Inter-relation between the three pillars in the Icelandic pension system

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Ingvi Már Pálsson
Ministry of Finance, Iceland

The structure of the Icelandic pension system

- First pillar – Tax financed public pensions
- Second pillar – Mandatory occupational pension funds
- Third pillar – Voluntary individual pension savings

First pillar
Tax financed public pensions

- Social security system with the main purpose of ensuring the livelihood of those unable to work because of age or disability
  - provides old age pension, disability pension, sickness, maternity and survivor pension
- Tax financed
  - Social security tax levied on employers
- Means tested based on all income above a minimum income level
- Minimum pension age is 67 years

Second pillar
Mandatory occupational pension funds

- The occupational pension system is a hybrid between a DB-system and a DC-system
  – 65% DC-pension schemes vs. 35% DB-pension schemes
- Mandatory minimum contribution is 10% of total salaries
  – 6% paid by the employer and 4% by the employee
- Taxed according to EET tax principles
  – Contributions and pension fund returns are exempt, while payments of pensions are taxed
- Benefits are generally indexed against inflation by the consumer index
- Retirement age is 67-70 years

Third pillar
Voluntary individual pension savings

- An individual can contribute up to 4% of his/her salaries to a private pension scheme, topped up by maximum 2% from the employer
  - introduced in the general pension legislation reform in 1998
- Tax incentive
  - employees deduct the contribution from their taxable income
- The minimum pension age is 60 years and the maximum is 67 years
- The pension is paid out in equal installments over the pension period

Demographic trends and retirement behaviour

- High fertility rate and high labour market pariticipation rates of the elderly decrease the pension related problem of ageing in Iceland, compared to other European countries
- No specific incentives for early retirement
- Average life expectancy 79,2 years for men and 82,7 for women
- Proportion of people aged 65 or over 11.8%
- Average retirement period 14 years for men and 19,5 years for women

Inter-relations, trends and conclusions (I)

- The share of the occupational pension system (pillar two) is increasing and the same can be said for the individuals pension savings (pillar three)
- The public pensions (pillar one) share will diminish in the years to come, easing the constraint on the Government finances
- Taxation on increasing benefits from the occupational pension funds and individuals pension savings will have the same effect on the Government finances
- There has been a trend from DB-schemes to DC-schemes, but the phase is slow

Inter-relations, trends and conclusions (II)

- Fiscal sustainability of the public pension system (pillar one) and the mandatory occupational system (pillar two) does not show any signs of weakness
- Contributions to pension funds are still far in excess of payments from them
  - due to the favourable age composition of the population
- Level of pension fund (and life insurance company) assets in relation to GDP, at the end of 2004, was 146.2% which is much higher than in other Nordic countries
  - the growth in pension funding is attributable to the mandatory occupational pension schemes

Inter-relations, trends and conclusions (III)

- The demographic development is not an imminent problem in Iceland in the years ahead
- Increasing number of disabled person is a phenomenon creating uncertainties for the occupational pension funds finances in the years to come
- The development on financial markets, both domestically and globally, is the most important variable in the equation of the Icelandic pension system’s sustainability in the future