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EXECUTIVE SUMMARY

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Views on how to improve the survivors' pension

This report is based on the addresses presented in a seminar arranged by the Finnish Centre for Pensions in March 2014. The aim is to present different views on the current status and the developmental potential of the survivors' pension.

The report is divided into two parts. Part 1 reviews the purpose and goals of the survivors' pension, the impact of social changes on this pension type, survivors' pensions elsewhere in Europe and problematics relating to survivors' pension. The first part ends with an overview of some alternative ways in which this pension type could be improved. This overview will serve as the basis for the discussions in Part 2. The chapters in Part 1 are based on reports written at the Finnish Centre for Pensions in 2013–2014 for the earnings-related pension negotiation group. Part 2 includes the views on survivors' pension and some development models presented by the commentators at the seminar arranged at the Finnish Centre for Pensions.

Chapter 2 of Part 1, *Purpose of the Survivors' Pension*, discusses the goals of the survivors' pension based on the statements of reason in the government proposal for the 1990 reform of the survivors' pension. In general, the survivors' pension has been considered a means to adjust the family's economy to changes in circumstances resulting from the death of the family's breadwinner and to maintain a reasonable livelihood in the family. The primary goal has been to secure the livelihood of under-aged children.

The surviving spouse's pension in the earnings-related pension system aims to make up for the income that is lost due to the death of the person through whom the benefit is derived, taking into account the surviving persons who are dependent on that income. In its current form, the surviving spouse's pension is based on the idea of the household consumption unit. Deducting the surviving spouse's pension according to the surviving spouse's own pension income encourages surviving spouses of working age to work.

According to Chapter 3, *The concept of a surviving spouse, the allocation and significance of the surviving spouse's pension* 86 per cent of all surviving spouses are entitled to a surviving spouse's pension and 74 per cent receive at least a small surviving spouse's pension. The majority of surviving spouses are retired women aged above 65 who live alone. Only 4 per cent are surviving spouses with under-aged children.

On the whole, the significance of the surviving spouse's pension can be estimated by comparing the equivalent income of those receiving a surviving spouse's pension with those surviving spouses who do not receive such a pension. The surviving spouse's pension appears to even out the income gaps of these two groups. The significance of the surviving spouse's pension is also depicted by the replacement ratio, or by how big a proportion of the income of the person through whom the benefit is derived is replaced by the surviving spouse's pension. Of the individual groups, the replacement ratios of women, those who are retired and those who have turned 60 years are higher than those of men, those in employment and those who are under 60 years of age. A high replacement ratio of the surviving spouse's pension or a high income level may reduce the willingness to continue working. There would appear to be no negative connection between a high replacement ratio or income level and a reduction in labour supply.

Chapter 4, *Social changes affecting the survivors' pension*, considers changes in and the future of family structures, women's working life and pension provision, changes in the outlook on social security insurance and the extended life expectancy.

The proportion of domestic partnerships of all family structures has increased, and in 2012, approximately 37 per cent of all domestic partnerships were families with children. Research on the forthcoming changes in family structures predicts that, as life expectancy will grow and the gap in life expectancy for men and women will narrow, the number of surviving spouses will increase slightly. Yet, the relative proportion of those who have turned 75 will be reduced considerably and the relative significance of the surviving spouse's pension will decrease.

In Finland, men and women participate in gainful employment to an almost equal degree. Women's participation is lesser than men's at the typical child-bearing ages. In Finland, the compensation in the pension system for childcare is at a relatively low level in an international comparison.

Due to the extended life expectancy, among other things, surviving spouse's pensions are paid for a considerably longer period of time than before. In two decades, the average period of payment has increased from 10.4 years to 16.7 years. The number of surviving spouse's pensions paid out for a long period of time has multiplied.

Chapter 5, *Survivors' pensions and pension accrual during periods of care in Central and Northern European countries*, examines survivors' pensions elsewhere. The criteria for receiving the surviving spouse's pension have been tightened in the countries of comparison in the recent decades. At the same time, the benefits can only be received for a limited maximum period of time. Denmark has abolished the statutory survivors' pensions system, and in Sweden, the period of benefit payment has been limited to a maximum of one year. The orphan's pension is paid to children under the age of 18 and 21 in all countries of comparison. In some countries, the orphan's pension is paid also to older children who are full-time students.

Pensions can be divided between spouses in Central European countries in particular. As a rule, pension provision that has accrued during the marriage can be divided equally between the spouses either when the couple divorces or possibly already while they are married. In Nordic statutory pension systems, pension entitlements can be divided only in the Swedish premium pension system.

Chapter 6, *Problematics relating to survivors' pension*, highlights the problems associated with the allocation, incentive effects and cost allocation of the surviving spouse's pension. When considering the fairness of the allocation of the surviving spouse's pension, the status of domestic partners, the poverty of other single households than those of surviving spouses', the retaining of the right to surviving spouse's pension when remarrying and the pension of a divorced spouse should also be taken into account.

In Chapter 7, *Models of development based on survivors' pension*, includes an alternative in the form of a fixed-term surviving spouse's pension and the current model with slight adjustments, including the raising of the upper age limit for the orphan's pension and changing the criteria for determining the surviving spouse's pension of working-aged surviving spouses.

If the survivors' pension were to be paid only to the children, the savings generated from abolishing the surviving spouse's pension would allow for an increase in the level of the orphan's pension and possibly an extension of its period of payment. The surviving spouse's pension could also be a fixed-term pension so that the surviving spouse would be paid the surviving spouse's pension in full, for example, for one year, regardless of whether the couple have under-aged children.

Chapter 8, *Development model: sharing pension entitlements between spouses*, examines previous reports on sharing pension entitlements and considers the protection of property, issues relating to sharing the entitlements and possible models of implementation.

The possibility to share the pension entitlement would, on the one hand, increase the options of choice in the pension system. On the other hand, it would make the earnings-related pension system more complex. The integration of the shared surviving spouse's pension with the benefits of the national pension system would also have to be solved. It is likely that only the component of the other spouse's pension that was accrued during the marriage or other agreed-on period would be sharable.

Chapter 9, *Development model: surviving spouse's pension in the form of joint annuities*, describes two different methods to calculate the actuarial size of the joint pension: one according to the currently valid calculation criteria of the system under the Employees Pensions Act, and the other according to the realized mortality risk rates from 2007 to 2011. In addition, the chapter contains a review of joint pension arrangements in force in other countries.

In the joint annuity system, the insured is given the opportunity to 'buy' a surviving spouse's pension for the other spouse by reducing the pension of the insured. In general, only a part of the insured person's old-age pension can be converted to a joint pension. Converting to a purely annuity-based system would shift the funding burden of surviving spouse's pensions from all individuals paying earnings-related pension contributions to only those couples who wish to use this benefit.

In Chapter 10 in Part 2 of the report, *Survivors' pension and social insurance*, Jyri Liukko, Senior Researcher at the Finnish Centre for Pensions, offers a conceptual viewpoint and a temporal perspective on the discussion of survivors' pension. In his commentary, Liukko examines the survivors' pension as part of social insurance, the relation between survivors' pension and life insurance and a few alternative ways to improve the survivors' pension.

According to Liukko, the survivors' pension of the earnings-related pension system as part of social insurance can be made more functional with only small adjustments. By renewing the rules by which this benefit is determined, the system can be made more equitable and cost-efficient. Furthermore, it is not necessary to stick strictly to certain principles of insurance. Instead, the issue can be approached from a pragmatic point of view and we can consider how surviving pensions can be made as functional, socially equitable and cost-efficient as possible.

In Chapter 11, *The impacts on wellbeing of possible alternative reforms of the survivors' pension*, researchers Karoliina Koskenvuo, Elina Ahola and Laura Kalliomaa-Puha review the development options of the survivors' pension from the Social Insurance Institution of Finland's (Kela) point of view. They observe that the death of one of the spouses or of the family's breadwinner usually has a long-ranging impact on the wellbeing of the family members and on their need for various benefits and provisions.

Statistics reveals that those who receiving a surviving spouse's pension from the national pension system also more often receive sickness allowances, unemployment benefits and a housing allowance for retirees than those receiving a surviving spouse's pension from the earnings-related pension system. Of those receiving a surviving spouse's pension within the earnings-related pension system, 0.5 per cent received a guarantee pension at year-end 2012, while the equivalent percentage among the rest of the population was 10 per cent.

Based on the example calculations, abolishing the survivors' pension would lead to an increase in the amounts of other benefits while the income would be reduced considerably. Using the SISU micro simulation model, it has been evaluated that the abolishment of the survivors' pension of the national pension system would generate savings of more than EUR 30 million, but the need for other benefits would increase, the collected taxes would decrease and the risk of poverty would increase. If the surviving spouse's pension of the earnings-related pension system were to undergo significant changes (for example, that the pension was abolished or made into a fixed-term benefit), the number of persons receiving the guarantee pension would grow considerably.

When developing the surviving spouse's pension, the upper age limit of the orphan's pension could be raised to correspond to that of the national pension. It would also be simpler if the benefits were more clearly directed towards the children. Married and cohabiting couples should receive equal treatment, and the young surviving spouses should be offered the opportunity to receive career planning. Pension provision could be developed in an increasingly individual direction by increasing the opportunities to make choices.

In Chapter 12, *An economist's view of the developmental needs of surviving spouses' pension*, Reija Lilja, Research Director at the Labour Institute for Economic Research, discusses incentives of labour supply and behavioural impacts relating to the surviving spouse's pension and how well the survivors' pension equalizes income risks and functions as insurance.

According to Lilja, the Finnish surviving spouse's pension system is not on a sustainable basis. She points out that our surviving spouse's pension system differs from the Nordic social security concept and is expensive with its lifelong benefits. The surviving spouse's pension compensates low-income spouses for the loss of their earnings-related pension income due to their interrupted working life and thus weakens their labour supply incentives. According to Lilja, statistics show that the survivors' pension system steers behaviour.

Lilja notes that the survivors' pension seems to be directed towards those households in which the income risks relating to the fluctuation of employment and capital income are lower than average. For this reason, the functionality of the current survivors' pension system as a part of the social income transfer system should be approached critically. Lilja also sees a problem with the fact that the individuals who have fallen under the scope of the survivors' pension insurance do not carry a direct personal financial responsibility for solutions relating to the division of labour within the family. Instead, everyone paying earnings-related pension contributions pay for these benefits.

In Chapter 13, *Do we still need the survivors' pension?*, Jaakko Kiander, Senior Vice President at Ilmarinen Mutual Pension Insurance Company, reviews the purpose of the survivors' pension and its significance in terms of the surviving spouse's standard of living. The earnings-related pension provision was constructed in order to prevent that the standard of living plunges in the event of a social risk, such as unemployment, the death of a family provider or longevity, being realised. The surviving spouse's pension can be seen as an attempt to maintain the surviving spouse's equivalent income after the death of the other spouse.

According to Kiander, there is still a need for an income level insurance. Without the surviving spouse's pension or an equivalent insurance, the standard of living may plunge when the spouse with a higher income dies. Without the surviving spouse's pension, the poverty risk of pensioners would be higher than it is today. To some extent, the surviving spouse's pension also allows for the former standard of living to continue after the death of one of the spouses and, for example, makes it possible for the surviving spouse to continue living in the couple's home.

A collective survivors' pension supports families since also those without families participate in the expenses. The pension system is an intergenerational link, and the pension system, as well as society at large, should support families and help to boost birth rates.

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