise, the pension is financed according to the PAYG principle. The pension is funded to its initial amount. Future index increases are financed according to the PAYG principle.

The responsibility for the funded initial amount of the pension is divided between the pension providers which have insured the employee's earnings during the two calendar years preceding the pension contingency. The funded component which is the responsibility of each pension provider is the part of the pension accrued under the pension acts for employees when the pension starts. This part is divided in proportion of earnings insured with the relevant pension provider of all the employee's earnings during the two years. However, there is no funded component which is the pension provider's responsibility, if the earnings insured under TyEL as regards an occasional employer or as regards the same insurance policy for other employers are less than 2,303.90 euros (in 2007). Each pension provider responsible for the funded component funds, when the pension starts, the part of the funded component of the pension which it is responsible for.

The level of the disability pension component of the pension contribution for pension insurance companies is determined so that through the accumulated assets it is estimated that it is possible to finance approximately half of the new disability pensions during the following two years, when taking into account the discount rate of 3 per cent, mortality, healing rate and the age of termination of the disability pension at 63 years. In 2007 the average disability pension contribution is 2 per cent of wages. In total the disability pension cost in 2007 is an estimated 3.4 per cent of wages in 2007.

The pension contribution of the employer who has taken out insurance with a pension insurance company depends on the size of the employer. The occasional employer's pension contribution is a fixed percentage of the earnings of the insured persons. If the employer has concluded an insurance contract with the pension provider and the amount of insured earnings per year is less than 1.542 million euros, the employer pays a basic contribution for the insured, which is independent of the person's age. The contribution components included in the total contribution are dependent on the person's age also in this case.

If the amount of insured earnings exceeds 1.542 million euros, the employer's disability pension contribution is determined partly according to the basic contribution and partly according to the category contribution. As the amount of earnings increases the share of this category contribution in the disability pension contribution increases linearly and when the earnings exceed 24.672 million euros the employer's disability pension contribution is determined fully according to the category contribution.

In order to determine the category contribution the employers are divided into contribution categories on the basis of their own disability pension cases. There are a total of 11 contribution categories determined for different disability risks, and in each category the level of the disability pension contribution is different. The basis for determining the contribution category is the risk ratio calculated for the employer, which means the ratio of the expenditure for new awarded disability pensions to the average disability pension expenditure according to the average risk level under TyEL, taking into account the age distribution of the employer's insured employees. The employer's risk ratio is calculated on the basis of the disability pension cases for two consecutive years.

Table 4.3. *Risk ratio limits and contribution category coefficients in 2007.*

Contribution category	Risk ratio limits of the contribution category	Contribution category coefficient	Average contribution in the contribution category, % of wages
11	at least 5	5.50	11.0
10	4.00–4.99	4.50	9.0
9	3.00–3.99	3.50	7.0
8	2.50–2.99	2.75	5.5
7	2.00–2.49	2.25	4.5
6	1.50–1.99	1.75	3.5
5	1.20–1.49	1.35	2.7
4	0.80–1.19	1.00	2.0
3	0.50–0.79	0.65	1.3
2	0.20–0.49	0.35	0.7
1	under 0.2	0.10	0.2

The category contribution is calculated by multiplying the basic contribution by the contribution category factor from the table above. The risk ratio limits and contribution category factors are confirmed annually by the Ministry of Social Affairs and Health on application of the pension insurance companies.

Contribution category 4 means an employer whose employees have an average disability risk. In the lower categories the disability risk is lower, and likewise the contribution is lower than the basic contribution. Correspondingly, in categories 5–11 the disability risk is higher than average and the contribution is also then higher than the basic contribution.

4.2.3 Financing unemployment pensions

Unemployment pensions are funded when the pension starts. The level of the unemployment pension component in the contribution is determined so that the accumulated assets on average suffice to finance the future unemployment pensions of those who become unemployed in the relevant year until retirement age.

Nowadays unemployment pensions may only be granted to persons born in 1949 and earlier. Both for this reason and due to the amount already accumulated in the equalisation reserves as buffer for the funded components of the unemployment pensions the unemployment pension component of the contribution has since 2006 been confirmed to the amount of zero. The cost for jointly financed unemployment pensions is in 2007 an estimated 0.7 per cent of wages.

The unemployment pension is funded when the unemployment pension includes a pension component for projected pensionable service[1] and the person has earnings under TyEL of less than 22,000 euros (in 2007). The right to a pension component for projected pensionable service is checked 31 December 2006. Otherwise, the pension is financed according to the PAYG principle. The pension is funded to its initial amount until the age of 63. Future index increases are financed according to the PAYG principle.

The pension provider which has insured the employment contract to which the pension component for projected pensionable service is connected handles the funding of the unemployment pension also as regards all previous private-sector employment contracts and is solely responsible for the whole funded pension.

When the insured earnings exceed 1.542 million euros, the employer's unemployment pension contribution is determined partly according to the basic contribution and partly based on a deductible. As the amount of earnings increases the employer's deductible share in the unemployment pension contribution increases linearly, and when the earnings exceed 24.672 million euros the employer himself finances the unemployment pensions in full. In certain situations, for instance if an ageing person's pension component for projected pensionable service is connected to an employment contract of less than three years, the costs for the pension are divided between the employers who have taken out insurance with the pension insurance company and whose insured earnings exceed 1.542 million euros.

[1] Before the 2005 pension reform the projected pensionable service, i.e. the time from pension contingency to retirement age (usually 65 years), entitled to a pension, if the employment contract had ended less than 360 days previously, not including days with certain benefits. For unemployment pensions the pension component for projected pensionable service is still determined in the manner valid before the pension reform and also the financing is linked to this formerly valid requirement checked separately for each employment contract as regards the projected pensionable service.

4.2.4 Pooling mechanism

The assets to finance each year's pension expenditure according to the PAYG principle are accumulated through the pooled component of the pension contribution. The deficit or surplus of the pooled component is transferred to the clearing reserve, the buffer fund for the pension expenditure according to the PAYG principle, the aim of which is to secure the pension providers' liquidity in case of changes in business cycles and other fluctuations which affect the clearing reserve. According to the decision of the Ministry of Social Affairs and Health, the minimum amount of the clearing reserve is 30 per cent of the following year's pension expenditure according to the PAYG principle.

As the level of the pooled component is determined annually, both the pension expenditure according to the PAYG principle and the assets needed for additional funding of old-age pensions, which are accumulated through the pooled component, are taken into account. Likewise the so-called EMU buffer component included in the clearing reserve is taken into account, and this component is used to lessen the pressure to increase contributions due to slumps in the business cycle. In normal circumstances the target level of the EMU buffer is approximately 2.5 per cent of wages.

The pooled component of the contribution is determined on the basis of the employee's age and gender, and in pension insurance companies also on the basis of the size of the employer. Through the component the gender-dependency of the old-age pension component of the pension contribution is evened out and the total contribution is made independent of age. The pooled component of the contribution is calculated for all employers as the difference between the basic contribution and the other contribution components (determined according to the basic contribution).

The costs for the pooled components of paid old-age pensions are divided between the pension providers in proportion to the pension provider's sum of pooled component income and clearing reserves in relation to the total sum of all pension providers' pooled component income and clearing reserves. The costs for the pooled components of other paid pensions are divided in proportion to the pension providers' insured earnings.

The Finnish Centre for Pensions settles annually each pension provider's share of the paid pension expenditure according to the PAYG principle and coordinates the related payments traffic.

4.2.5 Administrative costs

The contributions accumulated for the pension insurance companies' administrative costs and premium losses are determined on the basis of the wage bill of the employer or, alternatively, of the company group. They decrease when the wage bill increases, because the administrative costs and the risk of premium losses for large companies and company groups are on average smaller than for smaller companies. However, a lower limit of 654 euros (in 2007) for each insurance policy has been set for the administrative cost component, but at the most an amount corresponding to the pension contribution. Additional costs for the pension provider due to the lower limit are financed jointly. As regards occasional employers the administrative costs are always 40 euros (in 2007) for each earnings notification, but at the most an amount corresponding to the pension contribution.

The administrative cost component is used to cover the pension insurance company's total operating expenses, with the exception of the administrative costs for investment operations and administrative costs for operations to maintain the work ability of the insured and expenses due to disability pension decisions. The costs of investment operations are covered from the returns on investment operations.

4.2.6 Preparing for investment and insurance risks

The equalisation reserve is a preparation for losses in the insurance business, as regards pension insurance companies for years when more pensions than on average are granted. For the companies for equalisation reserves accumulate from the insurance business profits. The equalisation reserve has an upper limit. The reserve is kept below this limit primarily by lowering the contribution so that when determining the size of the contribution components the level of total equalisation reserves of all pension insurance companies is taken into account.

Preparation for fluctuations in the values of the pension insurance company's investments is done through the solvency margin. The pension insurance company's net wealth is calculated by deducting the debts from the company's assets valued to their current values. The solvency margin includes shareholders' equity, provisions, valuation differences and unallocated insurance reserve. The unallocated insurance reserve was set up in the 1997 investment reform to strengthen solvency in view of investment losses.

The changes to the investment rules for private-sector pensions which took effect at the beginning of 2007 raise the return target for the pension providers, but also the risk-bearing ability (further information in chapter 5). The pension providers may increase the amount of investments in shares. The buffer fund at the level of the pension scheme levels out the investment risk due to fluctuations in share values. The equity linked buffer fund acts as a common buffer for the investments in shares, and the buffer is used to annually adjust part of the returns on investment operations between the pension providers. The adjustment is done from the clearing reserves of each pension provider.

4.2.7 Use of surplus and bonuses

When earnings-related pension insurance has been taken out with a pension insurance company, the employer is entitled to a share of the possible surplus generated by the insurance business. The bonuses paid by the pension insurance company vary from company to company and from insurance contract to insurance contract.

The pension insurance company's annual surplus is determined when drawing up the annual accounts. In the TyEL insurance business a surplus may be generated when the returns on investments are higher than the fund transfer obligation. This return is transferred to strengthen the solvency margin and can from the solvency margin be further distributed to the policyholders. When the solvency margin exceeds the solvency border, the maximum amount for the bonus transfer based on investment returns is 1.1 per cent of the solvency margin. A surplus may also be generated if there are savings on the administrative cost component of the pension contribution. Of the surplus on administrative costs, about half may be distributed as client bonuses.

A surplus is also generated when the pensions which are the responsibility of the pension provider do not cause as large outlays as estimated when determining the calculation bases. Here outlays also include provisions for realised pension cases as well as transfer to the equalisation reserve for years of high claims frequency. An upper limit has been set for the equalisation reserve, and the excess is included in the annual surplus.

Reijo Vanne and Ismo Risku

5 Investment Operations of the Earnings-related Pension Scheme

The objective of pension funding and investment operations is to keep pension contributions more stable over time than pension expenditure. As the population ages earnings-related pension expenditures increase considerably, but the effect of ageing on the contribution level can be significantly reduced through funds. Currently the premium income exceeds the expenditure, but in a couple of years the situation will be reversed.

At the end of 1997 the private and public-sector earnings-related pension assets totalled approximately 41 billion euros, of which the share of the private sector was 75 per cent. In the private sector pensions have been funded already since the initial stages of the scheme, whereas in the public sector pensions have been funded only for just under two decades. The funding follows different principles in the private and in the public sector, and the investment rules are also different.

Since 1998 comparable data on returns are available for all earnings-related pension assets. In 1998–2006 the average annual rate of return on the assets has been 7.5 per cent. The real rate of return, i.e. adjusted for inflation, has been on average 5.8 per cent annually.

At the end of 2006 the investments of the whole earnings-related pension scheme amounted to approximately 114 billion euros. Of this amount, 70 per cent were private-sector investments. The largest proportion (43 per cent) was invested in shares and almost as much (41 per cent) in bonds. The proportion invested in real estate was 9 per cent. At the end of 2006 investments in shares was for the first time the most important investment object for Finnish earnings-related pension assets. In the mid-1990s premium lending under the Employees' Pensions Act (TEL) and other interest-bearing investments still made up the largest part of the investments of the authorised pension providers (see investment statistics appendix at the end of this chapter for details).

Of the investments 30 per cent were in Finland, 40 per cent in the rest of the eurozone and 30 per cent outside the eurozone. The share of Finland in the investments has decreased and the share especially of the countries outside the eurozone has increased. There is reason to assume that the geographical diversification of the assets reduces the risk level without, however, reducing the expected returns.

In the following we describe the realised investment operations of the pension providers from the final years of the previous decade to 2006 as well as the boundary conditions for investment operations during this period. In addition, the private-sector investment reform, which took effect from the beginning of 2007, is also described. Private-sector and public-sector pension investment are presented separately, because the rules governing pension investment differ significantly between the sectors.

5.1 Private sector

5.1.1 Boundary conditions of investments operations in 1997–2006

The implementation of private-sector earnings-related pension provision has been decentralised to pension insurance companies (7 companies), company pension funds (30 funds) and industry-wide pension funds (8 funds). In addition the Farmers' Social Insurance Institution handles pension insurance for farmers and the Seamen's Pension Fund handles pension insurance under the Seamen's Pensions Act (MEL) (further information in chapter 3).

The earnings-related pension scheme is a defined benefit scheme and partially funded. At the end of 2005 the private-sector pension assets amounted to 73.5 billion euros, which is slightly less than one-third of the present value of the pension entitlements. About 89 per cent of the assets were in pension insurance companies, 10 per cent in pension funds and 1 per cent in the Seamen's Pension Fund and the Farmers' Social Insurance Institution.

The size of the pension providers varies considerably. At the end of 2005 the value of the investments of the largest pension insurance company was 24.7 billion euros and that of the smallest 0.16 billion euros. The two largest pension insurance companies governed over two-thirds of the investments of all pension insurance companies. At the end of 2005 the value of the investments of the industry-wide pension funds varied between 32 million euros and 845 million euros and that of the company pension funds between 3 million euros and 1 billion euros.[1]

[1] Further information at http://www.vakuutusvalvonta.fi.

In pension insurance under the Employees Pensions Act (TyEL) the employer chooses the pension provider. However, the pension benefits do not depend on the pension provider. The pension providers may give bonuses or rebates on the pension contributions to the employers as permitted by its solvency. The level of the bonuses has varied considerably both between pension providers and over time. In 2005 the level of bonuses varied for the pension insurance companies between 0.3 and 0.9 per cent of the wage bill under the Employees' Pensions Act (TEL), being on average 0.6 per cent of the wage bill. In 2002, after the general slump in share prices, the average level of bonuses was 0.2 per cent of the wage bill under TEL.

The investment operations of the private-sector pension providers and the rules governing this have changed as the economic environment has changed. The boundary conditions for the investment operations which were valid to the end of 2006 mainly took effect in 1997. The main point of the reform was to make it possible for the private-sector pension providers to have a more diverse and riskier investment allocation by increasing the amounts of the solvency margins. This chapter describes the regulation of investment operations which was valid after the 1997 reform and section 5.1.3 describes the changes which took effect from the beginning of 2007.

Part of the future pensions under the private-sector pension acts for employees (TyEL and MEL) have been funded in advance and the rest of these pensions are financed through future pension contributions according to the pay-as-you-go principle (further information in chapter 4). In practice the partial funding has been carried out so that each individual pension is divided into a funded and an unfunded component. The funded components of the pensions are the responsibility of the pension providers. This liability generates technical provisions for the pension providers, the size of which is determined actuarially. On the basis of joint and several liability in case of bankruptcy the insured of an individual pension provider do not lose their pension benefits if the pension provider goes bankrupt.

The funding is carried out separately for each type of pension. The main part of the funding is for old-age pensions, but unemployment and disability pensions are also funded. On the other hand, survivors' pensions and part-time pensions are fully unfunded, and not even future index increases are funded. It lies in the nature of the funding technique that new liabilities occur continuously as pension rights accrue and old technical provisions are dissolved as pensions are paid out.

The pension providers cover the technical provisions through their investments. The proportion of the investments which exceeds the technical provisions is the pension provider's solvency margin. Through the solvency margin the pension providers prepare for the risks of the investment operations. The possibilities of an individual pension provider of giving client bonuses depend on the amount of solvency margin of the relevant pension provider. At the level of the pension scheme the increases to the funded pensions depend likewise on the average solvency of the scheme, i.e. the ratio of solvency margin to technical provisions as described in the following.

One crucial assumption when calculating technical provisions is the nominal discount rate of 3 per cent. This interest rate has been set pretty low, and thus in the investment operations it will be achieved in most years. However, one consequence of the low discount rate is that in most years the investment operations generate large surpluses unless additional measures are taken. The additional measure to solve the problem of fluctuating investment returns is the annual increases to the funded old-age pensions. The so-called adjustment factor depends on the average solvency of the authorised pension providers linearilly. When the average solvency remains at its ”typical level” of 20–30 per cent the adjustment factor varies between 1.6 and 3.6 per cent of technical provisions. In addition, regardless of the solvency of the pension providers the technical provisions increase annually by the three-per-cent discount rate.

The risk level of the investments is taken into account when calculating the solvency border of each pension provider. The investments are divided into seven groups on the basis of investment type (debt certificate, bond, share etc.), currency (euros vs others) and geographical area (OECD and EEA vs other countries.). For each investment group, indicators describing expected return, return dispersion as well as correlations have been defined.[2]

From the solvency border three operating zones are derived: *target zone, zone of restricted return distribution* and *crisis zone* (table 5.1). In the target

[2] Decrees on the calculation of the solvency border for pension insurance companies, for company pension funds involved in operations under the Employees' Pensions Act and for industry-wide pension funds involved in operations under the Employees' Pensions Act 23.12.1999/1281.

zone the amount of solvency margin is 2–4 times the solvency border. In this zone there are the least restrictions on the operations of the pension provider. If the solvency margin amounts to less than twice the solvency border but exceeds the solvency border, the provider is in the zone of restricted return distribution. The pension provider falls into the crisis zone when the solvency margin falls below the solvency border. Within the crisis zone there are also several alarm limits, which require measures from both the pension provider and the Insurance Supervisory Authority.

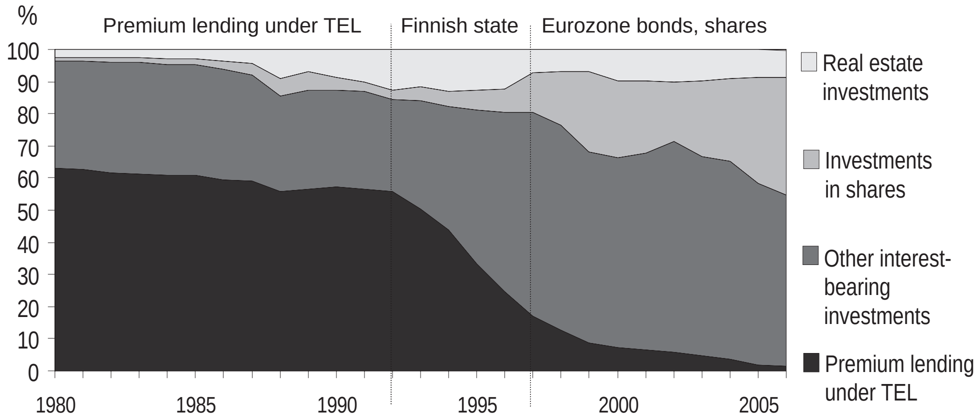
Table 5.1. *The pension insurance company's operating zones.*

Bonuses to be increased or investment allocation to be changed so that a return to a level below the upper limit of the solvency margin (SM) is achieved
2–4 × SM (4 × SM = maximum amount of the solvency margin) Target zone, bonuses according to calculation bases
1–2 × SM Restriction zone, distribution of client bonuses restricted
0–1 × SM Crisis zone, no client bonuses. The zone includes several alarm limits, which require measures by the company and the Insurance Supervisory Authority

5.1.2 Investment allocation, realised returns and solvency ratios

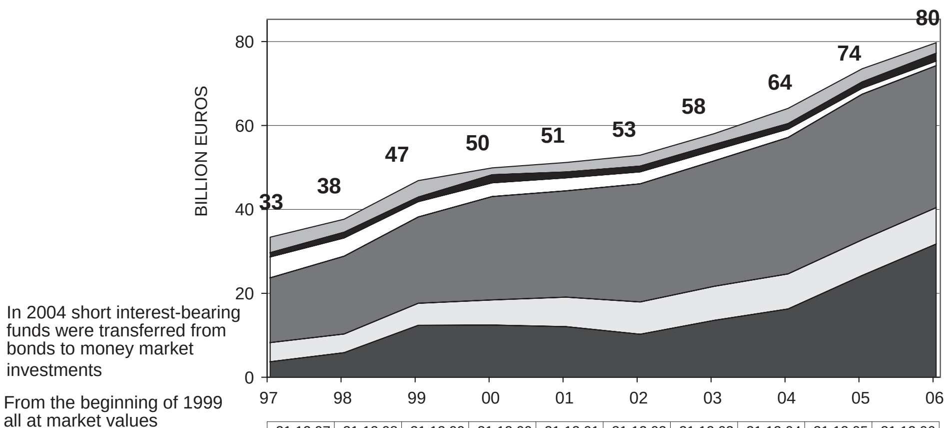
Until the investment reform in 1997 the investment operations of the pension providers focused on low-risk loans. Premium lending directed at the employers and investment loans were the most important investment objects up to the initial years of the 1990s. The deregulation of the financial market from the 1980s and the recession in the 1990s significantly reduced the demand for premium lending under the Employees' Pensions Act (TEL). At the same time the Finnish state rapidly acquired debts, and by 1997 Finnish government bonds had become the most important investment object for private-sector earnings-related pension assets (figure 5.1). Figure 5.2 shows in more detail the amounts and the allocation of earnings-related pension assets after 1997.

Figure 5.1. *Allocation of the pension insurance companies' investments in 1980–2006.*



Source: The Finnish Pension Alliance TELA.

Figure 5.2. *Investment portfolio of earnings-related pension assets in the private sector 1997–2006.*



	31.12.97	31.12.98	31.12.99	31.12.00	31.12.01	31.12.02	31.12.03	31.12.04	31.12.05	31.12.06
MONEY MARKET INVESTMENT	3.7	3.1	3.9	1.6	2.3	2.6	2.6	3.6	3.1	2.5
INVESTMENT LOANS	1.0	1.4	1.1	1.9	1.4	1.4	1.4	1.3	1.5	1.9
PREMIUM LOANS	5.0	4.4	3.7	3.3	3.1	2.8	2.5	2.0	1.5	1.1
BONDS	15.4	18.5	20.5	24.6	25.3	28.1	29.9	32.5	34.7	33.9
REAL ESTATE AND REAL ESTATE SHARES	4.6	4.5	5.3	6.0	7.0	7.7	8.1	8.3	8.5	8.7
SHARES AND EQUITY FUNDS	3.7	5.9	12.4	12.4	12.1	10.2	13.6	16.3	24.3	31.7
	33.4	37.7	46.9	49.9	51.2	52.9	58.1	64.1	73.5	79.7

Source: The Finnish Pension Alliance TELA.

The market value of the invested capital has more than doubled between 1997 and 2006. The growth is due to the returns on the investments and the fact that the funded contribution components have so far exceeded the funded components of pensions paid. Mostly the growth in assets stems from investment yields. The increasing effect on expected returns and risk-taking following the investment reform in 1997 shows above all as an increase in the proportion of investments in shares. At the end of 1997 the proportion of investment in shares in the private sector was 11.0 per cent and at the end of 2006 as high as 39.8 per cent of all investments.

The category Investment in shares includes listed shares as well as unlisted shares, participations in equity funds, capital investments and shares in hedge funds.

At the end of 2006 the proportion of listed shares was approximately 32 per cent of all investments. The proportion is seven percentage points higher than the expected average calculated over the business cycles according to the rules in effect before the 2007 investment reform. The excess weighting in relation to the average is probably due to the favourable business cycle, i.e. the increase in share prices, which has continued for a long time, as well as possibly the fact that earnings-related pension investors have anticipated the investment environment after the 2007 investment reform.

Table 5.2 shows the allocation of investments according to type of investment and area at the end of 2006.

Table 5.2. *Allocation of private-sector earnings-related pension investments by investment type and target area 31 December 2006, per cent of the value of all investments.*

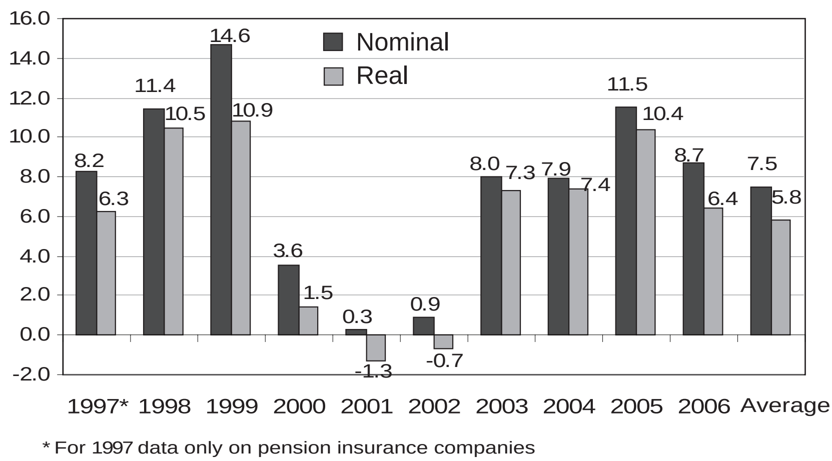
Type of investment and target area	Proportion of all investments, %
Shares, total	39.8
- Finland	12.6
- Rest of eurozone	6.9
- Other countries	20.3
Real estate, total	10.9
- Finland	10.2
- Rest of eurozone	0.4
- Other countries	0.2
Bonds	42.5
- Finland	4.0
- Rest of eurozone	29.9
- Other countries	8.6
Other interest-bearing instruments	6.8
- Finland	5.8
- Rest of eurozone	0.6
- Other countries	0.4
All investments	100.0
- Finland	32.6
- Rest of eurozone	37.8
- Other countries	29.6

Of the investments slightly less than 33 per cent were in Finnish objects, slightly less than 38 in objects in other countries in the eurozone and just under 30 per cent elsewhere. A considerable proportion of investments outside Finland were in shares and bonds. Most of the investments in bonds were issued by bodies governed by public law.

Comparable statistical data on the allocation of investments according to area are available as of 2000. The statistical data are presented in tables 5.5 and 5.6 in the investment statistics appendix. The proportions of investments in shares and of foreign investments have increased, which is probably a consequence, for risk management and risk diversification reasons, of the reform in 1997 which made possible the taking of additional risks. As for investments in shares, especially the proportion of the countries outside the eurozone has increased. Correspondingly the proportion of the countries of the eurozone has increased in bond investments. The introduction of the euro has been the main factor behind the popularity of bonds of these countries. Bond investments in Finland have decreased also in absolute terms and their share is now only minor. This development is due, for instance, to the reduced Finnish national debt.

The return record of private-sector earnings-related pension investments during the period of validity of the 1997 investment rules is shown in figure 5.3. Return means the change in value of the earnings-related pension investments and cash returns. The period is divided into three three-year periods according to the development in the share market. The years of 1997–1999 and 2003–2006 were years of strong increase in share prices and the years 2000–2002 were years of strong decrease in share prices. The figure shows both nominal returns ands real returns. The real return is calculated by deflating the nominal return by the change in consumer prices for the relevant year. The average return of 7.5 per cent has been calculated by weighting the observed return for each year with the average bound capital during the year (money-weighted average, MWR). The average real rate of return was 5.8 per cent a year[3].

Figure 5.3. *Return on private-sector earnings-related pension assets in 1997–2006.*



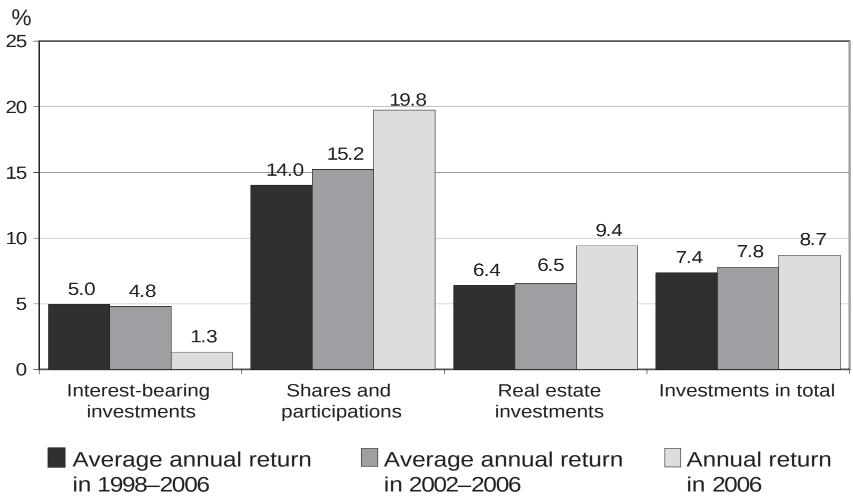
Source: The Finnish Pension Alliance TELA.

[3] The geometrical average (time-weighted average, TWR) of the return series is 5.7 and the arithmetic mean 5.8 per cent annually.

The realised real rate of return of almost 6 per cent clearly exceeds the annual real rate of return of 3.5 per cent assumed in the earnings-related pension contribution calculations. Even though the return has been achieved through fairly low-risk investments, there is reason to use a lower return assumption in the contribution calculations. The high realised returns are partly a consequence of the exceptionally good returns on Finnish shares in the period observed and of the increase in the value of bonds, which is a result of decreasing interest rates. The prevalence of either phenomenon cannot be relied on for the future.

The realised rates of return for different types of investments between the beginning of 1998 and the end of 2006 are presented in figure 5.4, where the figures are calculated on the investments of the pension insurance companies.

Figure 5.4. *Current value investment return in 2006 as well as in 1998–2005 and in 2002–2006 on average. Pension insurance companies (Pension Fennia, Tapiola Pension, Veritas Pension Insurance Company, Etera, Ilmarinen, Pensions Alandia, Varma).*

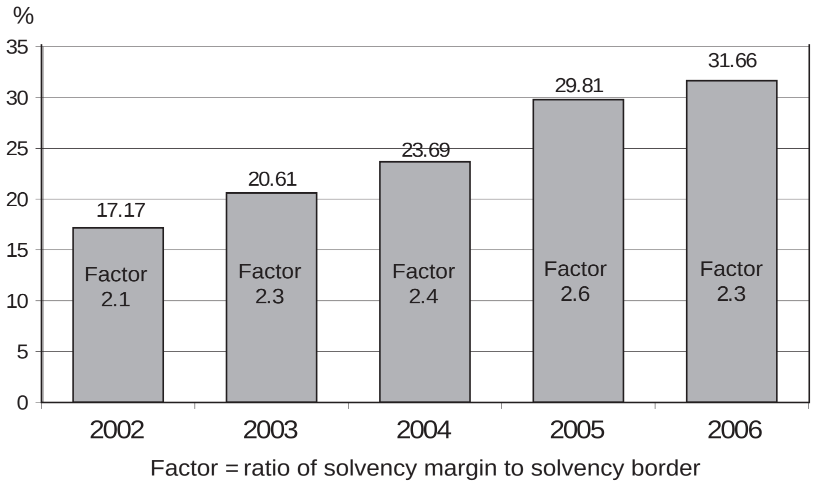


Source: The Finnish Pension Alliance TELA.

The average rate of return for shares has been 14.0 per cent and for interest-bearing instruments 5.0 per cent a year in 1998–2006. The share premium in this period has been high, clearly exceeding 6 per cent a year.

Figure 5.5 shows the development in average solvency of the private-sector earnings-related pension insurers weighted by technical provisions between the end of 2002 and the end of 2006.

Figure 5.5. *Solvency margin of the pension insurance companies and the pension funds as a percentage of technical provisions (solvency ratio) in 2002–2006.*



Source: The Finnish Pension Alliance TELA.

By the end of 2002 the decrease in share prices had continued for about three years already, but the average solvency was still within the target zone. This shows, for instance, in that the value of the factor in figure 5.5 was 2.1, i.e. the solvency margin more than exceeded twice the solvency border. The ratio of solvency margin to the technical provisions used in the solvency calculation was 17.2 per cent at the end of 2002.

At the end of 2006 the solvency margin was 31.7 per cent in relation to technical provisions, but the ratio to the solvency border had only increased to 2.3. A comparison of the 2006 figures with the 2002 figures thus shows that the solvency border had risen in relation to the technical provisions. The reason for the increase in solvency border is, according to that presented in section 5.1.1, the fact that the investment allocation has become riskier.

From the end of 2005 to the end of June 2006 the ratio of solvency margin to technical provisions decreased from 29.8 per cent to 27.4 per cent. The reason for this is that during this period the sum of the discount rate (three per cent a year) and the pension liability adjustment factor clearly exceeded the achieved investment yield. The technical provisions increased faster than the assets, and its faster growth rate reduced the solvency margin.

There is of course dispersion between the pension providers as regards the ratio of solvency margin to technical provisions. Both at the end of 2002 and 2006 the lowest ratio in the group of pension insurance companies was 1.7, whereas the averages ratios for the companies weighted by the technical provisions were 2.0 and 2.3.

The dispersion among the smaller pension providers is larger still. The average ratio of solvency margin to technical provisions weighted by the technical provisions was 3.2 at the end of 2006 for the group of company pension funds. The lowest ratio in this group was at the same time 1.8. Still, even the lowest relative solvency margins clearly exceed the solvency requirement.

5.1.3 Investment and financing reform in 2007

The investment operations and financing technique of the private-sector earnings-related pension scheme were reformed significantly through legislative changes at the beginning of 2007[4]. Background reports for the reform are the survey of the investment operations of the earnings-related pension scheme, published in spring 2006 and made on the initiative of the labour market organisations, and the proposals of Matti Louekoski's one-man-committee concerning the need to reform the legislation on pension insurance companies.

The main aim of the reform is to increase the risk-bearing ability of the pension providers so that they can increase the proportion of investments in shares in their investment allocation. This raises the expected return and risk level of pension assets. When realised, the improved investment returns reduce the need to increase the pension contribution in coming decades. In connection with the reform the rules on solvency and contribution margin are also updated. The increases of funded old-age pensions are exclusively directed to those having

[4] Government proposals on amendment of the pension insurance company act (76/2006), on amendment of the stipulations on the pension providers' solvency margin and technical provisions (77/2006), on amendment of the act on the Insurance Supervisory Authority (78/2006) as well as for acts on the calculation of the pension provider's solvency margin and coverage of technical provisions (79/2006).

reached the age of 55 with the aim of a stable development of the pension contribution.

As from the beginning of 2007 the obligation of each pension provider to cover its technical provisions is determined as the weighted average of the average solvency and realised returns on shares for all pension providers. After the five-year transition period the obligation to cover technical provisions is based to 90 per cent on the average solvency status of the pension providers and to 10 per cent on the realised returns on shares. As a result of the changes the solvency of the pension providers increases and the ability to bear share investment risks improves.

As a buffer against fluctuations in share returns a new collective equity linked buffer fund has been set up, which can be positive or negative. At the most the equity linked buffer fund is 5 per cent of technical provisions and at the least -10 per cent of technical provisions. On the basis of the realised share returns of the pension providers this new component of the technical provisions is either increased or reduced. The assets exceeding the upper limit (5 per cent) are transferred to the old-age pension liability at the individual level by increasing the size of the funded pension components. Falling below the lower limit (-10 per cent) is hindered by dissolving the pension providers' solvency margin.

The new act on the calculation of the solvency border and the covering of technical provisions for the pension providers concerns all private-sector pension providers handling statutory pension provision. The act includes a general rule on diversification of investments, according to which the diversification has to take into account the security, rate of return, convertibility into money and diverseness of the investments. The rules on calculating of the solvency border and covering of technical provisions direct the diversification of investments in more detail.

The solvency border depends on the pension provider's investment allocation and is dimensioned so that the probability of the pension provider going bankrupt within a year is low. Regardless of the pension provider's investment allocation the minimum level of the solvency border is, however, 5 per cent of technical provisions.

For calculation of the solvency the investments are divided into the following five categories: (1) money market instruments, (2) bonds and debt certificates, (3) real estate, (4) shares and (5) other investments. In each category the investments are further divided into subcategories, where for instance the currency and the location of the investment are of importance.

The level of the solvency border is affected by each investment category's expected return, dispersion and return correlations. These parametres describing the return on and risk of the investment portfolio are figures laid down in the act. In addition the solvency border depends on the level of the pension provider's pension liability adjustment factor, which depends on the pension provider's solvency and thus changes over time. The part of the technical provisions linked to share returns is taken into account in the calculation of the solvency border so that as regards the part linked to shares the solvency border is not affected by the dispersion of share returns but by the estimated deviation of share returns between the pension providers.

In future in principle all the pension provider's investments can be used to cover technical provisions. Investments covering technical provisions are covered by the general rule on diversification, in addition the inclusion of certain separately listed investment objects in the contribution margin is restricted. These restrictions regulate the regional allocation of investments, the size of individual risk concentrations and taking into account of counterparty risk.

Table 5.3. *The pension insurance company's operating zones.*

Bonuses to be increased or investment allocation to be changed so that a return to a level below the upper limit of the solvency margin (SM) is achieved
1–4 × SM (4 × SM = maximum amount of the solvency margin) Bonuses according to calculation bases ,normal zone of operations
1 × SM No bonuses
1/3–2/3 × SM (2/3 × SM = minimum amount of the solvency margin) Plan to improve financial position to the Insurance Supervisory Authority, plan also required if the proportion exceeding the solvency margin and the lower limit of the equalisation reserves combined falls below the solvency border.
0–1/3 × SM Short-term financing plan to the Insurance Supervisory Authority

Even though the rules on solvency margin are common for all pension providers, the zones derived from the solvency border which govern the operations differ somewhat according to type of pension provider.[5]

The solvency rules restrict the operations of the pension insurance company the least, if the amount of solvency margin exceeds the solvency border but is less than four times the solvency border. In this area the distribution of client bonuses is based on the calculation bases approved by the Ministry of Social Affairs and Health. Permanent exceeding of the maximum amount of the solvency margin is not permitted. If the solvency margin exceeds the maximum amount for a second year in a row, the company has to increase its bonus transfers by one-third of the sum exceeding the maximum amount. When below the solvency border the company cannot pay client bonuses. When the solvency margin is less than two-thirds of the solvency border the company has to file a plan to improve its financial position with the Insurance Supervisory Authority. If the amount of solvency margin falls below one-third of the solvency, the company has to file a short-term financing plan with the Insurance Supervisory Authority.

Table 5.4. *The pension funds' operating zones.*

Contributions to be reduced or investment allocation to be changed so that a return to a level below the upper limit of the solvency margin (SM) is achieved
3/2–4 × SM (4 × SM = maximum amount of the solvency margin) Solvency may be increased or dissolved through contributions
1/3–3/2 × SM Contributions may be reduced in a similar way as for companies
1/3–1 × SM Plan to improve the financial position to the Insurance Supervisory Authority, through increased contributions or other means strive to reach a level above the solvency border.
0–1/3 × SM (1/3 × SM = minimum amount of the solvency margin) Short-term financing plan to the Insurance Supervisory Authority

[5] The zones are defined in the Pension Insurance Company Act, the Company Pension Funds Act and the Insurance Funds Act.

The solvency rules restrict the operations of the pension funds the least when the amount of solvency margin is at least 1.5 times and at the most 4 times the solvency border. In this area pension funds may increase or dissolve solvency through contributions or solvency premiums. If the amount of solvency margin for a second year in a row exceeds the maximum amount, solvency has to be dissolved to decrease contributions so that the solvency margin does not exceed the upper limit. If the amount of solvency margin exceeds the solvency border but is at the most 1.5 times the solvency border, solvency may be dissolved to decrease contributions corresponding to the pension insurance companies' granting of client bonuses. If the amount of solvency margin falls below the solvency border, solvency must not be dissolved to decrease contributions. The pension fund has to file a plan for improving its financial position with the Insurance Supervisory Authority, and the plan should state how the amount of solvency margin will be raised back to a level exceeding the solvency border. If the solvency margin falls below the minimum amount, the pension fund has to file a short-term financing plan with the Insurance Supervisory Authority.

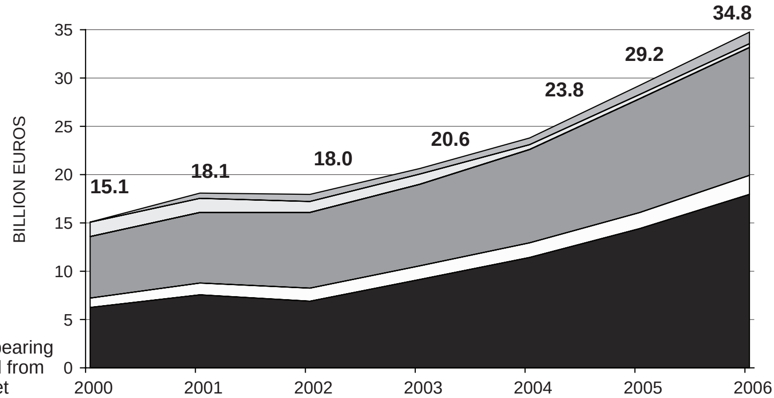
5.2 Public-sector earnings-related pension investments

The pension assets of the employees of bodies governed by public law are handled by five pension providers: the Local Government Pensions Institution, the State Pension Fund, the Central Church Fund, the pension fund for the employees of the Social Insurance Institution, and the pension provider of the Bank of Finland.

At the end of 2006 the Local Government Pensions Institution had 22.0 billion euros in investment assets and the State Pension Fund 10.3 billion. The Local Government Pensions Institution is the third-largest and the State Pension Fund the fourth-largest investor of earnings-related pension assets. In the local government pension scheme funding was started in 1988 and in the state employees' pension scheme in 1990. Up to the year 2000 the assets of the State Pension Fund were invested only in government bonds.

Figure 5.6 shows the development of earnings-related pension assets of the whole public sector from the end of 2000 to the end of 2006, when the total amount of assets was approximately 35 billion euros.

__Figure 5.6.__ Investments portfolio of public-sector pension providers in 2000–2006.



In 2004 short interes-bearing funds were transferred from bonds to money market investments

	31.12.00	31.12.01	31.12.02	31.12.03	31.12.04	31.12.05	31.12.06
MONEY MARKET INVESTMENTS	0.01	0.54	0.73	0.57	0.69	0.94	1.20
INVESTMENT LOANS	1.48	1.45	1.13	1.05	0.50	0.44	0.39
PREMIUM LENDING UNDER TEL	0.00	0.00	0.00	0.00	0.00	0.00	0.00
BONDS	6.36	7.30	7.84	8.44	9.66	11.77	13.23
REAL ESTATE AND REAL ESTATE SHARES	0.98	1.23	1.35	1.42	1.51	1.67	1.97
SHARES AND EQUITY FUNDS	6.25	7.56	6.90	9.15	11.43	14.41	17.96
	15.08	18.08	17.95	20.63	23.79	29.18	34.75

Source: The Finnish Pension Alliance TELA.

Of the public-sector earnings-related pension assets approximately 52 per cent are invested in shares. The proportion of foreign investments in all investments was about 80 per cent. The proportions of investments in shares and foreign investments were clearly higher than in the private sector.

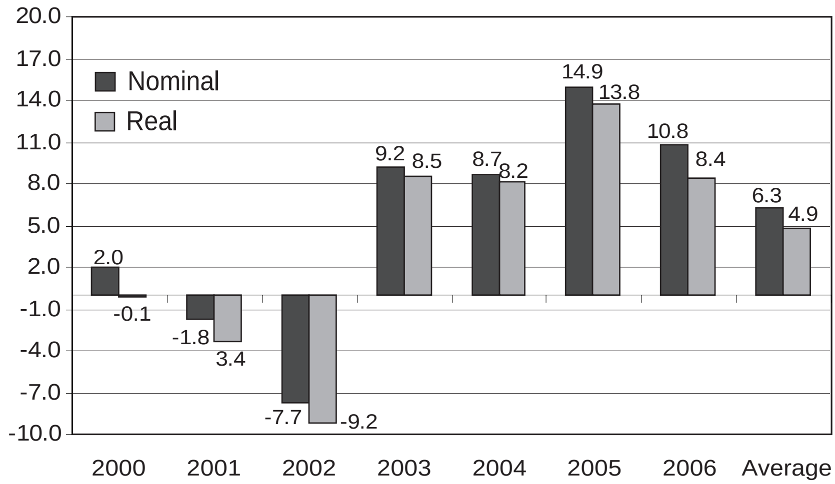
The higher proportion of investments in shares and foreign investments in the public sector is explained by the difference in funding mode. The public-sector pension providers function without competition in their own sector. To their character the assets are pure buffer funds in case of increase in the ratio of pension expenditure to the wage sum. For instance the Local Government Pensions Institution strives to, through accumulated assets, to keep the pension contribution stable from 2007 onwards. Accumulating and dissolving of assets is determined with this objective in mind. On the other hand, the State Pension Fund aims for a funding rate of 25 per cent in the long term. Annually 40 per cent of the earnings-related pension expenditure under the State Employees' Pensions Act is also financed from the State Pension Fund.

In the public sector only the amount of the employee's accrued pension rights has been determined, but not the share funded from it or thus the pension liability to be covered. The investment operations are based on the target allocation of investment objects as decided by the administrative bodies, from which deviations can be made within certain limits, for instance, on the basis of development in the view on interest rates or share prices.

The Local Government Pension Institution has also set a long-term target for the real rate of return, which is four per cent a year as of the start of funding. The average annual real rate of return of the investments of the Local Government Pensions Institution has been 5.2 per cent from the beginning of 1988 to the end of 2006. The State Pension Fund sets its targets annually.

Figure 5.7 shows the nominal returns of public-sector earnings-related pension assets annually in 2000–2006.

Figure 5.7. *Return of public-sector earnings-related pension assets in 2000–2006.*

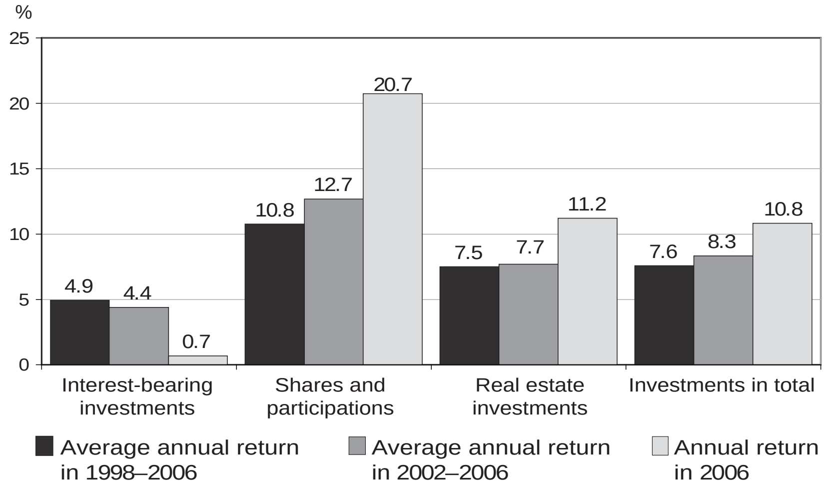


Source: The Finnish Pension Alliance TELA.

The public-sector investment returns have varied more than the private-sector returns (cf. figure above). In years of falling share prices returns have been lower and in years of rising share prices higher than in the private sector. The larger variation is due to the larger proportion of investments in shares in the public-sector assets.

Figure 5.8 presents the average returns on public-sector earnings-related pension investments from 1998 to 2006.

Figure 5.8. *Current value investment return in 2006 as well as in 1998–2006 and in 2002–2006 on average, public-sector pension providers (KELA, KEVA, KKR, SPERA, VER).*

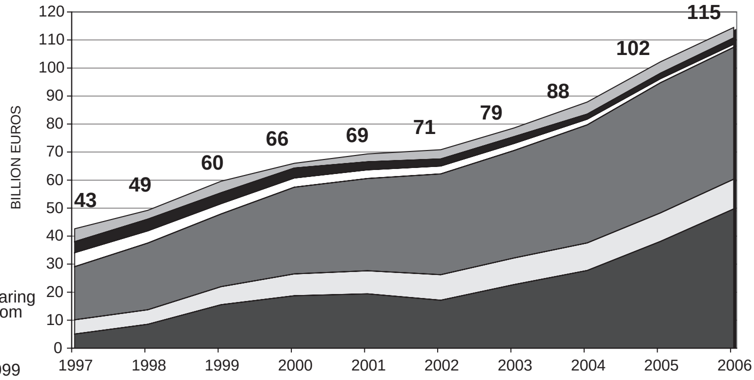


Source: The Finnish Pension Alliance TELA.

The premium on investments in shares in 1998–2005 is lower than for the investments of the pension insurance companies (cf. figure above). The reason is probably that in the years in question the returns on Finnish shares exceeded the average return on shares worldwide. Of the public-sector investments in shares a clearly larger proportion was directed abroad than was the case for private-sector investments. On the other hand, public-sector interest-bearing and real estate investments have yielded slightly more than corresponding private-sector investments.

Investment statistics appendix

Figure 5.9. *Investment portfolio in 1997–2006, private and public.*



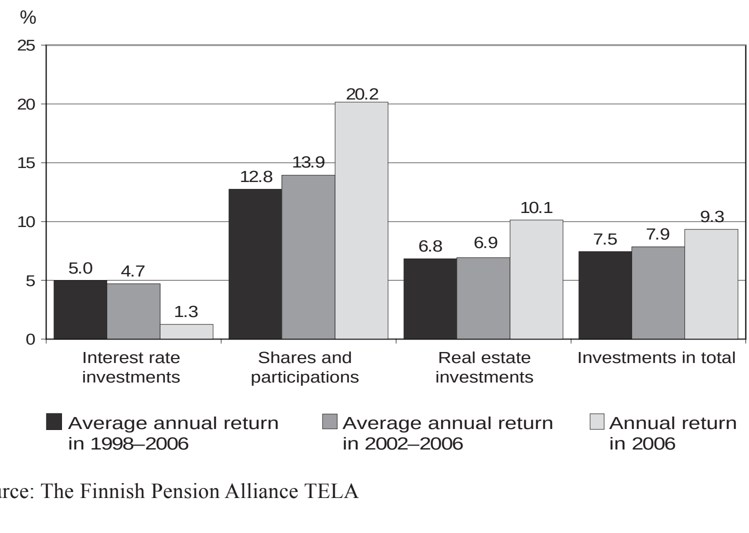
In 2004 short interest-bearing funds were transferred from bonds to money market investments

From the beginning of 1999 all at market values

	31.12.97	31.12.98	31.12.99	31.12.00	31.12.01	31.12.02	31.12.03	31.12.04	31.12.05	31.12.06
MONEY MARKET INVESTMENTS	4.6	3.2	4.1	1.7	2.8	3.3	3.1	4.3	4.1	3.7
INVESTMENT LOANS	3.9	4.2	3.9	3.5	2.8	2.5	2.5	1.8	1.9	2.3
PREMIUM LENDING UNDER TEL	5.0	4.4	3.7	3.3	3.1	2.8	2.5	2.0	1.5	1.1
BONDS	18.9	23.8	25.9	30.9	32.9	36.0	38.3	42.2	46.4	47.1
REAL ESTATE AND REAL ESTATE SHARES	5.1	5.2	6.5	7.8	8.2	9.1	9.5	9.8	10.2	10.6
SHARES AND EQUITY FUNDS	5.0	8.5	15.5	18.7	19.4	17.1	22.7	27.7	38.1	49.7
	42.5	49.3	59.6	66.0	69.2	70.8	78.6	87.9	102.2	114.5

Source: The Finnish Pension Alliance TELA.

Figure 5.10. *Current value investment return in 2006 as well as in 1998–2006 and in 2002–2006 on average, all member organisations of the Finnish Pension Alliance TELA.*



Source: The Finnish Pension Alliance TELA

Table 5.5. *Distribution of private-sector earnings-related pension investments by investment type and target area at the end of the years 2000–2005 and 31 December 2006, in per cent of the value of all investments.*

Investment type and target area	**31.12.2000**	**31.12.2001**	**31.12.2002**	**31.12.2003**	**31.12.2004**	**31.12.2005**	**31.12.2006**
Shares, total	25.0	23.6	19.5	23.4	25.4	33.0	39.8
- Finland	15.3	12.7	10.0	9.5	9.8	10.9	12.6
- Rest of eurozone	4.5	4.5	3.4	4.8	4.7	5.9	6.9
- Other countries	2.4	6.4	6.0	9.1	10.9	16.2	20.3
Real estate, total	12.0	13.7	14.6	13.9	13.0	11.6	10.9
- Finland	12.0	13.7	14.6	13.9	12.8	11.3	10.2
- Rest of eurozone	0.0	0.0	0.0	0.0	0.2	0.3	0.4
- Other countries	0.0	0.0	0.0	0.0	0.0	0.0	0.2
Bonds	49.3	49.5	53.1	51.5	50.7	47.1	42.5
- Finland	21.9	14.6	10.4	8.6	6.4	5.6	4.0
- Rest of eurozone	26.2	31.9	39.1	38.2	34.6	33.0	29.9
- Other countries	1.2	2.9	3.6	4.6	9.7	8.6	8.6
Other interest-bearing instruments	13.7	13.2	12.9	11.2	10.9	8.3	6.8
- Finland	13.3	12.5	12.3	10.2	9.4	7.1	5.8
- Rest of eurozone	0.2	0.6	0.2	0.7	0.9	0.7	0.6
- Other countries	0.2	0.1	0.4	0.3	0.6	0.5	0.4
All investments	100.0	100.0	100.0	100.0	100.0	100.0	100.0
- Finland	62.8	53.4	47.3	42.1	38.2	34.8	32.6
- Rest of eurozone	30.2	36.9	42.6	43.8	40.5	39.8	37.8
- Other countries	7.0	9.7	10.1	14.1	21.3	25.4	29.6

Table 5.6. *Distribution of public-sector earnings-related pension investments by investment type and target area at the end of the years 2000–2005 and 31 December 2006, in per cent of the value of all investments.*

Investment type and target area	**31.12.2000**	**31.12.2001**	**31.12.2002**	**31.12.2003**	**31.12.2004**	**31.12.2005**	**31.12.2006**
Shares, total	41.7	42.0	37.8	44.0	47.8	49.5	51.7
- Finland	11.9	10.5	5.6	8.2	7.5	5.8	6.3
- Rest of eurozone	7.3	7.2	10.0	11.6	12.6	14.8	17.0
- Other countries	22.5	24.3	22.2	24.2	27.7	28.9	28.4
Real estate, total	6.0	6.6	7.8	6.8	6.4	5.5	5.7
- Finland	6.0	6.6	7.8	6.8	6.4	5.5	5.2
- Rest of eurozone	0.0	0.0	0.0	0.0	0.0	0.0	0.5
- Other countries	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Bonds	42.4	40.4	43.9	40.5	40.8	40.2	38.0
- Finland	14.0	9.4	11.1	8.2	5.9	4.5	3.7
- Rest of eurozone	13.2	18.8	21.7	22.2	26.9	28.5	28.2
- Other countries	15.2	12.2	11.1	10.1	8.0	7.2	6.0
Other interest-bearing instruments	9.9	11.0	10.5	8.7	5.0	4.8	4.6
- Finland	9.9	11.0	10.5	8.7	4.2	3.8	4.0
- Rest of eurozone	0.0	0.0	0.0	0.0	0.8	1.0	0.6
- Other countries	0.0	0.0	0.0	0.0	0.0	0.0	0.0
All investments	100.0	100.0	100.0	100.0	100.0	100.0	100.0
- Finland	42.9	37.4	34.5	31.7	23.7	19.9	19.3
- Rest of eurozone	20.3	25.6	32.3	33.8	40.5	44.1	46.0
- Other countries	36.9	37.0	33.2	34.5	35.8	36.0	34.7

Kati Ahonen and Juha Knuuti

6 Supplementary Pension Provision Which Complements Statutory Pension Provision

In accordance with the international classification, social security systems are often divided into three pillars. Actual social security comprises the statutory and mandatory schemes of the first pillar, which provide people's basic income. First-pillar schemes are almost always part of the public administration and their benefits as well as the level and financing of the benefits are determined through legislation. In Finland statutory, i.e. first-pillar pension provision consists of the national pension and the earnings-related pension.

The second-pillar schemes complement first-pillar social security. These include collective industry-specific or employer-specific schemes, such as group pension insurance arranged by the employer. The occupational schemes are sometimes mandatory and there may also be legislation regarding them. However, the legislation is always framework legislation, which for instance determines the procedures or the requirements that the pension providers handling the scheme have to adhere to.

The third pillar consists of private insurance and this also usually supplements first and second-pillar pension provision. This includes, for instance, personal pension insurance policies.

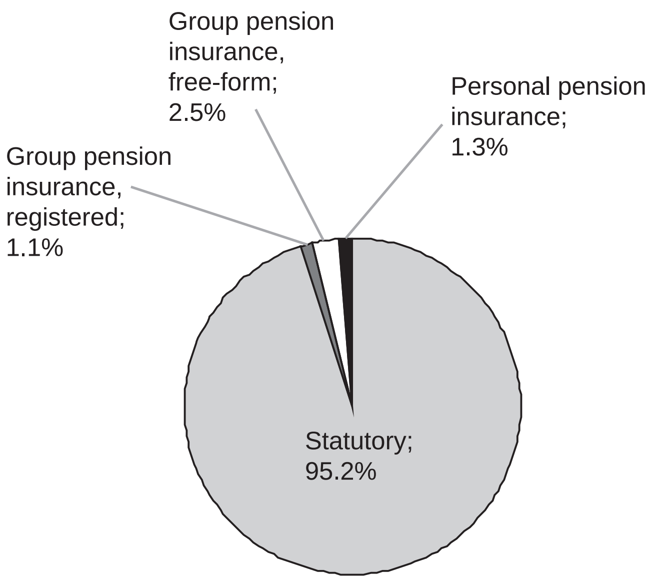
Voluntary pension insurance may be old-age or survivors' pension insurance as well as disability or unemployment pension insurance related to such insurance. According to the tax legislation, the pension must be paid in regular instalments at least once every six months for at least two years.

Voluntary supplementary pension provision may be arranged by the employer or the private individual has arranged it for himself or herself.

Voluntary pension provision supplements statutory and mandatory pension provision, and its significance increases if the income in retirement would otherwise be low due to, for instance, long periods of study, unemployment or child care. In addition to raising the level of income in retirement, voluntary supplementary pension provision offers the possibility of retiring before the actual retirement age. In that case, the accrual of a pension on the basis of employment ends, however, and the statutory pension is smaller due to early retirement.

In Finland the role of voluntary supplementary pension provision is not very significant, since statutory pension provision is broad in scope and neither the pensionable earnings nor the pension amount have a ceiling. We can say that total pension provision consists to 95 per cent of statutory pension provision and five per cent supplementary pension provision. The share of voluntary supplementary pension provision in total pension provision is thus small when compared internationally.

Figure 6.1. *Share of statutory pension provision and voluntary pension provision in total pension expenditure in 2004.*



6.1 Collective occupational pension provision arranged by the employer

The employer may arrange occupational pension provision for the employees through either group pension insurance or individual pension insurance. Group pension insurance is collective and a prerequisite is that the persons included in the group pension policy are selected objectively on the basis of, for instance, job tasks or profession. Besides persons insured under the Employees Pensions Act (TyEL), also persons insured under the Self-Employed Persons' Pensions Act (YEL) and the Farmers' Pensions Act (MYEL) may be included in collective pension insurance. If the intention is to target occupational pension insurance at a certain person, the employer has to take out individual pension insurance for this person.

Group pension insurance has a fairly long history in Finland, since it can be said to have functioned as earnings-related pension insurance before the establishment of statutory pension legislation. When the Employees' Pensions Act (TEL) was drawn up, registered group pension insurance was included as part of statutory pension provision. In the initial years of the Employees' Pensions Act (TEL) the basic pension stayed low due to the short period of accrual and occupational pension provision made possible a higher income in retirement than the statutory pension.

Already in the initial years of the scheme the statutory pensions did have a minimum level, but especially for the older age groups it was fairly low. In 1975 the target level for private-sector statutory basic pensions was increased from 40 to 60 per cent and the minimum level also in the oldest age groups to 25 per cent. The reform meant a significant reduction in the need for supplementary pension provision.

6.1.1 Registered and free-form group pension insurance

Group pension insurance arranged by the employer for the employees may be registered or free form. The registered supplementary pension schemes were closed from the beginning of 2001. After this date new supplementary pension insurance policies may no longer be registered and, as a rule, no new employees may be registered in existing supplementary pension insurance policies. Those already covered by the insurance policy maintain their entitlement to the supplementary pension.

Taking out registered supplementary pension insurance was voluntary but the contents and activities were subject to certain restrictions determined by law. For instance, this type of insurance is linked to the index mentioned in the pension acts. Besides old-age pensions, registered supplementary pension insurance may include disability and unemployment pensions as well as survivors' pensions and burial grants. If the supplementary pension insurance policy is registered, the employee automatically retains the right to the accrued supplementary pension also when the employment contract ends.

In practice group pension provision nowadays arranged by the employers is free-form collective supplementary pension insurance with life insurance companies. Taking out insurance is fully voluntary and the insurance policies may also to their contents be drawn up fairly freely. Usually free-form group pension insurance only concerns the old-age pension, but it may also include disability and survivors' pensions.

Usually free-form group pension insurance involves vesting of pension rights, i.e. the entitlement to the accrued supplementary pension when the employment contract ends. The entitlement to vesting of pension rights may, for instance be dependent on the length of the employment contract[1]. It may also be only partial, for instance, 50 per cent of the accrued supplementary pension. However, there is not necessarily any vesting of pension rights and in that case the employee loses the supplementary pension when changing jobs or if being fired. The accumulated fund share is either returned to the company or used to benefit the other insured.

6.1.2 Administration and supervision

Group pension insurance may be arranged as supplementary pension with an industry-wide pension fund or with a company pension fund or as collective supplementary pension insurance with a life insurance company. It may also be based on the company's own pension regulation. In that case it is not an insurance policy but a book reserve, where the employer is committed to paying pensions to a defined group of persons. Besides domestic life insurance companies, voluntary pension insurance in Finland is also offered by some foreign life insurance companies. Registered supplementary pension provision has been arranged with the authorised pension providers.

The Insurance Supervisory Authority supervises pension providers and funds in the insurance industry in Finland. The Authority especially supervises the development in the finances and solvency of the insurance and pension providers.

[1] The proposed Directive of the Commission COM(2005)507 strives to improve the transferability of occupational pension rights both between and within the member states. In this connection, the Commission proposes, for instance, that pension rights have to be vested if the employment lasts more than two years.

6.1.3 Structure and pension benefits

One prerequisite for group pension insurance is that it concerns a collective group of people which includes at least two persons. In contrast to previous practice, the group may no longer be made up of only one person (e.g. the managing director), except in cases where a group which originally consisted of several persons shrinks to include only one person. Old group pension insurance contracts remain unchanged also after the legislative reform.

The insured group may be defined, for instance, on the basis of a division based on the employee's position, profession, line of industry, establishment, date of commencement of the employment, date of birth, other pension provision arranged by the employer or transfer of the activities. The insured group may be closed, in which case new persons are no longer included in the insurance policy.

The occupational pension is typically either a complementing occupational pension in euros or it is intended to lower the retirement age. The insurance policy may also involve a combination of these benefits. In group pension insurance the lowest possible retirement age which entitles to tax deductions for the contributions is 55 years[2]. If the employee himself or herself pays part of the contributions, this age limit is 60 years. If the lower retirement age has been defined as the age of retirement in the employment contract, the employee does not have any subjective right to continue working after reaching the lower retirement age. However, the arrangement must not be unreasonable from the employee's viewpoint, that is, the size of the employee's pension at the lower retirement age may have to be taken into account when assessing the matter.

Group pension insurance may be built up in several ways. If the insurance policy involves a lower retirement age, the statutory old-age pension may be taken early and the occupational pension can be used to compensate for the reduction in income. If the lower retirement age is lower than the retirement age for the statutory early old-age pension, the income during the retirement years without a statutory pension are in their entirety financed through the occupational

[2] The Income Tax Act does not define the lowest age for the start of the old-age pension in cases where the employer pays the whole contribution. In collective pension insurance the lowest retirement age has so far been 55 years and the maximum level of the pension has been 66 per cent of the stabilised earnings. As the pension regulations changed these grounds are no longer referred to in the tax legislation. However, the intention is that the age of the start of the old-age pension is not changed.

pension. Until 2005 the statutory old-age pension could be taken early from the age of 60. As of 2005 the lower age limit for the early old-age pension is 62 years.

6.1.4 Determining the pension benefits

Group pension insurance may be defined benefit or defined contribution. In a defined benefit arrangement a certain benefit level has been determined for the employee, for instance, an old-age pension of 66 per cent of the wage at the agreed retirement age[3]. On the other hand, in a defined contribution scheme only the contribution level is defined and the occupational pension that will then be paid is determined on the basis of the accumulated savings. For instance, the contribution may be defined as a fixed percentage of the employee's wage or the contribution may be linked to the company's profits.

Nowadays almost only group pension insurance policies based on defined contribution are taken out. However, the share of defined contribution contracts in the insurance portfolio is only a couple of per cent, because such insurance policies have been taken out mostly only in recent years. Old defined benefit arrangements have also been converted to defined contribution arrangements.

6.1.5 Financing and taxation

Group pension insurance contributions are in their entirety deductible expenses for the company, and in contrast to private pension insurance the annual pension contributions have no maximum amount, as long as the bought occupational pension provision is at a reasonable level according to the tax authorities. The costs for life and disability insurance, which are often connected to the insurance policy, are deductible for the company.

Group pension insurance contributions are not considered income for the employee, and thus the employer does not have to withhold preliminary taxes on them, nor pay social insurance contributions. The occupational pension which will then be paid to the pension recipient is taxed as earnings.

[3] In connection with the 2005 pension reform the concept of pensionable wage and the restriction of the pension to 60 per cent of the highest pensionable wage of the work history were abolished, which means that the level of the total pension may be higher than previously. Although there is no longer reason to follow this limit since the taxation rules were changed, the use of the limit of 66 per cent is still common.

The employee may pay part of the group pension contributions. The contribution may amount to at the most half of the annual contributions. In the initial years of registered supplementary pension insurance this practice was widespread. According to data of the insurance sector, the share of contributions levied from the employees is nowadays only a couple of per cent of the premium income, however.

If the insured pays part of the contributions, he or she may deduct the contributions which he or she has paid in the income taxation to at the most 5 per cent of the wage that the employer in question has paid to him or her. In euros the deductions may amount to at the most 5,000 euros a year. The right to tax deduction for contributions that the employee has paid himself or herself and which are connected to collective pension insurance does not affect the right to tax deductions for the contributions for possible personal pension insurance.

6.1.6 Coverage

In the initial years of the statutory earnings-related pension scheme the employment contract commonly included a registered supplementary pension. Also at present almost every fourth recipient of an earnings-related pension in the private sector receives a supplementary pension. However, considered in euros the significance of supplementary pension provision arranged by the employer is slight. At present group pensions make up less than four per cent of pensions paid. (Figure 6.1.)

No numerical data on the level of the individual is available for group pension insurance, since the statistics are partly drawn up per insurance policy. The number of group pension insurance policies granted by life insurance companies includes vested pensions, the share of which is unknown. In reality group pension insurance covers clearly less than 210,000 persons. (Table 6.1.)

Table 6.1. *Numerical data on group pension insurance.*

	Number of insured				Number of pension recipients			
	2002	2003	2004	2005	2002	2003	2004	2005
Registered supplementary pension provision	40,000	33,700	22,000	17,000	64,900	67,100	76,200	80,090
Supplementary pension provision with life insurance companies (also vested pensions)	110,100	126,500	135,900	149,000	48,000	48,900	49,500	55,700
Free-form supplementary pension provision with company pension funds	50,800	49,800	43,100	35,600	34,600	38,300	36,200	31,300
Free-form supplementary pension provision with industry-wide pension funds	10,200	10,200	9,700	9,000	11,200	13,000	11,600	11,700
Group pension insurance total*	211,100	220,200	210,700	210,600	158,700	165,300	173,500	178,790

* Due to overlapping the number of insured is in reality lower than the total number of group pension insurance policies.
Source: The Insurance Supervisory Authority and the Finnish Centre for Pensions.

According to the survey 'Joustava eläkeikä' (flexible retirement age) of the employers, 19 per cent of the private-sector workplaces are workplaces where the employer has arranged supplementary pension provision for the employees. At approximately 14 per cent of private-sector workplaces supplementary pension provision covers the personnel of the establishment more broadly than just individual persons.

In 2004 group pension insurance involved pension assets of approximately 10.6 billion euros, of which an estimated 1.3 billion euros (slightly less than 13 per cent) was registered supplementary pension provision. The growth in recent years in group pension insurance policies awarded by life insurance companies can largely be explained by the transfer of the insurance portfolio of dissolved company pension funds handling supplementary pension insurance to life insurance companies.

6.2 Personal pension insurance

In Finland personal pension insurance has been arranged for a good one hundred years, that is, over the whole history of life insurance. Payment is made from the personal pension insurance policy to the policyholder from an agreed age in the form of an old-age pension. The insurance policy may be agreed on either for a fixed period of time or for life. Most personal pension insurance policies have been agreed on for a fixed period of time. A personal pension is not a hindrance for employment and part of the persons drawing a personal pension are still in active employment.

The insurance contract usually also includes life insurance provision for the event of the insured person's death. In that case the insurance savings are paid in predetermined parts to the insured person's beneficiaries. The right to terminate a personal pension insurance policy has been restricted.

The personal pension insurance policy may be drawn on early on the basis of permanent disability or in case of unemployment of more than a year the insured may draw the surrender value of the insurance policy, i.e. the assets accumulated in the insurance policy, reduced by the administrative costs. The practice differs between companies. Usually personal pension insurance policies which can be drawn on early on the basis of disability and unemployment presuppose that the insurance savings are covered by life insurance.

The retirement age which entitles to tax deductions on personal pension insurance policies has been changed several times. Originally the lowest retirement age for voluntary pensions was 55 years. The retirement age was increased to 58 years 1 October 1992. The lowest retirement age was increased further to 60 years in insurance policies taken out 24 June 1999 and later. The current lowest retirement age of 62 took effect for insurance policies taken out 6 May 2004 and later.

Personal pension insurance may be taken out by the insured himself or herself, the insured's spouse or the employer[4]. If the policyholder is the employer, the insured himself or herself may not pay contributions to the insurance. Personal pension insurance taken out by the employer for the employee does not necessarily

[4] Personal pension insurance may in principle be taken out for another person by anyone else, but in that case there is no entitlement to a tax deduction for the contributions.

include vesting of pension rights if the employment contract ends before the retirement age.

Personal pension insurance policies are awarded by life insurance companies and they are supervised by the Insurance Supervisory Authority.

6.2.1 Coverage

According to the Insurance Supervisory Authority, the number of personal pension insurance policies in 2005 was approximately 550,000, of which approximately 100,000 were taken out by companies (table 6.2). The number of personal pension insurance policies taken in 2006 is 630,000 according to the Financial and Insurance Institute FINVA.

Table 6.2. *Numerical data on personal pension insurance.*

Number of insurance policies				Number of pension recipients			
2002	2003	2004	2005	2002	2003	2004	2005
393,900	469,600	495,800	511,000	25,700	29,800	34,100	37,400

Source: The Insurance Supervisory Authority.

According to the data of the housing and wealth survey of Statistics Finland, 12 per cent of private households had personal pension insurance savings in 2004. Among self-employed persons personal pension saving is considerably more common than among wage earners. On the basis of the survey ’Joustava eläkeikä’ (flexible retirement age) by the Finnish Centre for Pensions and the Finnish Pension Alliance TELA in 2003 approximately 45 per cent of the self-employed persons aged 58–63 had taken out voluntary personal pension insurance, whereas the share in the corresponding age group of wage earners was 15 per cent (Hyrkkänen 2004).

6.2.2 Pensions savings and determining the pension

The pension which will become payable is determined on the basis of the accumulated insurance savings. When concluding the insurance contract a contribution plan is usually agreed on. Usually the insurance policies have flexible contributions, and thus higher or lower contributions may be paid than agreed in the contribution plan. Older pension insurance policies may have fixed contributions, in which case the client should adhere to the agreed plan.

According to the FINVA, on average 1,200 euros, i.e. approximately 100 euros per month, were paid into personal pension insurance policies taken out by private individuals in 2005. The time of payment is on average approximately 25 years. The time of payment has increased, because ever younger persons take out insurance policies and the retirement age has also increased.

Personal pension insurance may be interest rate-linked or investment-linked. The return on interest rate-linked pension insurance consists of the technical interest rate and a separate additional interest rate determined on the basis of the insurance company's profits. The return on investment-linked insurance is determined on the basis of the return on the funds chosen be the policyholder. The return on investment-linked pension insurance policies is affected by both the development of the value of the chosen investment objects and the fees charged by the fund management companies, which consist of the annual administration fees in per cent and subscription and redemption fees for the fund shares.

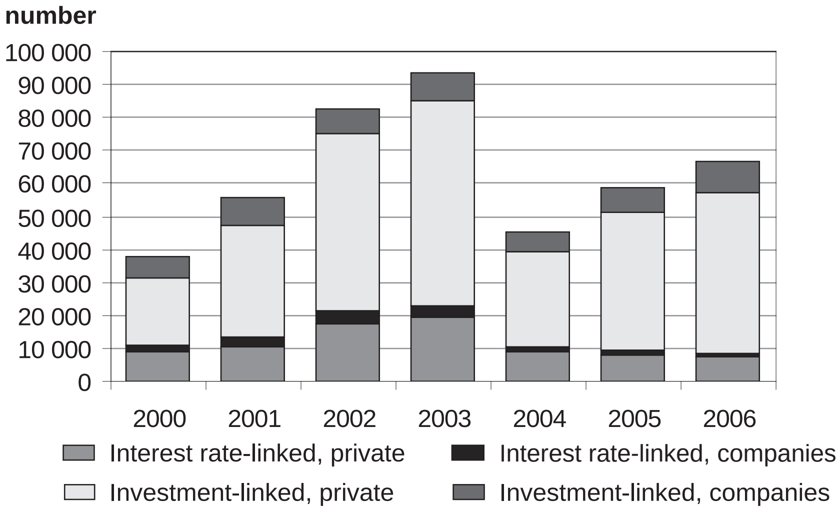
With investment-linked pension insurance it is possible to achieve higher yields than with interest rate-linked pension insurance. On the other hand, unfavourable development of the chosen investment objects may also lead to a decrease in the pension savings. The objective of investment-linked pension insurance is an optimal distribution of investments from the viewpoint of the development of the pension savings, which means that the riskiness of the investments is reduced as the start of the pension draws nearer.

The risk of the return on and the maintenance of the insurance capital in investment-linked insurance is carried by the client. In contrast to bank deposits the capital has no statutory deposit guarantee.

According to the FINVA, by the end of 2005 personal pension insurance policies had accumulated insurance savings to a total of 7,617 million euros. Of the pension insurance savings 74 per cent were in interest rate-linked insurance policies and 26 per cent in investment-linked insurance policies. The share of insurance policies taken out by companies in the pension insurance savings was 33 per cent and that of private individuals 67 per cent.

The majority of new personal insurance contracts are investment-linked pension insurance policies (in 2006 approximately 87 per cent of new business). New business decreased more than 50 per cent in 2004 compared to the previous year. One partial reason for the decrease in new business was the insecurity during the period of changes in the taxation rules. Until 2003 especially personal investment-linked insurance policies increased rapidly in popularity. In 2005 the sales recovered again to the level of the beginning of the 2000s. (Figure 6.2.)

Figure 6.2. *New business in personal pension insurance in 2000–2006.*



Source: The Financial and Insurance Institute FINVA.

6.2.3 Taxation

The right to tax deductions for personal pension insurance has been changed several times in the 1990s. After the legislative change approved in 2004 the lowest retirement age which entitles to tax deductions for new personal pension insurance contracts was increased from 60 to 62 years and the taxation of personal pension insurance was changed from income taxation to capital income taxation. The right to tax deductions for the contributions is changed from income taxation to capital income taxation and the pension paid from the insurance policy is taxed as capital income. The changes concern almost exclusively personal pension insurance policies taken out by private individuals.

The level of overall pension provision no longer affects the right to tax deductions for the contributions. The maximum annual amount of contributions is 5,000 euros, that is, the largest tax credit calculated according to the capital income tax rate (28 per cent) is 1,400 euros. If the insured has no capital income, a corresponding deduction is made in the income taxation in the form of a separate credit for deficit in capital income. The contributions to insurance policies taken out with a company active in the European Economic Area are subject to the same rules as the contributions to insurance policies taken out domestically.

Old personal pension insurance policies taken out by companies for their employees remain unchanged, but in new insurance contracts the lower age limit for entitlement to tax deductions is increased to 62 years. Personal pension insurance policies taken out by companies will remain subject to income taxation also in the future. If the annual contributions to the personal pension insurance policy taken out by the employer for the employees exceed 8,500 euros, the exceeding part is considered as the employee's wage.

If the wage earner's own insurance policy has been taken out 6 May 2004 or later, the contribution paid by the employer reduces the maximum deductible amount of the wage earner's own contribution to 2,500 euros. However, the amount of the contribution paid by the employer has not been determined, so even a small contribution reduces the wage earner's right to a deduction. On the other hand, the right to a deduction is not reduced even though the insurance policy taken out by the employer is valid, if the employer has not paid any contributions during the year in question. An insurance policy of the employer which already has been paid in full does also not affect the wage earner's right to a deduction. The contribution paid by the employer to the collective pension insurance policy does not reduce the right to a deduction for the contribution to the wage earner's personal pension insurance policy.

As regards old pension insurance policies (taken out before 6 May 2004) the income taxation model had a transition period of one year and the retirement age has a transition period of five years until the end of 2009. The pension is then taxed according to how the deductions have been made. For instance, the share of the pension accumulated in the old pension insurance policy before the beginning of 2006 and the yields paid on it later are taxed as earnings also in the future. The capital paid into the old pension insurance policy before 2010 may be withdrawn as agreed in the original contract before the age of 62.

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7 Taxation and Social Insurance Contributions

As a rule, statutory pensions are taxable earnings for the pension recipient. Voluntary personal pensions are taxed as capital income. In the taxation, the insured may deduct the statutory pension contribution in full, and voluntary contributions may be deducted with certain limitations. The employer may deduct paid pension contributions in his taxation. Pension providers are liable to pay income tax like any other companies.

The total tax rate in Finland (includes direct and indirect taxes as well as statutory social insurance contributions) in 2004 was 44.3 per cent of GDP. It was the fourth highest in the EU countries after Sweden, Denmark and Belgium. The average total tax rate in the EU countries in 2004 was 39.3 per cent. In 2004 the tax rate for the labour force in Finland was 41.9 per cent of wages, whereas the EU average was 35.9 per cent.

7.1 Main features of the Finnish tax system

Income tax is paid to the State, the municipalities and the parishes. The national income tax for natural persons is progressive. The lower limit for the national income tax in 2007 is 12,400 euros. Table 7.1 shows the national income tax scale.

Table 7.1. *National income tax scale in 2007.*

Taxable income euros	Tax at the lower limit, euros	Tax on the share of income exceeding the lower limit, %
12,400–20,400	8	9.0
20,400–33,400	728	19.5
33,400–60,800	3263	24.0
60,800–	9839	32.0

Other income taxes are proportional. The average municipal tax rate is 18.46 per cent in 2007. People pay tax to the parishes if they belong to the Evangelical-Lutheran Church or the Orthodox Church. The average Evangelical-Lutheran Church tax rate is 1.33 per cent in 2007.

The person liable to pay income taxes may be entitled to different tax deductions. Low-income wage earners and pensioners may deduct the basic deduction. The wage earner is also entitled to the earnings deduction in the municipal taxation and the national taxation. The pension recipient may in the municipal taxation deduct the pension income deduction.

In his taxation, the employee may also deduct costs for acquiring his income, membership fees for labour market organisations, contributions for the statutory earnings-related pension and the unemployment insurance, and interest on housing and study loans.

Capital incomes are subject to a capital income tax of 28 per cent. The income tax rate for corporations is 26 per cent in 2007, and it is divided into parts paid to the State, the municipality and the parish. Domestic insurance companies which have been constituted as limited companies are taxed as other limited companies, i.e. they pay corporate taxes on their business income. Company and industry-wide pension funds are also taxed in this way.

Value-added tax is paid to the State on the basis of turnover, and the tax rate for most commodities and services is 22 per cent. A premium tax of 22 per cent, equivalent to the value added tax, is collected from non-life insurance companies, and the tax is paid on the basis of accumulated or paid contributions. The premium tax is, however, not collected on life and pension insurance.

The net wealth tax was abolished from the beginning of 2006.

Owners of real estate and plots of land pay real property tax to the municipality in which the real estate is situated. The amount of the real property tax varies by municipality depending on the use of the real estate. The general real property tax rate varies between 0.5 and one per cent. Pension providers pay real property tax on the real estate they own.

7.2 Taxation of pensions

The taxation of statutory pensions is mainly determined in the same way as the taxation of other earnings. However, the taxation of pensions differs from that of wage earners due to different tax deductions and social insurance contributions.

A pension income deduction and in certain cases an invalidity deduction are granted on pension income. On the other hand, the wage earner is entitled to the deduction for the costs of acquiring his income and the earnings deduction. In addition the wage earner pays pension contributions and unemployment insurance contributions as well as the contribution for earned income in health insurance, and they are deductible in the taxation.

The pensioners' income in cash and benefits having a monetary value are considered taxable earnings, unless it is provided that they shall be taxed as capital income. Both statutory earnings-related and national pensions and collective supplementary pensions arranged by the employer are taxable earnings. Voluntary personal supplementary pensions are subject to capital income tax.

Some increments paid from the national pension scheme, such as child increases, front-veterans' supplements paid to front veterans, pensioners' housing allowance and pensioners' care allowance intended for pension recipients who are dependent on the assistance of others, are exempt from tax.

Prior to 1983, the national pension was fully exempt from tax. When it was laid down that the national pension should be taxable, there was a wish to maintain the pension recipient's net income by means of the pension income deduction. Even though pensions are normally taxable income, tax is not, in practice, withheld on income of an amount equal to the national pension.

In 2007 the pension income deduction in the national taxation is at the most 1,590 euros. However, the deduction does not have any practical significance, because it is not granted for annual incomes of more than 3,861 euros, and in 2007 national tax is not levied until the income exceeds 12,400 euros a year.

In the municipal taxation, the tax threshold depends on whether the pension recipient is married or not. In 2007 single persons start paying municipal tax on annual incomes from 8,021 euros and married persons on annual incomes from 7,011 euros. The full pension income deduction for single pension recipients is 7,150 euros and for married pension recipients 6,140 euros a year. The income which exceeds these limits reduces the full deduction by 70 per cent. Single persons are no longer entitled to the pension income deduction when the annual incomes reach 17,365 euros and married persons when the annual incomes reach 14,192 euros.

Thanks to the pension income deductions, the pensioner's take-home income within the lower income brackets is considerably higher than for wage earners at the same income level. On the other hand, with monthly earnings of approximately 1,100–2,600 euros the pension recipient's taxation, including social insurance contributions, is higher than that of the wage earner (pension contribution for persons aged less than 53). For monthly earnings of approximately 2,600–

3,000 euros the tax rates and contribution rates are almost the same for the pension recipient and the wage earner. Then again, for earnings which exceed 3,000 euros the wage earner pays higher taxes.

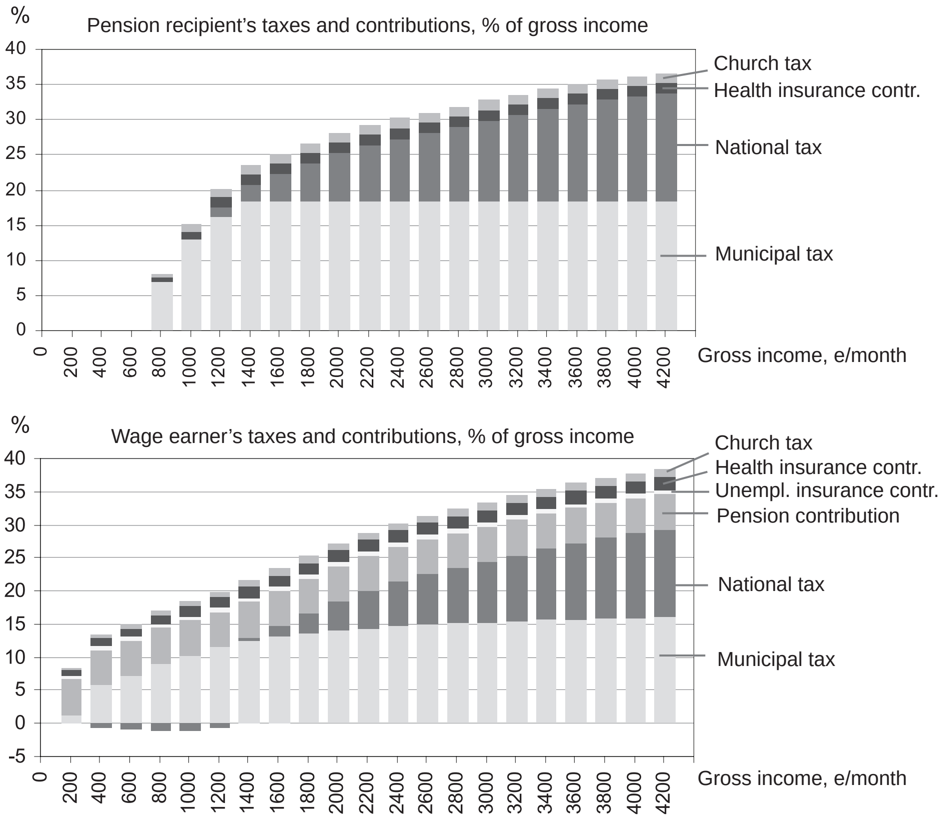
Figure 7.1 shows the difference in taxes and social insurance contributions of the pensioner and the wage earner.

Figure 7.1. *Taxes and social insurance contributions for the pension recipient and the wage earner (aged less than 53) in 2007, per cent.*

Figure 7.2 compares the taxation structure for the pension recipient and the wage earner at different income levels. For the wage earner the earnings deduction has an effect up to monthly earnings of approximately 9,000 euros. In the municipal taxation the deduction is made on the taxable income and its maximum amount is 3,250 euros a year. In the national taxation the earnings deduction is made on the tax and its maximum amount is 400 euros.

The earnings deduction in the national taxation was introduced from the beginning of 2006 and it is used to achieve tax reductions in the income taxation for wage earners which were previously achieved by increasing the earnings dedcution in the municipal taxation.

Figure 7.2. *Structure of the taxation for the pension recipient and the wage earner at different income levels. Calculated using the pension contribution for persons aged less than 53 and the average municipal (18.46%) and church tax rates (1.33%). Deductions made ex officio are taken into account.*



For wage earners the health insurance contribution includes the contribution for medical care insurance and the contribution for earned income insurance.
For low-income wage earners the national income tax is not sufficient for an earnings deduction in the national taxation, which appears here as a negative national tax. The share is deducted from the tax needed when calculating the tax withholding rate, but other taxes are calculated in the normal way.

7.3 International situations in the taxation of pensions

As of 2006 the Finnish pensions of persons who are permanently resident abroad, i.e. persons with a limited tax-paying liability, are taxed in the same way as the pensions of persons who are resident in Finland. The tax rate, deductions and tax return procedure are the same as for persons who are resident in Finland. Previously persons who were resident abroad were liable to pay a tax at source of 35 per cent. All taxes of the foreign pension recipient, also the calculated municipal tax, go to the State.

In some rare situations the pension is not taxed at all in Finland but only in the pension recipient's country of residence, and this is then based on a tax agreement between Finland and the person's country of residence.

The pension from abroad has often already been taxed in the country from which the pension is paid. In that case no income tax is debited on the pension in Finland, but the pension increases the tax on the income from Finland. The pension from certain countries is not taxed in the country in question and in that case Finland taxes the pension in the normal way.

The tax treatment of the pension from a specific country is determined by the taxation agreement between Finland and the country in question to prevent double taxation. Finland has concluded such agreements with more than 60 countries. Foreign pensions are in Finland usually subject to the insured's contribution for medical care insurance.

7.4 Pension contributions in the taxation

From their taxable income, employers may deduct the pension contributions paid for their employees in both the national and the municipal taxation. Self-employed persons may deduct their own and their spouse's statutory pension contributions in the taxation. The insured can also deduct their own statutory contributions in full.

For the contributions for collectively arranged supplementary pension provision the insured may deduct five per cent of the wage, but at the most 5,000 euros a year, however, and at the most the amount that the employer has paid for supplementary pension provision. One requirement for the right to a deduction is that the payment of the pension in the form of an old-age pension starts at the earliest when the insured reaches the age of 60.

The contributions for voluntary pension insurance taken out with an insurance provider in a country outside the EEA are not deductible. The contributions that a person who has moved from abroad to Finland has paid for this kind of insurance are deductible in the person's taxation for the year of moving and the three following years, if insurance has been taken out at least one year before the person moved to Finland.

The taxation of voluntary pension insurance was transferred from income taxation to capital income taxation from the beginning of 2005. From the beginning of 2006 all the taxpayer's and the spouse's contributions for voluntary personal pension insurance are deducted from capital income. The pension is then taxed according to how the deductions have been made. In old pension insurance policies the share of the pension which is paid from capital accumulated from contributions paid before the beginning of 2006 and the return on this capital is taxed as earnings.

Old insurance policies adhere to the previous age limits for the start of the pension until the end of 2009. If the insurance terms and conditions have not been changed during this time, the contributions are not deductible from the beginning of 2010 if the age for the start of the old-age pension is less than 62 years.

According to the new rules, the contributions for one's own voluntary pension insurance may be deducted from the capital income to an amount of 5,000 euros a year. If the employer has taken out this kind of insurance for the taxpayer, the contributions for insurance that one has taken out oneself are deductible up to at the most 2,500 euros.

The requirement for the right to a deduction is that the insurance contract determines that payment of the pension starts at the earliest when the insured reaches the age of 62 and that the insurance policy may not be repurchased at an earlier stage on other grounds than unemployment of at least a year, permanent incapacity for work, death of the insured's spouse or divorce.

7.5 Social insurance contributions

Wage earners pay mandatory social insurance contributions on their taxable income. The employee's pension contribution is 4.3 per cent in 2007. The contribution for medical care insurance is 1.28 per cent and the contribution for earned income insurance of 0.75 per cent. In addition the employee is liable to pay an unemployment insurance contribution of 0.58 per cent. The pension contribution, the contribution for earned income insurance in health insurance and the unemployment insurance contribution are deductible in the taxation.

Pension recipients only pay the contribution for medical care insurance in health insurance on their pension, and the contribution amounts to 1.45 per cent.

Employers pay national pension and health insurance contributions. Private-sector employers pay 0.901, 3.101 or 4.001 per cent in national pension contributions depending on the amount of depreciation and the total payroll.[1] On average employers pay 1.64 per cent in national pension contribution in 2007. Private-sector employers pay 2.05 per cent in health insurance contribution.

In 2007 companies in the private sector pay 2.29 per cent in unemployment insurance contributions, on average. The average earnings-related pension contribution (the employer's share) in the private sector is 16.7 per cent in 2007. The workers' compensation contribution varies according to the accident risk and amounts to 1 per cent on average in 2007. Employers pay a group life insurance premium of on average 0.08 per cent in 2007.

Table 7.2. *Social insurance contributions in 2007, per cent.*

	Employee	Private employer
National pension contribution	-	0.901, 3.101 or 4.001
Health insurance - contr. for medical care insurance - contr. for earned income insurance	 1.28 0.75	2.05
Workers' compensation contribution	-	0.4–8
Group life insurance premium		0.08 (on average)
Unemployment insurance contribution	0.58	0.75% of the wage sum up to 840,940 euros, and for the exceeding part 2.95%
Pension insurance - persons aged less than 53 - persons who have reached the age of 53	 4.3 5.4	16.7

[1] If the employer has in the national taxation of 2005 made depreciations on the purchase costs of fixed assets of less than 50,500 euros or over but less than 10 per cent of wages, the contribution in 2007 is levied in the lowest contribution category. If the depreciations exceed 50,500 euros and amount to 10–30 per cent of wages, contributions in the middle-range category are levied, and if the depreciations exceed 50,500 euros and 30 per cent of wages, the highest contribution is paid.

8 Pensioners’ Income Level and Income in Finland

In pensioners’ income, earnings-related pension provision plays the most important role. The national pension provides a minimum pension cover and supplements earnings-related pension provision. The income from the earnings-related pension and the national pension is called the total statutory pension. In all, the total pension cover is to about 95 per cent made up of statutory pension provision. At least as yet the significance of supplementary pensions is quite small in Finland, since the statutory pension cover is broad.

In addition to the pension the income is also increased by other income transfers. Pension recipients are paid a separate housing allowance, if the housing costs are high compared to the income. The Social Insurance Institution also pays separate supplements to the pension. Pensioners can also have production factor income, such as wage income and income from self-employment, or property income from wealth. Pensioners’ income is also affected by the fact that Finnish pension recipients often own their housing. This means that housing costs are lower than in countries were rented housing dominates. Of the pensioner households, 80 per cent own their housing.

The pension recipient’s income is also affected by family ties and the incomes of the other family members. For instance, older female pension recipients often live alone and partly for this reason have a lower income than other pension recipients.

This article studies the income level of pensioners from different viewpoints. First earnings-related pension provision is surveyed, then total statutory pension provision, after that the relation of the pension to earnings is analysed and finally the income of pension recipients when taking into account the incomes of the household.

8.1 Earnings-related pension provision

In 2005 the average earnings-related pension based on the person’s own work history was 927 euros/month (women 730 / men 1,171). The pension for men is higher than for women due to their higher wages and longer work histories. However, women more often receive surviving spouse’s pensions than do men.

When taking into account survivors' pension provision the average total earnings-related pension in 2005 was 997 euros/month (women 850 / men 1,179).

When analysing different types of pensions the average pension of an old-age pensioner amounted to 955 euros/month and the average pension of a person on a disability pension to 866 euros/month. The benefits awarded as disability pensions are partial pensions, full pensions and individual early retirement pensions, which can be granted to older age groups. New individual early retirement pensions can no longer be granted in the private-sector earnings-related pension scheme (in the public sector new individual early retirement pensions may still start for a couple of years). The average level of the pension is different for these different types of disability pension.

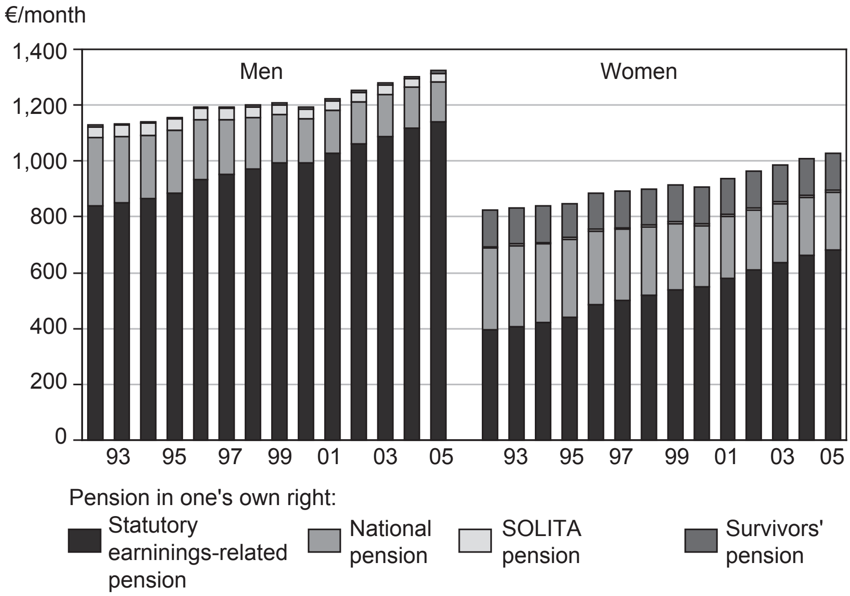
On average new earnings-related pensions are higher than all pensions in payment, for instance, for the reason that younger, newly retired pension recipients have had time to accrue an earnings-related pension for a longer period of time than older pension recipients. In addition, for younger persons the pensionable earnings are higher than for older persons. The higher level of new earnings-related pensions also means that for older age groups the share of the national pension in the total pension is higher than for those currently retiring. The average new pension in 2005 amounted to 1,084 euros/month (women 892 / men 1,271). The average new old-age pension amounted to 1,335 euros/month, and the average disability pension to 831 euros/month.

In the public sector both pensions that have already been in payment for some time and new old-age pensions are slightly higher than in the private sector, since public-sector pensions accrued at a higher rate before the reforms carried out in the initial years of the 1990s. The calculation rules have largely been harmonised and in the long term the differences in pension levels due to different calculation methods will disappear.

8.2 Total statutory pension provision

In new old-age pensions the share of the national pension has decreased over the years especially as a consequence of the 1996 pension reform, when the national pension was fully linked to other pension income. The flat-rate basic component of the national pension was gradually phased out completely by 2001 for persons having a certain level of earnings-related pension. Secondly, the level of the earnings-related pension has also increased, because the earnings-related pension scheme can be said to be still in its maturation phase. Also in all pensions in payment the share of the national pension decreases further as the share of older pension recipients, who often receive a national pension, diminishes and the share of new earnings-related pension recipients, who receive a higher pension, of all pension recipients increases.

Figure 8.1. *The average total pension (recipients of pensions in their own right) by pension structure and gender, euros/month, adjusted for the level in 2005.*



Source: Eila Tuominen, Jari Kannisto, Heidi Nyman, in Pensions and pensioners’ disposable income, 2006.

Figure 8.2. *Total pension distribution of pension recipients as at 31 December 2005.*

Source: The Finnish Centre for Pensions.

8.3 Statutory pension in relation to wages

Replacement rate usually means the new pension in relation to the person's own last wage. In theoretical calculations persons retiring on an old-age pension from full-time work are usually considered here. The replacement rate of the pension scheme describes the new pension in relation to the pension recipient's pensionable earnings, which are usually not the same as the person's last wage. The relation of new pensions to wages can also be described by comparing average pensions to average earnings in the economy.

Previously the targeted replacement rate of the earnings-related pension scheme was set at 60 per cent. As late as up to 2005 the maximum level of 60 per cent still existed, because in the private sector the earnings-related pensions were restricted to 60 per cent of the highest pensionable wage of the work history. Before 2005 the Finnish earnings-related pension was based on the total pension of the different employment contracts, and then the pension was not based on one single wage, except in the case when the whole work history consisted of one single employment contract. It was possible to achieve the targeted pension level by working for slightly less than 40 years. If the earnings-related pension scheme's replacement rate was a full 60 per cent of the pension recipient's highest pensionable wage, this could in practice mean a replacement rate of about 50 per cent of the pension recipient's latest wage level, as the pensionable wage was the average of the wages of the last years of the employment contract, from which the employee's pension contribution was deducted. In addition pension indexation only partially took into account wage increases in the national economy. On average people's work histories have been shorter than 40 years, meaning that both the pension scheme's replacement rate and the pension in relation to the last paid wage have in reality been on average lower than the aforementioned 60 or 50 per cent. However, there is large individual variation in the replacement rates due to different wage careers.

Starting in 2005 every earned euro affects the earnings-related pension by accruing pension rights at slightly different rates depending on the person's age when the euro is earned. In addition, the final pension is affected by the year of birth, because for each one-year age group a separate life expectancy coefficient is calculated, which takes into account the increase in life expectancy for the age group. The coefficient reduces the starting monthly pension, if longevity continues rising. In this case it is no longer possible to talk about the pension scheme's target replacement rate in the same way as before. When continuing to work for longer the pension also improves.

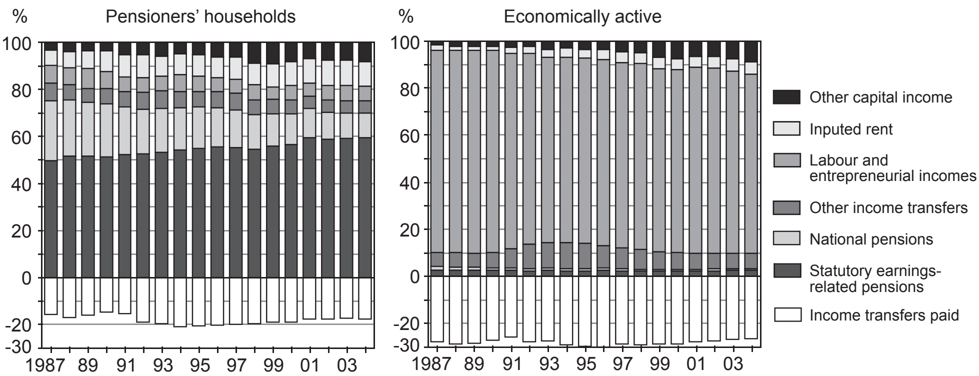
As yet the replacement rate cannot be calculated from the pension scheme's statistics, because due to the decentralised pension scheme the wage data have been stored with the pension providers. The central registers have only contained data on the earnings from employment contracts and self-employment on the basis of which the pensions from the employment contracts and periods of self-employment have been calculated. So far the replacement rate calculations have mainly been theoretical calculations (see Finnish Centre for Pensions, Reports 2005:4) or they have been based on separate research data (e.g. Rantala 2003). From 2005 onwards all earnings from work are registered in a common earnings and accrual register, so in future it may be possible to calculate also actual replacement rates on the basis of the registers.

In the monitoring of the realisation of the national pension strategies the so-called aggregate replacement rate is also used as indicator. This means the median pension of pension recipients aged 65–74 in relation to the median earnings of persons aged 50–59. According to preliminary calculations, the Finnish aggregate replacement rate is approximately 48 per cent, which is pretty low for the EU countries. A similar figure is arrived at when comparing the average pension of all those who have retired on an earnings-related pension to the earnings of all economically active people. The level of new old-age pensions compared to the earnings of economically active people is higher, however, being about 61 per cent in 2004.

8.4 Income of pensioner households

The earnings-related pension is the most important source of income for pensioner households (Rantala 2006). In all, the share of pensions in the gross income of pensioner households is approximately 70 per cent. The share of wealth income in pensioners' gross income is approximately 20 per cent, of which half is net housing income describing the value of owning one's own housing. In Finland 80 per cent of pensioner households live in their own housing, and for them the housing costs are not as high as for people living in rented housing. Pensioner households paid approximately 18 per cent in taxes and contributions in 2004.

Figure 8.3. *The structure of gross income and the income transfers paid by pensioners' households and economically active households in 1987–2004, share (%) of gross income.*



Source: Juha Rantala, in Pensions and pensioners' disposable income, 2006.

Persons whose disposable income[1] is below the poverty limit defined through the median income are classified as poor. The poverty risk is calculated through the proportion of poor people in the population. The poverty limit is a relative concept. If the population's median income increases, the poverty limit rises, and if the income decreases, the poverty limit decreases correspondingly. The prevalence of poverty is affected by the chosen poverty limit. In 2004 about 15 per cent of those living in pensioner households fell below the 60 per cent poverty limit nowadays used by the EU. If the limit is 40 per cent of the median income, the poverty risk of pensioner households decreases to 3.5 per cent.

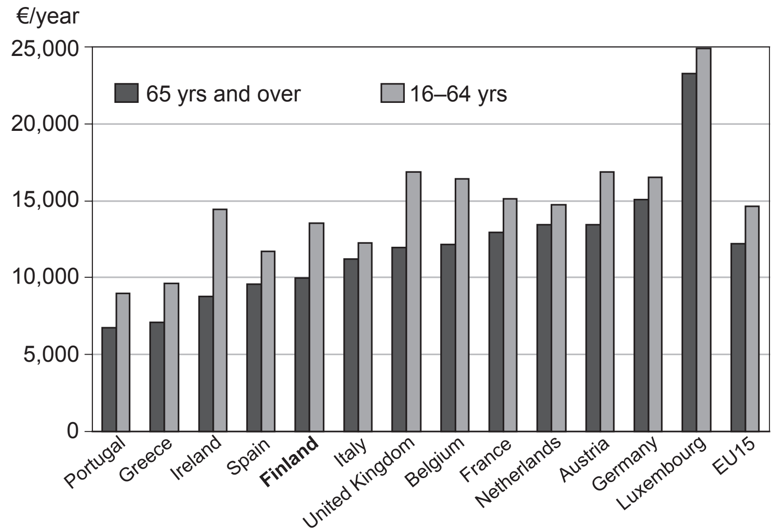
Compared internationally the income distribution of Finnish pensioners is one of the most even of the EU15 countries, along with Sweden and Denmark. The poverty risk of persons of retirement age is also among the lowest, with the exception of women aged 75 and over, whose poverty risk is of an average level for the EU15 countries. A partial reason for this is that in Finland the average size of pensioner households is among the smallest in the EU15 countries and it is common for elderly people to live alone. Due to longer life expectancy a majority of the elderly who live alone are women. If an elderly person with low income lives with his or her gainfully employed child (as is more common, for instance, in continental Western Europe and Southern Europe) instead of living alone, his or her household-specific income probably exceeds the poverty risk limit even though when living alone the income falls below the limit.

Pensioners' disposable equivalent monetary income[2] is in Finland lower than on average in the EU countries and the purchasing power of the income is lower than on average in the EU15 countries. The income of persons of retirement age in relation to the income of persons of working age is also lower in Finland than elsewhere in the EU15 countries. In Finland the income of persons of retirement age is approximately 75 per cent of the income of persons of working age, whereas it is on average 81 per cent in the EU15 countries.

[1] The person's disposable income (equivalent income) is calculated by adding up the household's production factor income and income transfers and deducting paid income transfers and dividing this sum by the household's consumption unit factor, which is calculated by adding up the weightings of the members of the household in the consumption burden. On the OECD consumption scale the 1st adult receives the weighting 1, the following the weighting 0.5 and the children the weighting 0.3 each.

[2] The equivalent monetary income is the household's disposable income (without possible calculated components, such as housing income) per consumption unit.

Figure 8.4. *Equivalent monetary income of the pensionable-aged and working-aged populations in PPS in certain EU countries in the year 2001.*



Source: Kati Ahonen 2006 / COM 2006 final, in Pensions and pensioners' disposable income.

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Ismo Risku

9 Prospects of Pension Provision

In many countries, including Finland, statutory pension schemes have been reformed significantly in recent years. From the beginning of 2005 the reform of the earnings-related pensions entered into force, through which the determining of the pension benefits was unified and simplified. The determining of the earnings-related pension separately for each employment was discontinued and the increasing life expectancy is taken into account through the life expectancy coefficient. The pension accrual rates and the linking to the level of prices and earnings were also changed. The pension accrual for different unpaid periods was harmonised and the number of different kinds of unpaid periods which accrue a pension was increased. The unemployment pension and the individual early retirement pension will be abolished, and the age limit of 65 years for the old-age pension was made flexible between the ages of 63 and 68. The reform reduces earnings-related pension expenditure and pension contributions. For the individual the pension is to an increasing extent determined on the basis of the earnings during the whole lifetime.

The investment activities and financing techniques under the private-sector earnings-related pension acts are reformed from the beginning of 2007. The most significant reform proposals are included in a survey on earnings-related pension investments, which was drawn up on the initiative of the labour market organisations.

The pension expenditure calculations in this chapter are based on the legislation which took effect in 2005, but the calculations concerning the financing of pensions follow the rules which take effect from the beginning of 2007. The calculations have been done at the Finnish Centre for Pensions in autumn 2006.

In 2004 pensions made up approximately two-thirds of the income transfers paid. Most of the pensions were statutory earnings-related pensions and national pensions (table 9.1, figures according to national accountancy). Unemployment allowances constituted a good one-tenth and income transfers to families with children (family allowances, child home care allowance and parents' allowances) slightly less than one-tenth of the income transfers paid. The share of pensions in GDP is increasing due to changes in the population structure and the share of pensions in the income transfers paid will also increase in the future.

Table 9.1. *Social security benefits and assistance paid in 2004.*

	EUR million	%
Pensions	**17,441**	**65.4**
- Mandatory earnings-related pension	13,585	51.0
- National pension	2,739	10.3
- Others	1,117	4.2
Daily allowances	**4,211**	**15.8**
- Unemployment allowances	2,931	11.0
- Sickness allowances*	670	2.5
- Parental allowances*	610	2.3
Other benefits and assistance	**5,011**	**18.8**
- Family allowances and child home care allowance	1,788	6.7
- General housing allowance	436	1.6
- Income support	424	1.6
- Financial aid for students	731	2.7
- Statutory workers' compensation	455	1.7
- Others	1,177	4.4
Total	**26,663**	**100.0**
*Social expenditure in total***	*42,130*	
GDP at market prices	*151,935*	

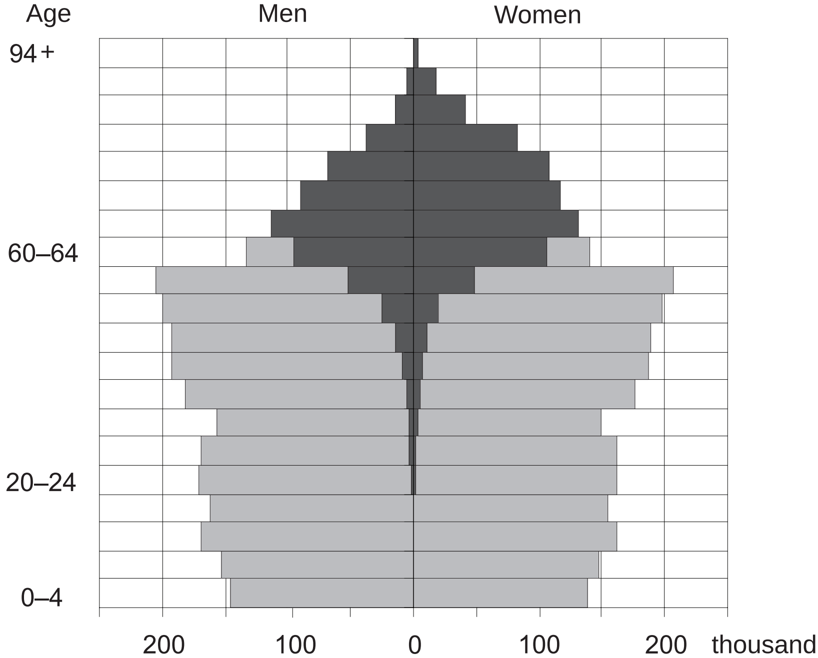
Sources: Statistics Finland, *Social Insurance Institution, **Ministry of Social Affairs and Health.

These calculations follow the current legislation. They describe the future prospects of the earnings-related pensions under the assumption that the current legislation remains unchanged and the developments in the population and in the economy follow the assumptions.

9.1 Population development

Population ageing has increased the interest in the development in public expenditure and in pensions in the long term. The largest age groups ever in Finnish history are nearing retirement age (figure 9.1). Over the next few decades the age groups that enter the labour market are smaller than the age groups that exit the labour market. In 2004 there were 412,000 persons aged 55–59, whereas the preceding five-year cohort numbered 273,000 persons. The age groups entering the labour market number a good 300,000 persons; in 2004 there were 318,000 persons aged 15–19.

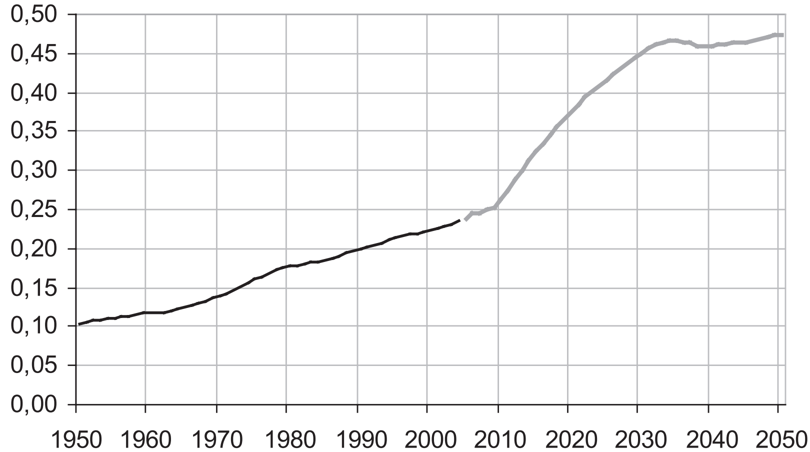
Figure 9.1. *Finnish population and persons receiving a pension in their own right, 31 December 2004, the horizontal bar describes the whole population and the darker portion the pension recipients.*



Sources: Statistics Finland and Statistical Yearbook of Pensioners in Finland 2004.

From a pension expenditure viewpoint the crucial indicator for population development is the old-age dependency ratio. The indicator describes the number of elderly persons in relation to the number of persons of working age, i.e. those who have reached the age of 65 compared to those aged 15–64. The Finnish population has been ageing steadily since the end of the war, but in the next few years the ageing trend speeds up considerably (figure 9.2). The old-age dependency ratio increased from the beginning of the 1960s over the next 40 years by 10 percentage points. According to the 2004 population forecast of Statistics Finland, the old-age dependency ratio increases more steeply from the 2010s onwards, so that in 20 years the old-age dependency ratio increases by 20 percentage points.

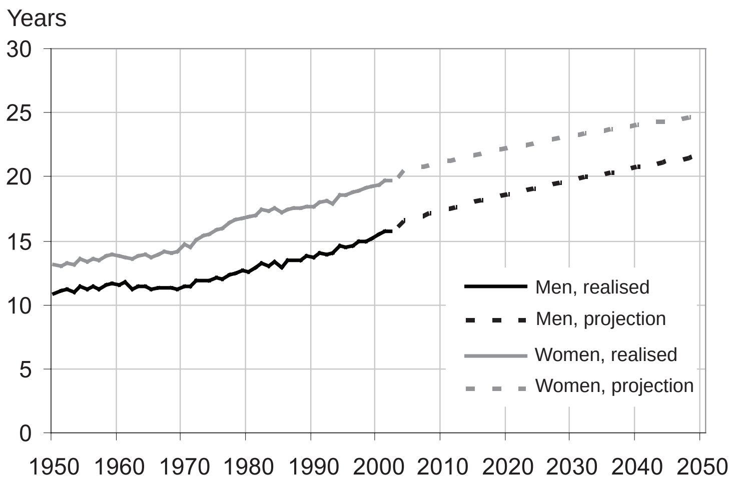
Figure 9.2. *Old-age dependency ratio, persons having reached the age of 65 per persons aged 15–64 in 1950–2050.*



Source: Statistics Finland.

The continuous increase in life expectancy explains part of the realised and the projected increase in the old-age dependency ratio (figure 9.3). The main reason for the increasingly rapid population ageing from the 2010s onwards is, however, the sharp decrease in the birth rate, which started in the 1950s and continued till the beginning of the 1970s.

Figure 9.3. *Life expectancy for 65-year-olds in 1950–2050.*



Source: Statistics Finland.

The relative share of pension recipients does not increase quite as steeply as the share of the elderly, because the relative significance of pre-retirement pensions decreases. Nowadays a significant proportion of pension recipients are aged under 65 (figure 9.1). In addition to the change in population structure the abolishment of the unemployment pension and the individual early retirement pension reduces the share of recipients of pre-retirement pensions in the total number of pension recipients.

The pension expenditure and contribution calculations in chapter 9.2 are based on the 2004 population forecast of Statistics Finland. The main assumptions are:

1) Total fertility rate 1.8
2) Net migration 6,000 persons annually
3) Current rate of decrease in mortality continues.

Assumptions 1 and 2 mean a slow decrease in population, each generation is smaller than the previous one. The last assumption means a significant rise in life expectancy in the long term. According to the forecast, the life expectancy for 65-year-olds will increase by the 2050s by approximately five years. If this is not accompanied by changes in effective retirement age, this increase in longevity will show in full in an increase in the number of years spent in retirement.

Currently the Finnish old-age dependency ratio (22 per cent) is slightly lower than on average in the EU countries (23 per cent). According to the Eurostat forecast[1], the Finnish old-age dependency ratio will, however, become the highest in the EU by 2025 (Finland 41 per cent, EU 36 per cent). When the projection is continued to the 2050s the Finnish population is still ageing, but at a slower pace than in Europe on average. In 2050 the estimated old-age dependency ratio is 47 per cent in Finland and 53 per cent in the EU on average.

The differences in the pace of population ageing are mainly explained by differences in birth rates. In Finland the post-war baby-boomers were born earlier than on average in Europe. Thus the birth rate increased earlier after the war, but also started to decrease earlier. This means that in the next few decades the Finnish population ages fairly rapidly. On the other hand, the birth rate in Finland is currently higher than on average in the EU countries, as a consequence of which the old-age dependency ratio in the more distant future will not rise as high as in Europe on average.[2]

[1] Eurostat's 2005 population forecast covers all EU member states. As regards Finland the forecasts of Eurostat and Statistics Finland are almost similar in their contents up to the 2030s, but from then onwards Eurostat assumes a slightly slower rate of decrease in mortality (i.e. higher mortality) than Statistics Finland.

[2] Biström and Elo (2007) survey the most recent population forecasts and their assumptions.

9.2 Pension expenditure and pension contribution

The population forecast provides the framework for long-term pension expenditure calculations. In addition actuarial pension calculations require assumptions on employment rate, retirement risk and development in the earnings level. The connections between the different components of the expenditure calculation are shown in the box below.

Ratio of pension expenditures to the wage sum by component

$$\frac{pens.\exp}{wagesum} = \frac{pop.(65+)}{pop.(16-64)} \times \frac{nr\ \ pensioners}{pop.(65+)} \times \frac{pop.(16-64)}{nr\ econ.active} \times \frac{aver.pension}{aver.wage} \qquad (1)$$

The first component above is the demographic old-age dependency ratio. The second component describes the relative share of pre-retirement pensions, since it can be written in the form,

$$\frac{nr\ \ pensioners}{pop.(65+)} = \frac{nr\ old-agepensioners}{pop.(65+)} + \frac{nr\ earlypensioners}{pop.(65+)} \approx 1 + \frac{nr\ earlypensioners}{pop.(65+)}$$

The third component in equation (1) is the reverse employment rate. If one so wishes, it is possible to shrink these three components into a ratio of pensioners to the economically active population. The fourth component describes the relative benefit level.

The first of the components is derived directly from the population forecast and also the following two components are partly dependent on population structure. The first component shows that when the demographic old-age dependency ratio doubles the ratio of pension expenditures to the wage sum also doubles, if the other factors remain constant. However, as the population ages the second component also reacts automatically, but in the opposite direction to the old-age dependency ratio. The ratio of recipients of pre-retirement pensions to the population having reached the age of 65 decreases, because in the future the age groups reaching retirement age grow but the age groups reaching the age limit for pre-retirement pensions shrink. The development of the employment rate is also connected to the population structure but probably depends more on other factors.

The most significant assumptions of the long-term calculations presented in the following are:

1) The population follows the 2004 population forecast of Statistics Finland
2) The effective retirement age increases by two years by 2025 and by three years by 2050
3) The employment rate increases to 70 per cent by 2025 and to 72 per cent by 2050
4) The real annual growth rate in earnings is 1.75 per cent
5) The real return on pension assets is 3.5 per cent or 4.0 per cent

This last assumption is significant when evaluating the development of pension contributions and funds. The assumptions are described in more detail in the report Biström et al. (2004).

The 2005 pension reform includes the life expectancy coefficient, through which the capital values of old-age and surviving spouse's pensions should stay unchanged even though the life expectancy for the population of retirement age changes. If the current downward trend in mortality continues, new old-age pensions decrease due to the effect of the life expectancy coefficient. A projection of the future development of the coefficient can be calculated on the basis of the population forecast.

Figure 9.4 shows the development of the life expectancy coefficient up to 2050 according to the forecast of Statistics Finland as well as according to alternative population forecasts where the rate of decrease in mortality either slows down or speeds up. The horizontal axis shows both the calendar year when the coefficient is applied for the first time and the birth year of each cohort to which the coefficient is applied. If the population forecast of Statistics Finland is realised, for instance the initial amounts of the old-age pensions for persons born in 1963 are multiplied by the factor 0.93.

The pension expenditure under the pension acts for private-sector employees (TEL, LEL and TaEL/TyEL) in proportion to the wage bill has increased almost in a straight line since the acts entered into force (figure 9.5). The recession in the 1990s and the recovery from this recession are the main deviations from this trend. In 2005 the expenditures amounted to 18.1 per cent of the wage bill. The growth in expenditure continues up to the 2030s, after which the expenditures settle at a good 30 per cent of the wage bill. The partial funding shows in the figure in that in the past the contributions have exceeded the expenditures, except for the worst years of the recession. The difference between contributions and expenditures as well as the yields on the assets have accumulated more pension assets. The expenditure level will exceed the contribution level permanently from the initial years of the 2010s onwards. The difference between expenditures and contributions is financed through yields on the assets.

Figure 9.4. *Life expectancy coefficient in 2005–2050, according to the population forecast of Statistics Finland (trend) and alternative calculations, where the rate of decrease in mortality is halved or increases to 1.5 times the base scenario (0.5 x trend and 1.5 x trend).*

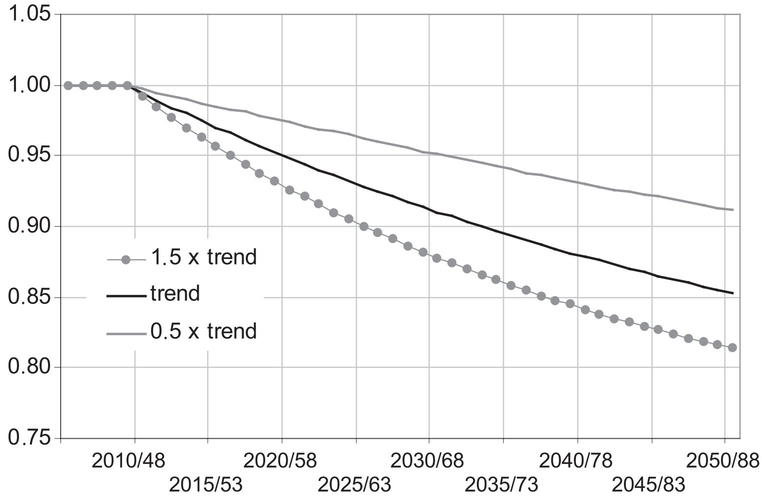
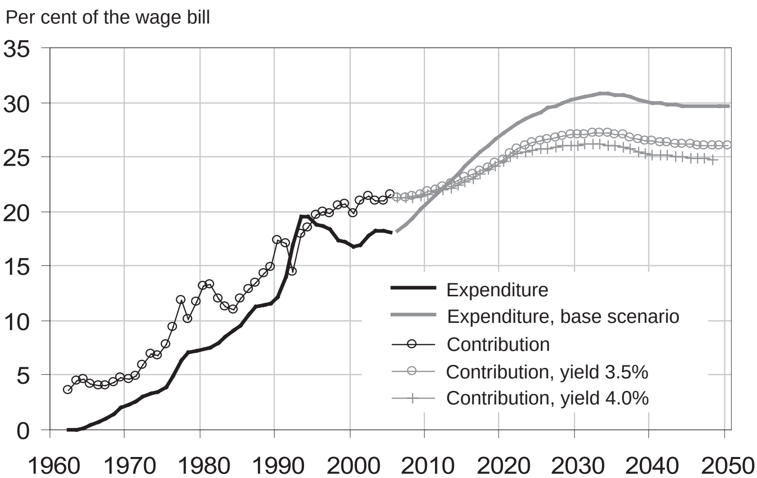


Figure 9.5. *Pension expenditure and contribution as percentages of the wage bill for TEL, LEL and TaEL/TyEL in 1963–2050.*



So far the increase in the expenditure and contribution levels has been a consequence of the implementation of the acts and of population ageing. As regards expenditure the pension acts are still in the maturation phase, since the oldest age groups have not had time to accrue an earnings-related pension during their whole work history. However, mostly the visible increase in expenditures is a consequence of population ageing.

Although the expenditure level under TyEL will exceed the contribution level in the near future, the value of the investment assets of the pension providers handling TyEL insurance (TyEL assets) increases over the whole calculation period. Even the proportion of TyEL assets to the wage bill increases under the calculation assumptions used. At the end of 2005 the TyEL assets amounted to approximately 1.8 times the corresponding wage bill. Assuming the return on the pension assets to be 3.5 per cent, the pension assets will amount to 2.1 times the wage bill in 2015 and almost 2.5 times the wage bill in 2050.

It is also interesting to compare the amount of pension assets to the capital value of accrued pensions (table 9.2). The funding ratio can be defined to mean the proportion of pension assets to the value of accrued pensions at a certain time. The value of the accrued pension rights is the money amount which suffices to finance all pensions accrued up to that time when taking into account the return on the assets and future index increases to the pensions. The value of the pensions accrued up to the end of 2005 was approximately 400 billion euros and the amount of pension assets a good 100 billion euros, so of the accrued pensions about one-fourth has been funded in advance. The funding ratio under TyEL is approximately one-third and the funding ratio of public-sector pensions approximately one-fifth.

Table 9.2. *Accrued pension rights and funding ratio 31 December 2005.*

	Pension rights bn euros*			Assets bn euros	Funding ratio*		
	3.0%	3.5%	4.0%		3.0%	3.5%	4.0%
TyEL	243	224	207	70.1**	29%	32%	34%
Private	274	252	233	71.5**	26%	28%	31%
Public	149	138	128	29.2	20%	21%	23%
Total	422	390	361	100.7**	24%	26%	28%

* Pension rights and funding ratio at different real-term discount rates
** From the amount of pension assets according to the data of the Finnish Pension Alliance TELA deducted 1.5 billion euros of assets from registered supplementary pension provision.

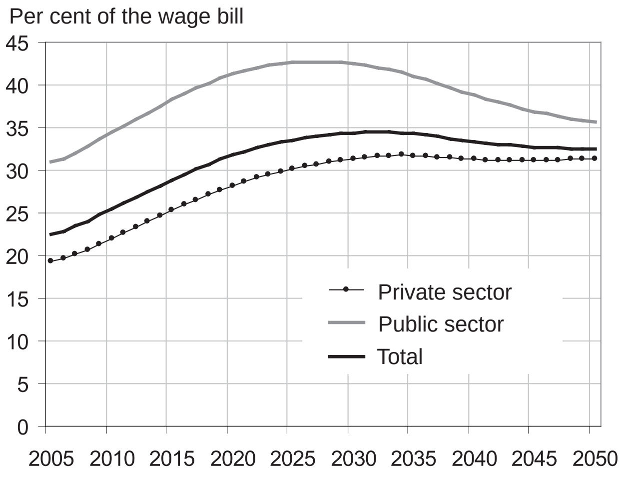
The development in the funding ratio depends first and foremost on the return on pension assets. If the future rate of return is 3.5 per cent, the funding ratio stays at the current level, but higher returns mean an increase in the funding ratio (table 9.3).

Table 9.3. *Funding ratio under TyEL in 2005–2020.*

	2005	2010	2015	2020
3.5% interest	31.6%	32.7%	32.8%	32.8%
4.0% interest	34.2%	35.9%	36.5%	37.1%

The expenditure development in the private and in the public sector clearly differ from each other (figure 9.6). Private-sector expenditure is made up of the pension acts TyEL, MEL, YEL, MYEL and VEKL[3], and public-sector expenditure of the acts VEL, KuEL and VEKL. Public-sector pension expenditure in proportion to earned income is initially about 10 percentage points higher than private-sector expenditure. This difference will continue to grow in the next few years, but in the longer term the differences in pension expenditure percentages between the sectors will narrow.

Figure 9.6. *Earnings-related pension expenditure, percentage of the wage bill by sector in 2005–2050.*

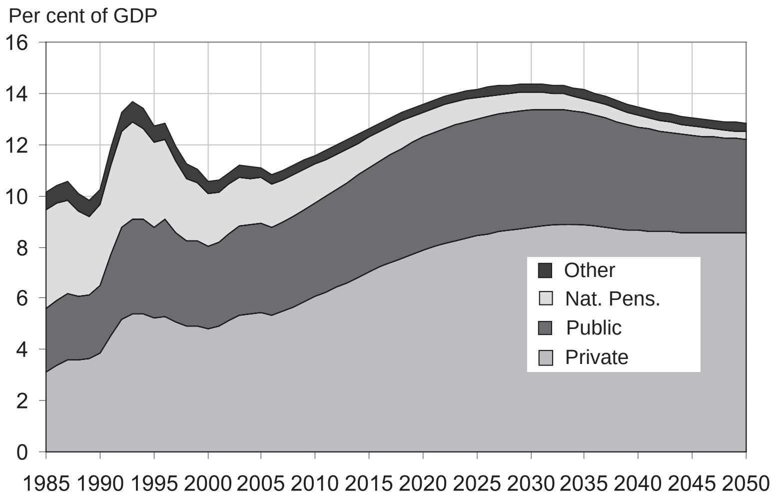


[3] The Act on Pension Accrual for Child Care and Periods of Study (VEKL) is not actually a part of neither public-sector nor private-sector pension expenditure, instead the expenditure under the act is technically divided between the different sectors in proportion to the young persons' primary employment.

The current difference in pension expenditure percentages is due to the traditionally more generous pension benefits of the public sector and privatizations, as a consequence of which job tasks have been transferred from the public to the private sector. On the other hand, there are no significant differences in accruing pension benefits between the sectors in the future. In the calculation the labour force shares of the different sectors is assumed to remain at the current levels. If the labour force share of the public sector shrinks, the differences between the sectors in the expenditure development increase. Transfer of labour force from one sector to the other does not change total pension expenditures or the amount of premium income required to finance them; instead there may occur a need to change the financing techniques of public-sector pensions.

The total statutory pension expenditure can be divided into private-sector earnings-related pensions, public-sector earnings-related pensions and national pensions as well as the group other pensions, which includes pensions from workers' compensation and motor liability insurance and military accident compensations, early pensions for front-veterans and special pensions for farmers (figure 9.7). In 1985 earnings-related pensions constituted 55 per cent of statutory pension expenditure, whereas nowadays the share is 80 per cent and by the 2030s 90 per cent.

Figure 9.7. *Statutory pension expenditure in per cent of GDP in 1985–2050.*[4]



[4] Development in national pension expenditure is based on the Social Insurance Institution's actuarial publication 7 (2006).

The share of statutory pension expenditures in GDP is currently not significantly higher than 20 years ago even though the old-age dependency ratio of the population has increased continuously and the earnings-related pension scheme is still in its maturation phase. The business cycles, especially the recession in the 1990s, show clearly in the development of the share of pension expenditures in GDP.

The future growth in earnings-related pension expenditures is mainly a consequence of population ageing. On the other hand, the decrease in national pension expenditures is mainly due to the fact that in the calculation no real-term increases have been made to the national pensions after the 2008 reform of the cost-of-living categories.[5] If national pensions were linked fully to the earnings level, the share of national pension expenditures in GDP would remain more or less at the current level of slightly under two per cent.

9.3 Benefit level

Pension levels and development in the level can be studied from many different viewpoints. Replacement rate means the size of the pension in proportion to the preceding earnings. When the pension acts were enacted in the 1960s the aim was a replacement rate of 40 per cent and in connection with the overall increase in pensions in the 1970s a replacement rate of 60 per cent. The surveying of the level of realised replacement rates is restricted by the availability of data.[6]

The surveying of the purchasing power of pensions (level of pensions in relation to the general price level) or the relative pension level (level of pensions in relation to the general earnings level) is considerably easier than studying replacement levels. In 2005 the average total earnings-related pension (pension in one's own right and survivors' pension) was 1,025 euros a month.[7] At the price level of 2005 the average pension in 1985 was 569 euros, i.e. in twenty years the purchasing power of the average earnings-related pension increased by almost 80 per cent. The purchasing power of total pensions (earnings-related and national pension) is higher, but it has increased at a slower pace than the purchasing

[5] Currently national pensions are paid according to two municipal cost-of-living categories. From the beginning of 2008 the cost-of-living categories will be unified so that the pensions in the lower category will be increased.

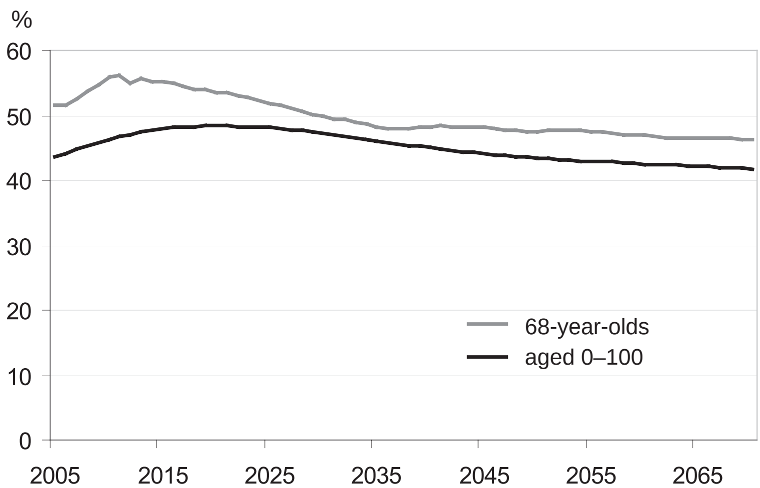
[6] Rantala (2003) has studied the replacement levels of persons having retired in 1996–1997.

[7] Pensioners living in Finland without part-time pensioners and farmers receiving early retirement aid.

power of earnings-related pensions. In 2005 the average total pension was 1,122 euros[8], whereas in 1985 it was 738 euros a month in the price level of 2005, an increase of a good 50 per cent.

The size of the earnings-related pension is calculated on the earnings through the accrual rates, and thus the purchasing power of earnings-related pensions automatically follows the development in the earnings level. The assumed annual increase in the earnings level of 1.75 per cent in the pension expenditure calculation means a doubling of the general earnings level in 40 years. In this case, the level of earnings-related pensions also almost doubles over the same time period. On the basis of the pension expenditure calculations it is possible to evaluate the purchasing power of pensions and the relative pension level also in more detail by making use of the aforementioned division of pension expenditure into components (see box). The views on the future relative pension level in figure 9.8 and the development of the pension expenditure percentage in figure 9.6 are based on the same pension expenditure calculation.

Figure 9.8. *Earnings-related pension in per cent of the average wage.*[9]



[8] All pensioners without part-time pensioners and survivors' pension recipients.

[9] In 2005 the average wage was 2,292 euros per month. The benefits include pensions in one's own right and survivors' pensions. Pension recipients resident abroad as well as special pensions for farmers, part-time pensions and partial disability pensions are not included in the calculation.

The ratio of the average earnings-related pension to the average wage has increased from about 35 per cent to a good 40 per cent in the last 20 years. This ratio will continue to increase for another 10–15 years, since the oldest age groups are replaced by age groups who have accrued a ”full pension” (figure 9.8). In a good 40 years the level of earnings-related pensions in proportion to wages will be the same as now. In the Figure the relative level of starting old-age pensions is approximated at the pension level of 68-year-olds. This ratio follows the level of new old-age pensions with a couple of years’ delay. The level of new old-age pensions is a good fifty per cent of the average wage. The ratio will continue to increase for a few years still, until the effect of the life expectancy coefficient causes it to start decreasing slightly in the initial years of the 2010s.

Surveying of the average relative pension level passes over many viewpoints that are crucial as regards income. Nowadays about one-third of those of active age receive no wage and no income from self-employment. On the other hand, all pensioners by definition receive a pension. In addition children are typically taken care of by persons of active age. Capital income as well as paid and received income transfers also affect the income of different groups of people. The average figures are also not in any way dependent on income distributions or insecurity connected to earnings at the individual level.

The report of the Finnish Centre for Pensions (Hietaniemi et al. 2006) strives to survey the development in benefit level in different ways. According to the calculations based on earnings development data, the replacement rates of the earnings-related pensions for persons who retire at the age of 65 after an average work history of 35 years will in the next few years be about 50 per cent and will stay at almost the same level for the next 40 years. Including the national pension increases the replacement rate to a good 55 per cent. According to the theoretical calculations, in Finland the replacement rate of the total pension (earnings-related and national pension) is for a person with average wage and a work history of 40 years nowadays approximately 57 per cent and will be at the same level in 2030, after which the replacement rate decreases to about 54 per cent in 2050.

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Kimmo Kontio

10 History of Pension Provision

10.1 Early history of statutory pensions

Civil servants' pensions for a privileged few

Modern statutory pension provision is most significantly based on civil servants' pensions. In 1870 there were 3,500 state civil servants, i.e. 0.2 per cent of the population at the time.

The civil servants' pensions reflected the estate society of the time. The person's origins dominated his or her whole life. For a long time the civil servants were noblemen. Still, positions within the Church could also be achieved by persons of a lower estate. Without inherited wealth, pension provision was tightly connected to a life-long office and yields from a residence.

Civil servants' pensions cannot be considered extensive. Individual need for assistance or social reasons played an insignificant role. For instance, the successor of a dead vicar had to provide for the deceased vicar's widow and children for one year. After that the widow had to find a breadwinner for the family or survive on her own. Help could be obtained from widows' and orphans' funds if the deceased had been a member of one.

As the country got wealthier, civil servants' pensions also changed. For instance, the retirement age was lowered from 70 years to 65 years in 1826 and then with a couple of years in 1866, and the public-sector general retirement age remained the same until the 1990s. A full pension required 35 years of service.

The Civil Servants' Pensions Act of 1924 still showed the attitude of the estate society: ”entitlement to a pension, as to a salary, is a subsistence-like remuneration for the civil servant putting his whole work input at the disposal of the State”.

Life annuity contracts and care for paupers

A considerably larger group than the civil servants which formerly benefited from a fairly secured income in old age were freeholders. The income for old farm-owners was based on a confirmed life annuity contract between them and their heirs, where a mortgage was applied for with the district court as security for the agreement. The new generation paid definitely for the house by caring for the former occupants in old age. The house could also be given to a stranger against life annuity.

Legally valid life annuity contracts are still drawn up to some extent and thousands of them are still in force. Life annuities mainly supplement farmers' change-of-generation pensions.

For most people old age, disability, death of the family breadwinner or other lack of income meant well into the 20th century scraping a living on one's own or relying on help from relatives. For the population outside the estates, that is more than 80 per cent, the pensions were intended to be arranged as cheaply as possible although the official legislation required charity for the old and disabled.

Paupers who were provided for and the inmates of old people's homes had to work against their care for as long as they were able to. The authorities also tried to shirk their responsibilities. The municipalities had the right to refuse to take into their territory persons who might cause a care burden and who were aged more than 40 years. Retirement was thus earlier a clearly distinguishable phase in life only for a small proportion of Finns.

By the beginning of the 20th century about 5 per cent of the Finnish population was aged over 65, that is, less than half of the share in Sweden. There are no reliable estimates of the number of others in need of pension cover.

10.2 Towards a comprehensive pension system

The first proposals for comprehensive arranging of pension provision for Finns were made already in the 1860s. However, forming the proposals into real efforts took more than fifty years. The period up to the end of the 1950s can be termed the period of national and private try-outs in Finnish pension provision.

Of the Nordic countries, Finland remained for the longest time an agriculture-based country (table 10.1), which slowed down the development of a modern social security. The agriculture-based social structure significantly affected the trends and priorities of the social security legislation carried out in Finland.

The aims and ambitions were still high right from the start. Researchers and leading officials closely followed European trends in social security and social insurance already from the end of the 19th century.

Broad concrete social research provided a basis for the committees that sat at the beginning of the 20th century. The invalidity insurance committee pondered old-age and disability provision. The modern proposals remained briefs or the legislation enacted was not approved during the unparliamentary and also otherwise politically unstable end of the period of autonomy, when the relations with Russia dominated politics.

Immediately when Finland had become independent in December 1917 people again began thinking about social insurance. No measures could be taken before the end of the 1930s.

Table 10.1. *The gainfully employed population in Finland and in Sweden according to sector in 1870–1970, per cent.*

Year	Finland			Sweden		
	Agriculture	Industry	Other	Agriculture	Industry	Other
1870	87	5	8	73	12	15
1910	75	12	13	50	26	24
1940	64	18	18	30	37	33
1970	20	34	46	8	40	52

The first National Pensions Act was based on individual pension accounts and a principle of insurance

In 1930 the Finnish social security covered only 4 per cent of the people, whereas the percentage in Sweden was 53 and in Denmark even 73.

The social problems caused by the global deep recession at the beginning of the 1930s clearly showed the underdevelopment of the Finnish social security. After the recession, when the political situation also was clarified towards the end of the decade, important social reforms could be put into effect at top speed.

The most important one was the national pension scheme of 1937, which remained in force until 1956.

The national pension in case of old age or disability concerned the whole population, not just wage earners. The then more numerous rural population saw the national pension as providing more benefits than health insurance, the second main alternative for developing social security.

National pension insurance was mandatory for persons aged 18–65. Provision was based on personal pension savings accounts. Over time the cover was increasingly supplemented by a subsistence principle financed by tax revenues. An independent Social Insurance Institution, supervised by Parliament, was established to implement the Act, and it still follows this administrative model.

Despite its long period of implementation the National Pensions Act of 1937 never achieved its aims. Due to the modest 2 per cent contribution the level of the pensions could never even have become very high. In addition the war and reconstruction together with high inflation gnawed at the solvency of the scheme. After the wars the basic infrastructure in Finland, such as electricity, was still mainly created through national pension funds.

The national pension also did not, despite its name, cover the whole population, since the oldest age groups had been left outside its scope and there was a minimum contribution period for disability provision.

Start of private earnings-related pension insurance

Earnings-related pension cover had already previously been arranged privately. In addition to widows' and orphans' pension funds mentioned in connection with the civil servants' pensions, the employers and the employees had often together established pension funds for the employees. These can be seen as the successors of the assistance funds of spiritual communities and the professions, known already in the Middle Ages. The first Act on Pension and Other Assistance Funds came in 1897.

However, administration of the funds lacked actuarial know-how and their affairs were not supervised. At the most the pensions awarded by the industry-wide pension funds might amount to approximately one-third of the annual wage, which neared the target level of 40 per cent of the 1961 Employees' Pensions Act (TEL). However, the resources of most pension funds evaporated through the inflation of the First World War.

Despite early failures the private pension funds grew slowly to become highly significant. At the end of the 1950s they covered about 220,000 people. The Act on Company Pension Funds took effect in 1955. In addition the pensions for 25,000 persons were arranged in private insurance companies.

Seamen's Pensions Act (MEL) pilot act in earnings-based pension provision

In the insecure atmosphere of the Cold War in the 1950s the Finns were even more dependent on foreign trade than today. In practice the only route to the Western international markets was by sea. Those working at sea then had the rare opportunity to compare their situation with that in other countries. As a key group, the seamen obtained their own earnings-related pension act, which is still in force, already in 1956. The act functioned as the pioneer for the later earnings-related pension acts.

10.3 Incoherence and gaps as problems of pension provision in post-war Finland

By the mid-1950s Finnish pension provision had become a mosaic-like net, which despite its diversity had large gaps and faults.

The State had its civil servants' pensions, and many municipalities had their own pension regulations for their officials. Private pension arrangements were also significant but not extensive. The pension entitlements were usually lost when changing jobs. The low level of the national pension was the cause of dissatisfaction.

According to section 5 of the Public Welfare Act, the employer was liable to provide for his long-term employee in case of loss of work ability due to old age or illness. One requirement was an employment contract of 20 years and that the employee did not get an income elsewhere, not from his own resources, nor from the spouse or the children. The recipient of assistance was still liable to work for the employer to a reasonable extent.

Until 1970 the Act also maintained the liability for the children to provide for their ageing parents.

The war and a changing labour market increased the need for pension provision

In the 1950s pension provision was no longer able to answer the real needs of Finnish society. The demands to improve the pensions can be derived from the experiences of the war and the unity it created. In Finland the previous war was literally a battle of the whole population.

The post-war period is usually remembered for the settlement of the evacuees from the territories ceded to the Soviet Union and front veterans. A lot of people already then moved into towns. The structure of the labour force changed rapidly. The share of people working in agriculture diminished from 46 to 35 per cent in 1950–1960. An increasing number of people were working for a company or in public service, and no longer in private professions or as assistant employees. The numbers of the rural population started decreasing at the end of the 1950s.

Women continued to participate in the labour market after the war, so the security in old age based on home care diminished. Assistance pensions for war widows, orphans and invalids provided a new model for pension provision. The number of people of retirement age started increasing in the 1950s.

Production and productivity increased in all Western countries. The increasing number of wage earners started demanding their share of this growth. In Finland statutory earnings-related pension provision became an important means of distributing the yields of the economic growth.

”Civil servants’ pension for all” – dispute over the development of the national pension

There was general agreement on the need to reform the National Pensions Act, but all the more disputes about the direction of change, even within parties. So the flat-rate scheme financed by tax revenues, supported by the representatives of the rural population (the Agrarian Party and also the People’s Democrats), was approved amid tensions caused by a general strike and tight presidential elections in 1956.

The level of the smallest national pensions increased even 2.5 times. The revaluation of the accumulated pension accounts was felt as an income transfer to the farmers. This caused resentment especially in the employees’ organisations. The disappointment was aggravated by the fact that some wage earners already had a pension, such as civil servants and members of pension funds. The lack of sufficient income in old age and rigid pensions did not fit the post-war mobility of the labour force. Civil servants’ pensions were still considered as a good model in principle, however. When shaping the earnings-related pension act, the motto was ”civil servants’ pension for all”.

Pension committee seeks new benefits for the employees and financing modes for the employers

The earnings-related pension committee established at the end of 1956 was needed. As the war reparations had been paid in industrial products, the employees' organisations in the 1950s already knew their worth. Strikes and threats of strikes were the rule. The war and the war reparations did of course not create savings for the people. Due to repeated devaluations inflation gnawed at the pay packet, so the representation of interests needed a long-term perspective.

Although devaluation always brought a momentary competitive advantage for the export companies, they would also have sourly needed money for investments in production in a country poor in capital. So it was suggested that the companies get the right to reborrow the accumulated pension funds. Such an inducement was needed, since the plan was to levy the insurance contribution solely from the employers. The employers' support for the act was also sought through suggesting that earnings-related pensions be handled by private insurance providers in contrast to the Swedish solution of 1959. The committee evaluated the experiences gained from the pension funds and saw a decentralised scheme also as cheaper than a centralised scheme.

The employees found the guarantee of receiving the accrued pensions from different employment contracts very important. Due to this vesting principle the competing pension providers needed the Finnish Centre for Pensions as liaison body, maintaining a common register of pension entitlements. The Finnish Centre for Pensions was to handle pension components financed jointly, such as revaluations, and divide the liability for the pension between the relevant pension providers. The pension applicant was to be in contact with only one pension provider.

To secure the functioning of the investment of pension funds the committee suggested credit insurance reliant on employer contributions. The committee also thought it necessary to establish a pension appeals board as an independent first level of appeal in pension matters.

All these committee suggestions were incorporated as such into the earnings-related pension acts.

Creation of earnings-related pension act exceptionally headed by labour market organisations

The general private-sector pensions act, the Employees' Pensions Act (TEL) was enacted on 8 July 1961. It took effect at the same time as the Temporary Employees' Pensions Act (LEL) on 1 July 1962. LEL was the key question for approval of TEL. These acts, together with unemployment insurance of 1959, were the only acts in Finland born of extra-governmental initiative on direct suggestion from the labour market organisations. Due to the attention caught by the inflamed international political situation actually only the labour market organisations understood the importance of the matter already at the time.

The earnings-related pension scheme initiated a period of labour market-driven development of social insurance in Finnish social policy. The following, supplementing but perhaps also competing act to be enacted was the Health Insurance Act of 1963.

The start of the earnings-related pension acts was facilitated by the fact that in the 1960s the share of elderly people in the population stayed relatively low from a European perspective, and those who had exited the labour market before the scheme took effect were left outside the scope of the scheme and the target level of the pension was moderate.

10.4 A comprehensive pension scheme

The 30-year period after the enactment of TEL in 1961 was a period of extension of the range of pension benefits. As the number of pensioners was still low compared to the number of insured, the financing basis was favourable for reforms. The period was also dominated until the mid-1970s by the dispute over the direction in which to develop the pension system, which has speeded up improvements both in the earnings-related pensions and the national pensions.

Period of broadening pension benefits

Originally the earnings-related pension acts covered only old age and disability. The TEL target level was 40 per cent of the final wage. An old-age pension accrued from employment contracts of at least six months from the age of 23, and a full old-age pension based on the final wage accumulated in 40 years. The old-age pension could be taken at the age of 65. In contrast, in the LEL industries, where still in the 1960s the work typically consisted of short-term employment contracts, average earnings were the basis for the pension. In the beginning, earnings-related pensions were very small. They mainly supplemented the national pension, where the earnings-related pensions were not taken into account.

In case of incapacity for work the person's pension was calculated as if he or she had continued working to the general retirement age of 65.

Due to transition provisions a large part of the wage earners, so far only covered by the national pension, were now for the first time covered by earnings-based pension provision. At the end of 1962 an average monthly pension of FIM8,700 was paid to 185 persons. In current money terms and with revaluations this average pension would be about 150 euros.

Despite a seemingly modest start the acts were a good basis for the development of the earnings-related pension scheme. Working groups immediately started preparing reforms. Survivors' pensions extended the personal scope of the scheme significantly in 1967.

The first private-sector earnings-related pension acts immediately affected the modernisation of the civil servants' pensions. Local government pensions were harmonised through a separate act (Local Government Employees' Pensions Act KVTEL) and a separate pension provider, the Local Government Pensions Institution, in 1964. The State Employees' Pensions Act (VEL) and the Evangelical-Lutheran Church Pensions Act (KiEL) were enacted in 1966. The State Treasury is still responsible for state pensions and the Church Council for church pensions.

In 1970 also entrepreneurs and farmers obtained statutory pension provision through the Self-Employed Persons' Pensions Act YEL and the Farmers' Pensions Act MYEL. The following year the pension benefits were extended by the unemployment pension. The partial disability pension soon followed. The original waiting period of six months in TEL was first shortened to four months and then to one month. The earnings-related pension already covered more or less the same life situations as nowadays.

Earnings-related pension provision was improved especially through an overall increase in 1975, when the accrual rate was increased from 1 per cent to 1.5 per cent and the target pension rose from 40 to 60 per cent. In this connection, the roles of the earnings-related and the national pension were redefined, and the primary role of the earnings-related pension was emphasised.

Instead of the earlier wage index a half-way index was used for pension calculation and revaluation of pensions in payment in 1977–1995, where the price and wage indices had an equal weighting. The index is a key factor to maintaining the value of pension entitlements and pensions.

At the same time, due to the recession triggered by the energy crisis the pension contribution was lowered in 1977 by one percentage point for labour market policy reasons. The statutory pension contribution has also later been used as a tool in stabilisation policy.

From 1979 the pensionable wage under TEL was calculated on the earnings of the last four years, of which the best and the worst year was left out.

During the following decade especially the retirement ages were considered. In the studies, ageing was mainly felt to be an individually progressing phenomenon. Instead of profession-specific retirement ages, which had been in use in the public sector, the solution was the individual early retirement pension from 1986 and the part-time pension the following year. Also certain independent professionals who work under an employment contract obtained their own pensions act (Pensions Act for Performing Artists and Certain Groups of Employees TaEL) in 1986.

Although some have thought the earlier pension policy of the 1970s and 1980s with its pre-retirement pensions excessively generous, the reforms helped to alleviate the structural problems of Finland, as Finland had been rapidly modernised. For instance, the unemployment pension was stipulated at the beginning of the 1970s as a temporary arrangement until it became a fixed part of our pre-retirement pensions. Its significance has been greater than that of the individual early retirement pension. For instance, the farmers' farm closure pensions and change-of-generation pensions have been motivated by the unemployment pensions. Until the 1960s it was still usual that people had to start working right after grammar school. The long work history which started well before the age of twenty and with considerably less resources than today has worn people in quite a different way than those used to the welfare of the past few decades.

When the war experiences are added to the life situation of a Finn born at the beginning of the previous century, the differences to those who have lived in more peaceful conditions become obvious. Among the war generation the number of disability pensions is clearly the highest in Finland among the Nordic countries.

So pensions based on service at the war front and the change-of-generation pensions in agriculture of the 1970s and 1980s should be seen against their broader background. However, the solutions at the time have indeed had their impact on the currently, on average, two to three years too early effective retirement age.

In the labour market the change in life overall is reflected in the improved state of health among younger age groups and in increasing average longevity. Among the population that did not experience the war we already have proportionally less disability pensioners than Sweden and Norway.

The earnings-related pension as the citizen's basic pension

The earnings-related pensions, which had become the most important statutory pensions, were in for a real challenge due to the recession at the beginning of the 1990s and the mass unemployment, which at its worst reached almost 20 per cent.

In order to lessen the cost burden of the employers the employees were made directly responsible for part of the earnings-related pension costs from the beginning of 1993, when the contribution was divided into the employers' and the employees' shares. This change concerned all wage earners, except those covered by the Seamen's Pensions Act (MEL), where the contribution had even originally been divided between employer and employee. The accrual rates especially in the public sector were lowered and the age limits were harmonised on the basis of the Employees' Pensions Act (TEL).

The real diminishing effect on pension expenditure was due to the calculating of the pensionable wage in TEL on the basis of the earnings of the ten last years of each employment contract and the change in the revaluation as well as in the way of calculating the pre-retirement pensions, and especially the abolishment of the basic amount of the national pension, all in 1996.

Although the 1990s are usually connected only with pension cuts, also the lowest wages and other short-term employment contracts than those in the LEL and TaEL industries were decreed as accruing pension rights on 1 January 1998. Likewise increased flexibility was introduced to the labour market by improving the criteria for the part-time pension in 1998.

When one hundred years ago maybe a few per cent of the population received a pension, in 2005 the share of pension recipients was already one-fourth, almost 1.4 million people. The number of people aged over 65 has increased fourfold to approximately 16 per cent in the same period.

In 2005 the average new earnings-related pension amounted to approximately 1,100 euros a month. Since the national pension is gradually reduced when the earnings-related pension increases and ends altogether when the earnings-related pension exceeds 900–1,000 euros, most new pensions consist only of an earnings-related pension.

Pension provision has many dimensions

The overall picture of pension provision has become continuously more diverse even if old age, disability and the family breadwinner's death remain the most important pension risks. Still, a pension has not for a long time meant a complete life change or exiting the labour force. The aim of the part-time pension, which has become very popular in recent years, is to keep ageing people in active employment and create new jobs. Rehabilitation pensions are made more encouraging towards work. The unemployment pension is abolished for those born after 1949, but the effects of the mass unemployment of the 1990s recession will be felt for a long time still.

Statutory pensions can still be supplemented by personal pension insurance that people pay for themselves or collective supplementary benefits financed by the employer. The registering of supplementary benefits as corresponding to TEL ended at the end of 2000. However, supplementing of statutory pensions is still supported through taxation.

In an increasingly globalised world the pension system created for people living in Finland and for Finns more and more concerns Finns temporarily working abroad and also foreigners living and working in Finland. Nowadays pensions are paid from Finland to other countries to over 50,000 people.

The pension incomes are a crucial basis for consumer demand and tax revenues especially in areas of net emigration and developing areas.

10.5 Developing the Finnish pension system

In comparison to other Western countries Finnish social security developed slowly. The most important explanation for this is that the overall modernisation of the economic structure only started in the 1960s. Finland so to say jumped directly from an agricultural country to a post-industrial information society.

It is also exceptional that the development of social security has always started with pension provision, first as a national pension in the 1930s and then as earnings-related pension provision, which rapidly became the basic pension, from the beginning of the 1960s.

The earnings-related pension scheme, which was enacted in Finland more than 40 years ago and which is extensive and mandatory and based on the earnings, together with the national pension provided the possibility of targeting a pension of 60 per cent. The earnings-related pension in itself brought dynamism into society, since an earnings-related pension contribution proportional to the wage encouraged more efficient production and use of labour.

Deficiencies in the earnings-related pensions have been solved through other statutory pension schemes and arrangements. The amount of the earnings-related pension has not been restricted through a pension ceiling, however.

For more than 40 years all reforms, such as the harmonisation of public-sector pensions and the pension acts for self-employed persons and independent professionals have followed the 1961 Employees' Pensions Act (TEL). The main principles of the Employees' Pensions Act (TEL) did not change even though dozens of changes were made to the act.

The first earnings-related pension acts were the result of interest group policy. The earnings-related pension scheme has stayed in the tight control of the labour market organisations. The representatives of the labour market parties prepared together with experts in the earnings-related pension scheme a pension reform at the beginning of the 2000s. The development of Finnish earnings-related pension provision by common agreement has aroused interest especially in countries which have a similar need to change pension provision.

The need to develop the earnings-related pension scheme was again due to societal reasons, since because of the large age groups of the post-war baby-boomers the number of old people increases exceptionally much in Finland compared to other European countries in the next two decades. The reforms took effect in 2005, i.e. in the same year as more people started exiting the labour market than there are new employees entering it.

The aim of the reforms is to harmonise and clarify pension provision as well as make it even fairer than before. Instead of the previous pension calculation mode based on the employment contracts the earnings-related pension is now determined directly on the basis of the person's time in employment and earnings.

Of course the aim of the reform is also to adjust pension expenditure to the inevitable rise in the pension cost burden. The aim of, for instance, the accrual rate which increases with age and the flexible retirement age is to get people to stay on at work longer. Yet, preparations for the expenditure caused by an ageing population have been made since the 1960s through advance funding. The funds accumulated by the private-sector pension providers would suffice to pay the pensions for five years even if no pension contributions were levied. The baby-boomers have participated in the accumulation of funds during their whole work history.

During the first 30 years of the earnings-related pension scheme investments were made and domestic employment was supported by premium lending of earnings-related pension assets. Premium lending decreased sharply in the 1990s and nowadays attention in investment of earnings-related pension assets is only paid to the yield and risk of each pension provider's investment portfolio. Despite this the domestic financing effect of the funds accumulated from earnings-related pension contributions is still significant.

The reforming of the earnings-related pensions has in no way ended yet. For instance, the pension acts for private-sector employees, the Employees' Pensions Act (TEL), the Temporary Employees' Pensions Act (LEL) and the Pensions Act for Performing Artists and Certain Groups of Employees (TaEL) were abolished and replaced by the Employees' Pensions Act (TyEL) from the beginning of 2007. The new unified act simplifies insurance and creates common rules for determining the benefits.

The life expectancy coefficient is a mechanism which affects the old-age pension amount and through which increasing longevity is taken into account. If average longevity continues to increase, the life expectancy coefficient reduces the monthly pensions. The life expectancy coefficient will affect pensions for the first time in 2010 and it concerns persons born in 1948 and later.

The transition period between the old and the new legislation for the pension benefits ends in 2012. Still the reform will only affect fully the persons insured for earnings-related pension benefits born after 1 January 1987, which reflects the typically long time span of the development of the earnings-related pensions.

Appendix 1

Important Years for the Pension System

Main changes to the earnings-related pension and national pension legislation from 1956 onwards

1956
The Seamen's Pensions Act (MEL) took effect.

1957
The new National Pensions Act (KEL) took effect.

1962
The Employees' Pensions Act (TEL) and the Temporary Employees' Pensions Act (LEL) took effect.

1964
The Local Government Employees' Pensions Act (KVTEL) took effect.

1967
The State Employees' Pensions Act (VEL) and the Evangelical-Lutheran Church Pensions Act (KiEL) took effect.

The survivors' pension was included in the pension benefits of the earnings-related pension scheme.

1968
Started calculating the pensionable wage on the basis of the two best years of the four last years of the employment contract (earlier calculated on the basis of regular earnings for the year when the employment contract ended and the preceding year).

1969
The general Survivors' Pensions Act (PEL) took effect.

The State Survivors' Pensions Act took effect.

1970
The Self-Employed Persons' Pensions Act (YEL) and the Farmers' Pensions Act (MYEL) took effect.

1971
The unemployment pension was included in the pension benefits with an age limit of 60 years. The age limit was later lowered and in the 1980s it was as low as 55 years, but it was raised again in practice back to the original one from the beginning of 1991.

1973
The partial disability pension was included in the pension benefits.

1975
General lump-sum increase, accrual rate increased from 1 to 1.5 per cent a year.

1977
The bases for the index increase to earnings-related pensions were changed. The index is based on the average for the changes in the price and the wage level (earlier the index was based solely on changes in the wage level).

1979
Started calculating the pensionable wage by taking into account the two middle-most years as regards the earnings of the earnings for the four last years (earlier the two best years).

1980–1985
The structure of the national pension was reformed and it became taxable.

1986
The Freelance Employees' Pensions Act (TaEL) took effect. In 1998 its name was changed to the Pensions Act for Performing Artists and Certain Groups of Employees.

In the national pension scheme and the earnings-related pension scheme of the private sector the individual early retirement pension and the early old-age pension were added to the pension benefits.

1987
The part-time pension was added to the pension benefits in the earnings-related pension scheme of the private sector.

1989
The individual early retirement pension, early old-age pension and part-time pension were added to the pension benefits in the earnings-related pension scheme of the public sector.

Obligation to take out insurance from the beginning of the year when the person reaches the age of 14.

1990
Survivors' pension reform (e.g. entitlement to survivors' pension for widowers, and the surviving spouse's own earnings affect the surviving spouse's pension).

1991
Rehabilitation reform, where the division of labour of the parties providing rehabilitation is clarified, rehabilitation possibilities to be clarified before granting a disability pension and the rehabilitation allowance introduced in the earnings-related pension scheme.

1992
National pension contribution also for pension recipients.

1993
Employees' pension contribution introduced. The change in the contribution is taken into account as reducing the TEL index.

In the public sector the pension accrual period, targeted level and retirement age were changed to correspond to those of the private sector.

1994
The lower age limit for the individual early retirement pension was increased from 55 to 58 years.

The age limit for the part-time pension in the private sector was lowered to the same as in the public sector, i.e. from 60 years to 58 years.

Accelerated accrual rate of 2.5 per cent for persons who have reached the age of 60.

Scope of the increment for credited periods broadened.

Precondition for granting of a national pension five years of residence in Finland.

The national pension and the survivors' pension paid by the Social Insurance Institution were made proportional to the time of residence in Finland.

Index adjustments of earnings-related and national pensions not carried out for 1994.

1996

Earnings-related pension reform took effect. The pensionable wage gradually calculated on the earnings for the 10 last years of each employment contract. The index for persons of working age and the index for persons of retirement age were taken into use in the adjustment of earnings-related pensions. The index for persons of working age took into account half of the real-term change in earnings and the index for persons of retirement age 20 per cent. Pensions paid to persons aged over 65 are revalued in line with the index for persons of retirement age. The time-limited disability pension was changed to cash rehabilitation benefit, which promotes a return to work. The accrual rate for projected pensionable service was weakened after the age of 50 being 1.2 between the ages 50 and 60 and 0.8 between the ages 60 and 65.

The employees' pension contribution was deducted from the wage for the first time before calculating the pension (the Act took effect in 1994).

The national pension was made proportional to the earnings-related pension.

Levying of national pension contribution from the insured and from the pension recipients terminated.

1998

Employment contracts of shorter duration than a month or with low wages became covered by pension provision.

The age limit for the part-time pension lowered to 56 years.

2000

The age limit for the individual early retirement pension raised to 60 years.

2002

The earnings-related pension scheme changed to the euro.

2003

Parliament approved a pension reform package, which aims at e.g. postponing retirement.

The age limit for the part-time pension was raised to 58 years.

2004

The principle of the last insurer was extended to the public sector.

Subjective right to rehabilitation on certain conditions.

2005

The pension reform took effect. The employee has to be insured between ages 18 and 68, and the pension is calculated on the earnings for each year, starting in 2005. The pension rights for employment contracts which continued over the turn of the year 2004/2005 were calculated according to the old legislation to the end of 2004 and the new accrual rates took effect from the beginning of 2005. The former index for persons of retirement age, i.e. the earnings-related pension index, is applied to all pensions in payment. The retirement age is flexible between ages 63 and 68.

Old-age pensions were in 2005 calculated in the new way. This meant that the pension could be taken without any reductions from the age of 63, pension integration was abolished completely in the private sector, the accrual rate was 4.5 per cent for earnings after the age of 63 and 1.9 per cent between ages 53 and 63. Accrued pension rights and pensionable wages were adjusted with the new wage coefficient, where the real-term change in earnings is taken into account to 80 per cent. Increment for deferred retirement can be paid from the age of 68 (0.4% per month) and reduction for early retirement can be made at the earliest from the age of 62 (0.6% per month).

The unemployment pension is abolished for persons born after 1949 and the individual early retirement pension for persons born after 1943. The unemployment pension is replaced by continued days of daily allowance in the unemployment security scheme and the criteria for the individual early retirement pension were included in the rules on disability pension. In addition, the life expectancy coefficient will be taken into use from 2009.

The reform was carried out at the same time in the legislation on the national pension, but there the retirement age remained at 65, and the increments for postponed retirement and the reductions for early retirement were unchanged. However, the age limit for the early retirement reduction was changed to 62.

2006

The second phase of the pension reform took effect. Also other types of pensions than old-age pensions are calculated in to new way. The calculation of the pension for projected pensionable service was changed in its entirety, so that from the age of 50 the accrual rate is 1.3 per cent to the termination age 63 years for the projected pensionable service, and the earnings for projected pensionable service are after the transition period calculated on the basis of the earnings for the five years which precede the pension contingency.

2007

The Employees Pensions Act TyEL took effect. It replaced the Employees' Pensions Act TEL, the Temporary Employees' Pensions Act LEL and the Pensions Act for Performing Artist and Certain Groups of Employees TaEL. The State Employees' Pensions Act VEL was also rewritten and changed to VaEL. Likewise, the pension acts for self-employed persons, the Self-Employed Persons' Pensions Act YEL and the Farmers' Pensions Act MYEL were rewritten.

The investment reform was carried out.

2008

National pension reform. Start of the annual sending of register extracts from the private-sector pension providers to all the insured.

Appendix 2
Statistical Data

Some general statistics on Finland

Population

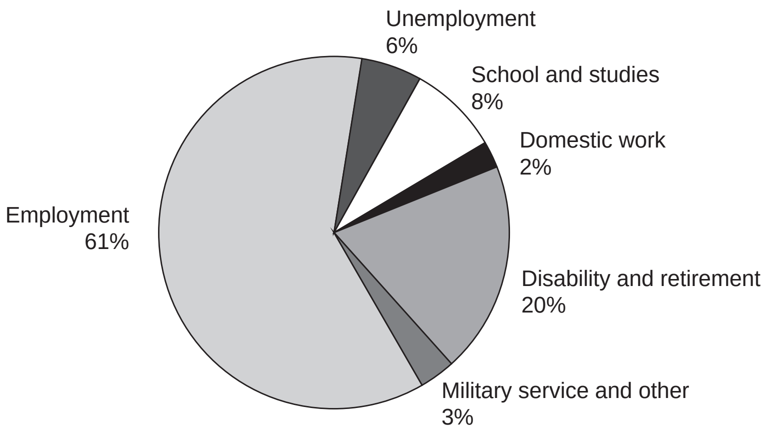
The population in Finland was 5,194,901 on 31 December 2005. The estimated rate of population growth is 2.1 per cent during the period 2005–2040.

1. Population by age group in 2005–2040, per cent.

Age group	2005	2010	2020	2030	2040
0–14	17.3	16.4	16.2	15.7	15.2
15–64	66.7	66.2	61.0	58.2	58.2
65–	16.0	17.4	22.8	26.1	26.6
All	100.0	100.0	100.0	100.0	100.0
Population growth, % compared with previous year	0.4	0.2	0.2	0.0	-0.2

Source: Statistics Finland.

2. Population aged 15–74 by activity in 2005.



Source: Statistics Finland.

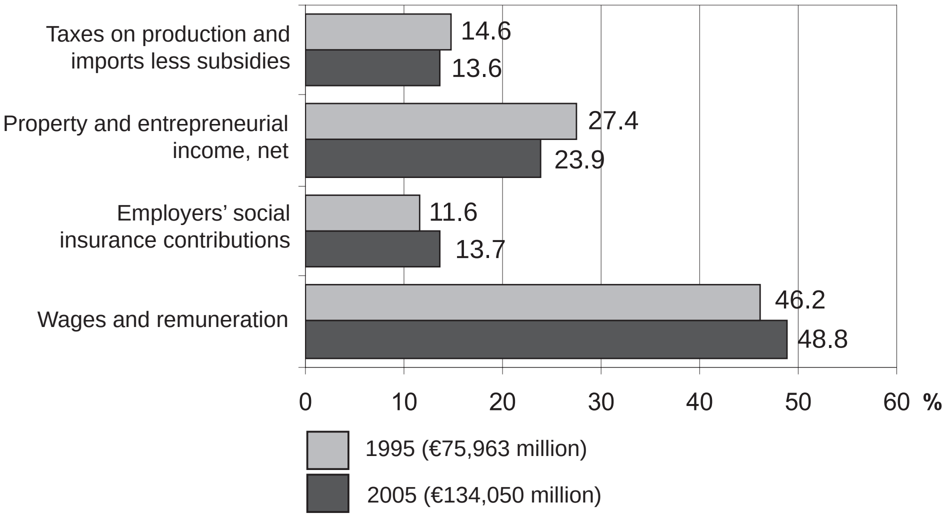
3. Employed and unemployed persons in 1990–2005.

	Employed	Unemployed	Unemployment rate, %
1990	2,045	82	3.2
1995	2,099	382	15.4
1996	2,127	363	14.6
1997	2,169	314	12.7
1998	2,222	285	11.4
1999	2,296	261	10.2
2000	2,335	253	9.8
2001	2,367	238	9.1
2002	2,372	237	9.1
2003	2,365	235	9.0
2004	2,365	229	8.8
2005	2,401	220	8.4

Source: Statistics Finland.

Economy

4. Distribution of net national income in 1995 and 2005, per cent.



Source: Statistics Finland

5. Taxes, EUR million and taxes per GDP, per cent in 2005.*

	EUR million	% of GDP
All taxes	69,062	43.9
National taxes	37,290	23.7
- income and property tax	12,749	8.1
- value added tax	13,720	8.7
Municipal taxes	14,328	9.1
Social security funds	17,290	11.0
European Union	154	0.1

* Preliminary figures.
Source: Statistics Finland.

Social security

6. Gross domestic product and social expenditure in 2000–2005.

	Gross domestic product			Social expenditure			
	at current prices EUR bn	at the price level of 2000 EUR bn	change from previous year %	at current prices EUR bn	at the price level of 2000 EUR bn	change from previous year %	Social exp./ GDP %
2000	132.3	132.3	5.0	33.1	33.1	-0.4	25.1
2001	139.9	135.8	2.6	34.8	40.0	2.5	24.9
2002	144.0	138.0	1.6	36.9	35.4	4.3	25.6
2003	145.9	140.4	1.8	38.7	36.9	4.0	26.5
2004	151.9	145.4	3.5	40.6	38.5	4.6	26.7
2005*	157.4	149.6	2.9	42.1	39.7	3.0	26.7

* Preliminary figures.

7. Financing of social expenditure in 2004 and 2005, per cent.

	The State	Municipalities	Employers	Persons insured	Capital income	Total
2004	24.6	19.5	38.8	11.6	5.4	100
2005*	25.1	19.6	38.9	11.3	5.2	100

* Preliminary figures.
Source: National Research and Development Centre for Welfare and Health (Stakes) and Ministry of Social Affairs and Health.

8. Social expenditure by major items in 2004 and 2005, per cent.

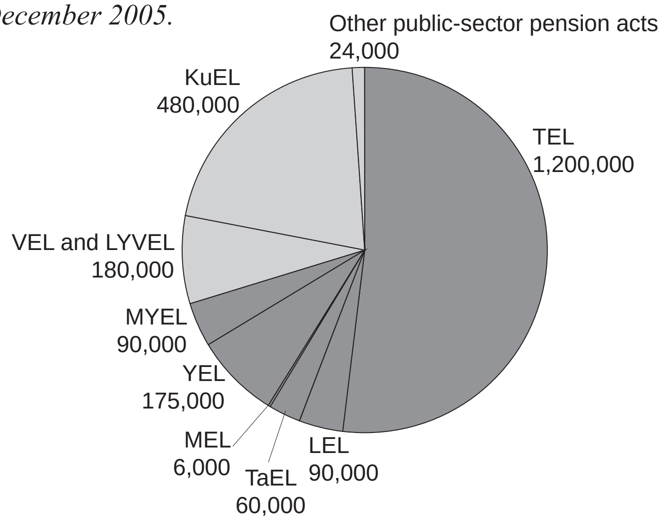
	2004	2005*
Sickness and health	24.7	25.0
Disability	12.8	12.6
Old age	32.2	32.6
Surviving spouse and close relatives	3.6	3.5
Family and children	11.1	11.3
Unemployment	9.5	9.0
Housing	1.1	1.0
Other	2.0	1.9
Administration	3.2	3.1
Total	100.0	100.0

* Preliminary figures.
Source: National Research and Development Centre for Welfare and Health (Stakes) and Ministry of Social Affairs and Health.

General data on the Finnish pension system

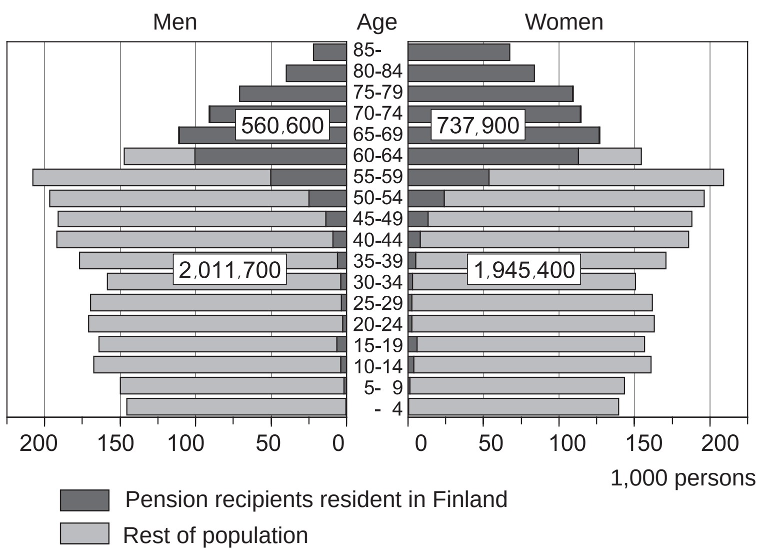
Persons insured, population and pension recipients

9. Persons insured under different earnings-related pension acts as at 31 December 2005.



The figures are estimates of persons in employment at the end of the year. The person may be insured under several different earnings-related pension acts simultaneously.

10. Age structure of the whole population and of the pension recipients as at 31 December 2005.



11. Proportion of population receiving a pension in their own right, resident in Finland.

	All [1]		Persons aged 55–64		
	Number	Popul. share [2] %	Number	Popul. share [2] %	Popul. share [3] %
1995	1,134,000	27.6	282,800	54.1	55.1
1997	1,140,400	27.5	272,700	50.5	51.8
1999	1,160,200	27.4	278,500	47.5	50.8
2001	1,183,000	27.4	290,300	43.2	48.0
2003	1,216,000	27.7	300,300	38.9	45.0
2005	1,240,700	28.2	300,100	37.2	41.8

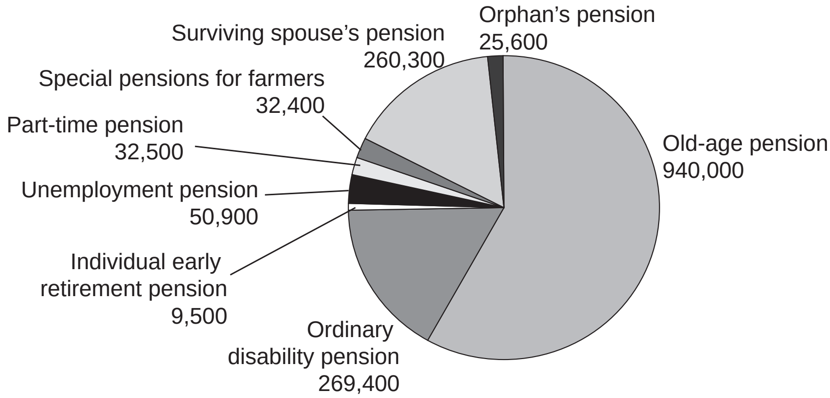
[1] Persons over the age of 16.
[2] Does not include recipients of a part-time pension.
[3] Includes recipients of a part-time pension.

12. All pension recipients by pension scheme as at 31 December 2005.

Recipients of earnings-related pensions	1,250,000
- private sector	1,076,700
- public sector	532,400
Earnings-related pension, only	662,900
Recipients of national pensions (Kela)	587,100
National pension, only	105,100
All pension recipients	1,355,100

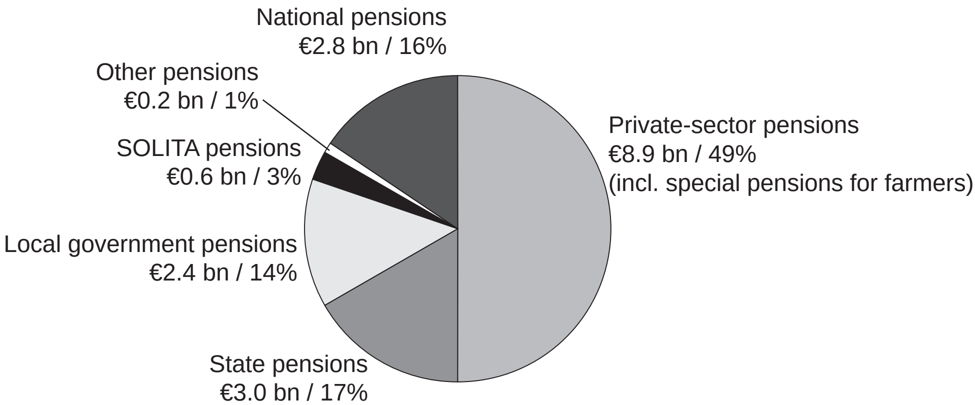
The person may simultaneously receive pensions under different pension schemes.

13. All pension recipients by pension benefit as at 31 December 2005.



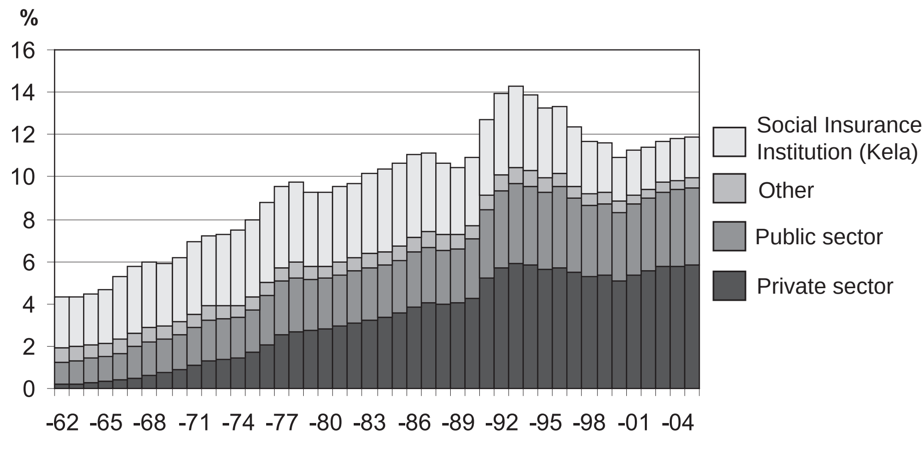
Pension expenditure, premium income, technical provisions and pension assets

14. Total statutory pension expenditure (EUR 17.7 bn) by pension act in 2005.



SOLITA pensions include pensions under the Workers' Compensation Insurance Act, the Motor Liability Insurance Act, the Military Injuries Act, and the Compensation for Military Injuries Act. Other pensions include pensions for the employees of the Evangelical-Lutheran Church, the Bank of Finland, and the Social Insurance Institution (KELA).

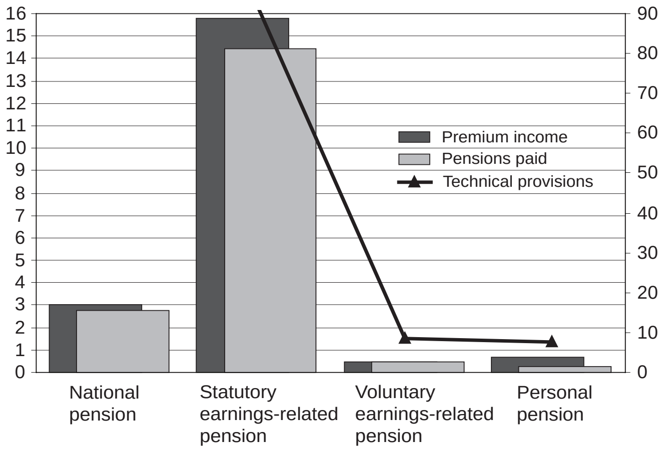
15. Share of total pension expenditure in GDP in 1962–2005, per cent.



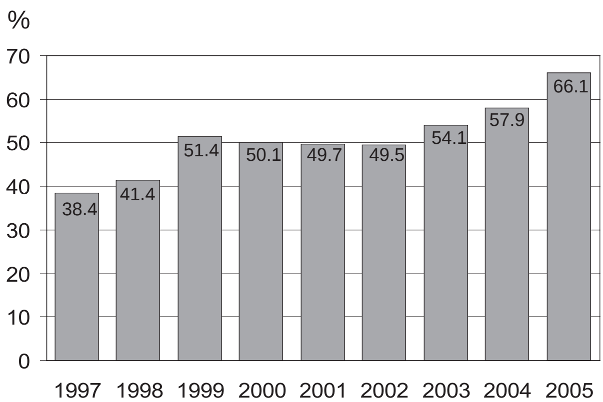
16. Total pension expenditure in 1990–2005.

	EUR million	Share of social expenditure, %
1990	9,562	43.3
1995	12,606	41.7
2000	14,351	43.3
2001	15,179	43.6
2002	16,085	43.6
2003	16,735	43.2
2004	17,327	42.7
2005	17,885	42.6

17. Premium income, pensions paid and technical provisions EUR billion in 2005.



18. Earnings-related pension assets in the statutory pension schemes, in per cent of GDP at the end of the years 1997–2005.

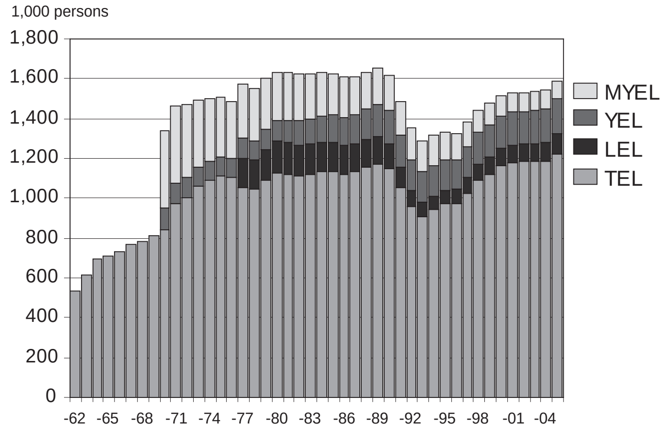


Source: The Finnish Pension Alliance TELA & Statistics Finland.

The private-sector pension scheme

Persons insured, pension recipients

19. Number of persons insured at the end of the years 1962–2005.

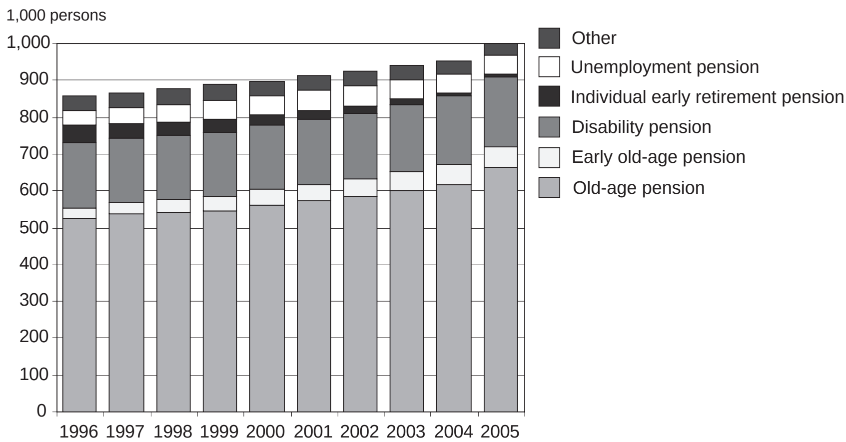


20. Persons insured by pension act at the end of 2005.

Earnings-related pension acts				Self-employed persons' pension acts		Total
TEL	LEL	TaEL	MEL	YEL	MYEL	
1,222,900	97,900	73,600	4,800	175,500	89,300	1,609,100

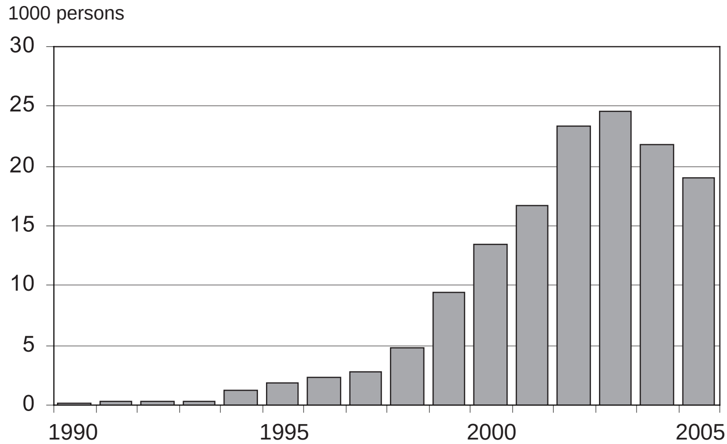
The person may simultaneously come under several earnings-related pension acts. In the column Total the person is included only once.

21. Retired persons by pension benefit in 1996–2005.

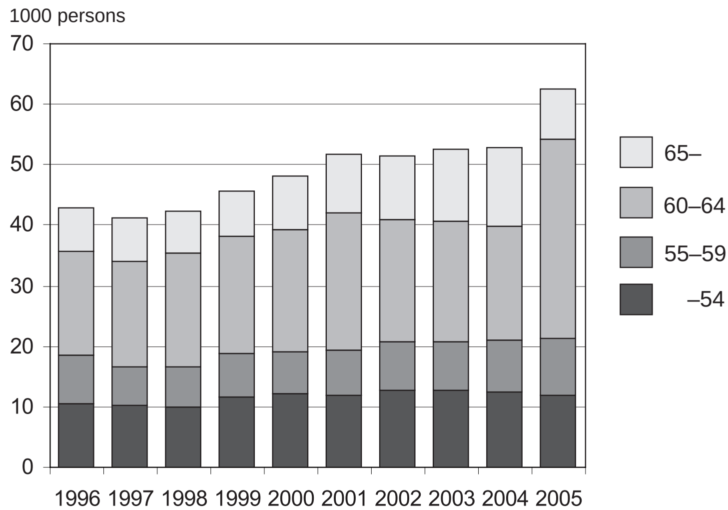


Other = special pensions for farmers.

22. Persons receiving a part-time pension in 1990–2005.



23. Persons having retired on a pension, by age in 1996–2005.



A person having started to receive a part-time pension is not considered as having retired.

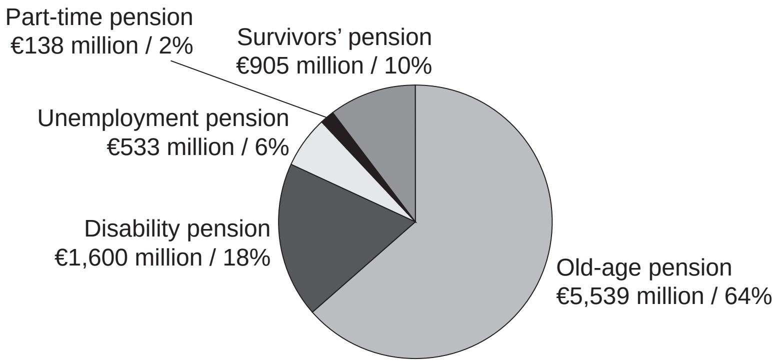
Pension expenditure, average TEL contribution and premium income

24. Pension expenditure by pension act in 2005, EUR million.

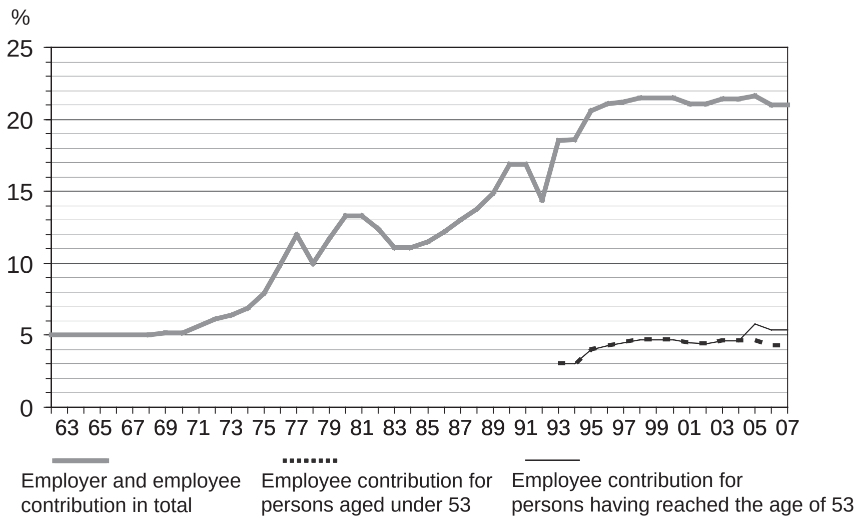
Earnings-related pension acts				Self-employed persons' pension acts		Total
TEL	LEL	TaEL	MEL	YEL	MYEL	
6,446	771	26	100	756	616	8,715

In addition, special pensions for farmers were paid to the amount of 147 million euros.

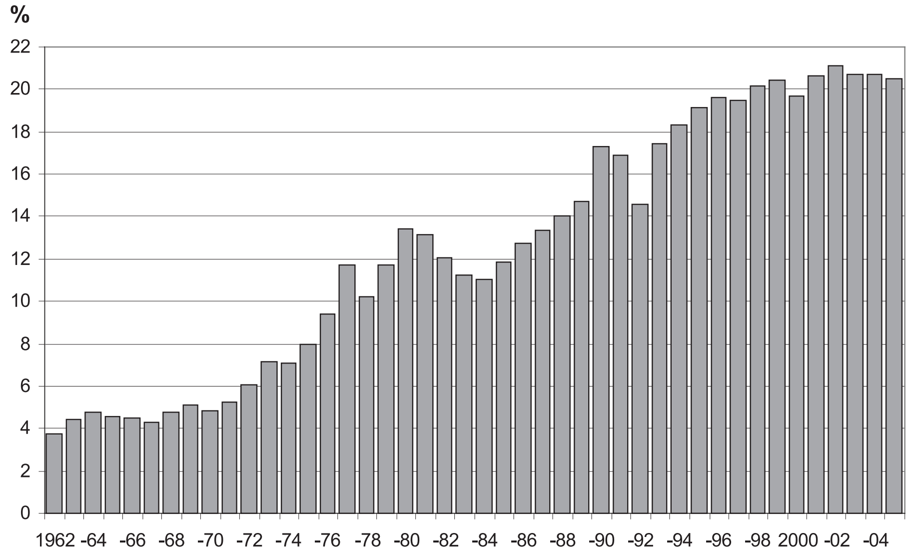
25. Pension expenditure (EUR 8,715 million) by pension benefit in 2005, EUR million.



26. Average TEL contribution in 1962–2007.



27. Premium income (incl. supplementary pensions) in 1962–2005, per cent of wages.

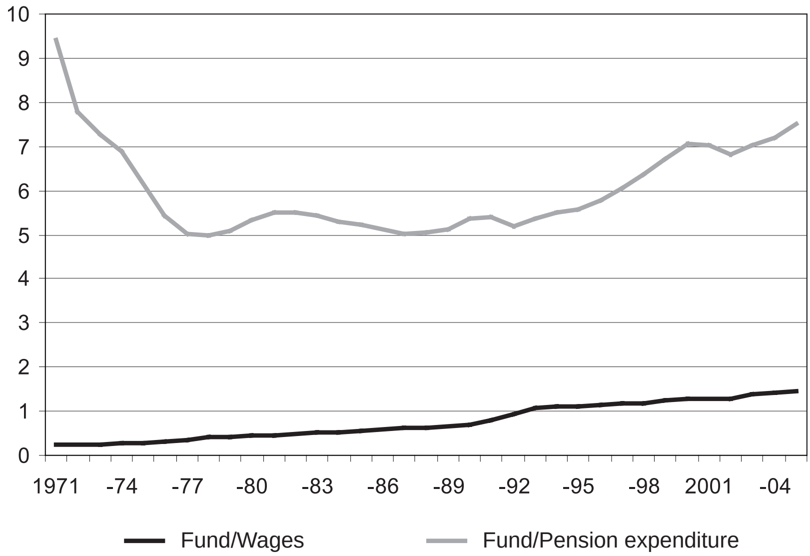


28. Premium income (incl. supplementary pensions) by pension act in 2005, EUR million.

Earnings-related pension acts				Self-employed persons' pension acts		Total
TEL	LEL	TaEL	MEL	YEL	MYEL	
7,723	545	126	55	602	137	9,188

Funds

29. Ratio of the earnings-related pension funds to pension expenditure and the wage bill in 1971–2005.

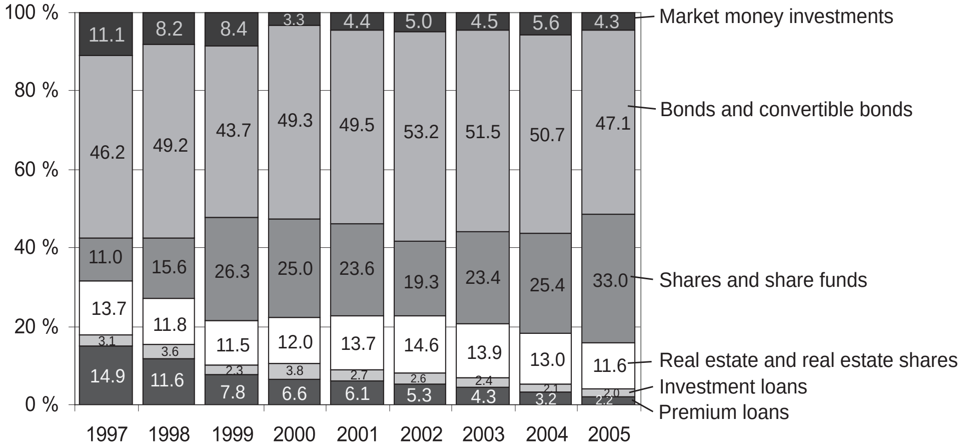


30. Funds and their ratio to the wage bill in 2005.

	EUR million	
TEL	37,435	1.326
LEL	2,396	0.106
TaEL	594	0.007
MEL	252	0.012
YEL	2,977	0.003
MYEL	1,251	0.001
Total	44,905	1.455

Investment

31. Investment portfolio of the authorised pension providers in 1997–2005.



Source: The Finnish Pension Alliance TELA.

Administration

32. Number of pension providers in 1962–2005.

	Insurance companies TEL and YEL	Company pension funds TEL	Industry-wide pension funds TEL	*Of which also YEL pension funds*	LEL pension providers	TaEL pension providers	MYEL pension providers	MEL pension providers	All
1962	9	16	3		4	-	-	1	33
1970	9	137	12	*5*	4	-	1	1	164
1975	8	115	13	*5*	4	-	1	1	142
1980	8	95	12	*5*	1	-	1	1	118
1985	7	83	12	*5*	1	-	1	1	105
1990	7	65	12	*5*	1	1	1	1	88
1995	7	44	8	*4*	1	1	1	1	63
2000	6	37	8	*4*	1	1	1	1	55
2005*	7	30	8	*4*	-	-	1	1	47

* Etera Mutual Pension Insurance Company has been included as an insurance company in 2005. Etera still handles insurance under LEL and TaEL in 2006.

33. Administrative costs of the pension providers in 2005, EUR million and per cent of pensions paid.

	EUR million	%
TEL	270	3.1
LEL	31	0.4
TaEL	12	0.1
MEL	6	0.1
YEL	44	0.5
MYEL	19	0.2
Total	382	4.4