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The AOV system made Affordable, Sustainable and Equitable

Advice on the report “Towards a Sustainable and Affordable AOV pension system”

The Social Economic Council Sint Maarten (“Sociaal Economische Raad”, referred to below as “SER”) is an independent advisory body to the government of Sint Maarten. The SER advises upon request by one or more Ministers (solicited) or on its own initiative (unsolicited) on all important social economic issues. The SER was established by law (“Landsverordening Sociaal- Economische Raad”) in 2010. The SER consists of representatives of employees’ and employers’ organizations as well as independent experts. The objective of the SER is to achieve a broad concept of wealth in Sint Maarten by offering quality advice and reaching consensus on social economic issues. For more information, please visit our website www.sersxm.org

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Introduction

The advice on the report “Towards a Sustainable and Affordable AOV pension System” is a solicited advice at the request of the Prime Minister of Sint Maarten, Mrs. S.A. Wescot-Williams.

The report that is advised upon, was prepared in 2012 by a Steering Committee consisting of the Secretaries General of the Ministries of Public Health, Social Development and Labor, Finance, and Tourism, Economic Affairs, Transport and Telecommunication, the director of SZV and the department heads of Social Development and Public Health.

The report focuses on the future of the AOV system, and contains a number of specific recommendations to ensure the sustainable future of the general pension scheme. Furthermore, it touches upon some related topics that complement the general AOV system and that aim to ensure a solid old age provision for the population of Sint Maarten. These topics include the recommendation to introduce a mandatory second tier pension scheme for all worker, and the broadening of the tax-deductibility of third tier private pension arrangements.

The report on the AOV pension system in turn relies on the study “A sustainable Pension System for country Sint Maarten” (Exploratory Policy Report) drafted in December 2010 by Keesen Actuarissen, commissioned by the Government of Sint Maarten.

1 Background and history

1.1 The three tiers of the pension system

AOV or Algemene Ouderdoms Verzekering is to be considered the foundation or “first tier” of the Sint Maarten framework of pension benefits.

1.1.1 First tier pensions (basic state pensions)

Many countries in the world, Sint Maarten among them, have funds for their citizens and residents to provide income when they retire. Qualifying for benefits from such a fund typically requires payment of premiums (or residency) during the citizen’s working life. Examples are the Sint Maarten AOV, the Dutch AOW, the US Social Security and the British National Insurance. In most cases, premiums are collected in a fund outside the government budget, from which entitlements are paid out. If no specific premium is levied to finance the general state pension, the term “social pension” is used. In these cases, the pension is fully tax-funded from the government budget. Eighty countries around the world know such a system. This is not the case in Sint Maarten however. Our system is financed from earmarked premiums levied on employers and employees.

Traditionally, first tier (basic state pensions) are “unfunded”, that is to say, at any given moment present-day contributions, or government tax revenue, need to be sufficient to cover present-day benefits. This system is commonly known as “pay-as-you-go” or PAYGO.

Box 1

Pay-as-you-go versus funded pension schemes

General old-age pension arrangements provided by the state are usually ‘unfunded’. In any given year, the premiums collected from the insured are used directly to pay out the benefits to the retirees in the same year. In some cases, not even an earmarked premium is levied, and the cost of the social pension is paid directly from the government budget. Such a system is known as ‘pay-as-you-go’ or PAYGO. This makes sense from the point of view of government finance, as governments do not typically save and invest to cover future costs, nor insure themselves against common risks. The Sint Maarten AOV is an example of such a pay-as-you-go arrangement (Dutch: omslagstelsel).

The weakness of PAYGO systems is that the coverage of costs is dependent on demographics. In a relatively young population, the burden per worker is low, as many people pay premiums and few collect benefits. In an ageing population, fewer active participants have to fund the benefits for a larger number of retirees. As the ageing process is to a large extent predictable, a young population might set part of the premiums aside in a fund and accumulate capital to be able to afford the benefits once the population has aged, making the system partially ‘funded’. Many (European) countries have made their state pension schemes into a mix of funded and unfunded components or ‘hybrid’.

Fully ‘funded’ programs on the other hand (second and third tier pension plans) depend entirely on the collection of premiums over a period of time. Premiums may be paid by the insured, by the employer or shared by both parties. Contributions are invested and the principal and the yield

(dividends, interest) are accumulated until the insured person retires. From that moment on, the sum is used to fund an annuity to the retiree. The financing of funded pension schemes is less dependent on demographics, as premiums/contributions as well as entitlements are connected to the insured person. Funded systems however do insure against the 'risk' of longevity; the pay-out is based on the average life expectancy calculated from the age of retirement. As a consequence, those who benefit from a funded system for only a few years after retirement, subsidize those who live to a high age.

1.1.2 Second tier pensions (employment-based pensions/ retirement plans)

Second tier pensions are retirement plans connected to the employment of the future retiree. Typically, employer and employee both contribute towards the premium for the pension plan, though not necessarily in the same measure. Premiums are collected in a pension fund and invested. These are so-called 'funded' plans, as opposed to the 'pay-as-you-go' nature of first tier schemes like AOV. Offering an employer-bound second tier pension is typically only feasible for government, large companies, or cooperative funds shared by several companies (like the Dutch industry-based pension funds). In Sint Maarten, government offers such a system through the APS, and some large companies like GEBE, TELEM and the Harbor Group of companies. Only 36% of the Sint Maarten working population¹ has a second tier entitlement at this point in time. This underscores on the one hand the importance of the level of the AOV benefit (as the main post-retirement income for the vast majority) and on the other hand stresses the importance of promoting second tier plans among our working population.

Traditionally, second tier pensions are of the 'defined benefit' variety. The entitlement as of retirement age is usually based on a percentage of the average of the final years worked (Final Average Pay or FAP, Dutch: eindloonstelsel) or a percentage of the average income during the entire career (Dutch: midloonstelsel). Inherent weakness in this type of system is, that it is unknown in advance if the premiums collected will be sufficient to guarantee the entitlements promised during the remaining lifespan of the retiree.

Socio-economically, an important disadvantage of most current second tier pension schemes is in the reduction of labor market mobility. Employees enrolled in a company-based pension fund will not be able to change jobs without severely harming their pension entitlements. (Dutch: pensioenbreuk) This leads to 'freezing' of large segments of the labor market, which is especially harmful in small island economies like Sint Maarten.

Nowadays, second-tier pensions are not necessarily employer-bound however. Many mid-sized companies offer second-tier pension plans through an outside insurance company. Even in most of these cases, the employee can only migrate his/her pension entitlements at great cost. However, the recent introduction of a compulsory second tier pension arrangement in Aruba solves this problem by offering a hybrid of second tier elements (contribution shared between employer and employee) and third tier elements (the fund is unrelated to the employer, accrued entitlements move with the employee from job to job without economic consequences). Labor market mobility is ensured in this model.

¹ Steering committee 2012, p.10

Defined benefit versus defined contribution pension schemes

*Traditional employer-related pension schemes (second tier) are of the **defined benefit** variety. The employee receives an entitlement, based for instance on a percentage of his/her salary over either the last few years of his/her active career or the career average (70% in the Dutch tradition). To finance this, the insured pays a certain percentage of the gross salary into the pension fund over the years. For several reasons, it is very hard to determine whether the accrued premiums paid, will be sufficient to finance the pension benefit that will have to be paid out decades from the start of collection.*

The defined benefit system has several weaknesses. The most important are:

** at the start of the plan, it is unknown at which salary level the insured will end his/her career, therefore the level of benefit during retirement is unpredictable. If an average career path is used for calculation purposes, people with a slow career will effectively subsidize fast movers. This constitutes the 'back service' problem.*

** at the start of the plan, it is unknown what the life expectancy will be of the average person at the time of retirement. As people tend to live longer as time progresses, pension funds may become underfunded.*

** it is very hard to predict the yield (rate of interest, dividend or increase in value) of the investments that are made with the premiums collected. The crash of the financial markets in 2008 caused severe trouble for virtually all defined benefit pension plans.*

General old-age pensions provided by the state – like AOV – are by definition 'defined benefit' as the purpose is to provide retirees with a certain basic/minimum income level.

*The vulnerabilities of the defined benefit plans have led to an increase in **defined contribution** plans. In this system, only the amounts paid into the fund are known. Third tier pension plans, which are basically structured personal savings plans combined with life insurance, are always of the defined contribution variety. The risk pertaining to the level of retirement benefit rests completely with the insured/ future retiree. Depending on the sum set aside, plus the success of the investments done, combined with the life expectancy calculated when the retirement age is reached, the insurance company offers a certain annuity (monthly or otherwise) (Dutch: *lijfrente*). Alternatively, the accumulated sum may be paid out as a lump sum. However, this is far less attractive in terms of taxation in most countries. Second tier (employer related) pensions are more and more moving in the direction of defined contribution as well, as insurance companies and pension funds are increasingly weary of the risks of defined benefit schemes.*

Obviously, in socio-economic terms, defined contribution plans offer the retiree far less security than defined benefit schemes.

1.1.3 Third tier retirement benefits

Traditionally, independent professionals and other non-employed workers had to rely on individual retirement schemes, managed by an insurance firm or investment firm. Under certain conditions, contributions to such a retirement plan are tax-deductible to a certain extent in most countries, in

correspondence with the tax-deductible nature of second-tier (employment-based) plans. Examples are the Individual Retirement Accounts (IRAs) and 401(k) arrangements in the US and Dutch 'lijfrente verzekeringen'. Being basically earmarked savings/investment accounts, these plans are always 'defined benefit' i.e. the actual benefit at retirement age (annuity or lump sum) is based on actual amounts paid into the plan plus the yield on the investments. Tax deductibility is sometimes conditional on the accrued capital being used to purchase an annuity (Dutch: lijfrente), or at least on non-withdrawal of funds before retirement age.

Recently, third tier schemes have become popular among employees as well, as an additional form of retirement savings, in the absence of an employer-based scheme, or as a way to avoid the disadvantages connected with a second-tier scheme.

In Sint Maarten however, under the former Antilles tax code, third-tier schemes are hardly tax deductible². In this respect our tax legislation is seriously lagging behind most of our Kingdom partners as well as any country that is commonly used as a frame of reference.

As mentioned above, the Aruban model combines the technical form of a third tier scheme (individually based, private insurance company) with second tier content (premiums paid jointly by employer and employee), thus combining socio economic advantages of the second and third tiers.

1.2 AOV in the context of the Sint Maarten pension system

Decisions about the Sint Maarten AOV cannot be entertained without observing the AOV in the context of the other two tiers in the pension system. The second tier (employment based pensions) is only enjoyed by 36% of the working population. The third tier (private life insurance schemes) is underdeveloped and almost without tax incentive.

1.3 SER Netherlands Antilles history on the topic of AOV

No advice was given on any comprehensive overhaul of the AOV system during the Netherlands Antilles SER days. The level of the AOV benefit (AOV uitkering) however has been a recurring topic of discussion however. On December 6, 2006 the SER Netherlands Antilles last advised on the proposed increase of the AOV benefit.

1.4 Current legal framework

In connection with the Algemene Ouderdomsverzekering:

- Landsverordening Algemene Ouderdomsverzekering 1960 (Landsverordening van 14 mei 1960, regelende een algemene, de gehele bevolking omvattende, verplichte verzekering tegen geldelijke gevolgen van ouderdom)³

In connection with the tax-deductibility of third tier pension premiums:

- Landsverordening op de Inkomstenbelasting 1943

² See LV Inkomstenbelasting 1943, article 16.1.e and 16.2. Deductibility is capped at Naf. 1,000.-

³ The Landsverordening AOV 1960 and the Landsverordening Inkomstenbelasting 1943 can be retrieved from www.overheid.nl

2 The current AOV system and its challenges

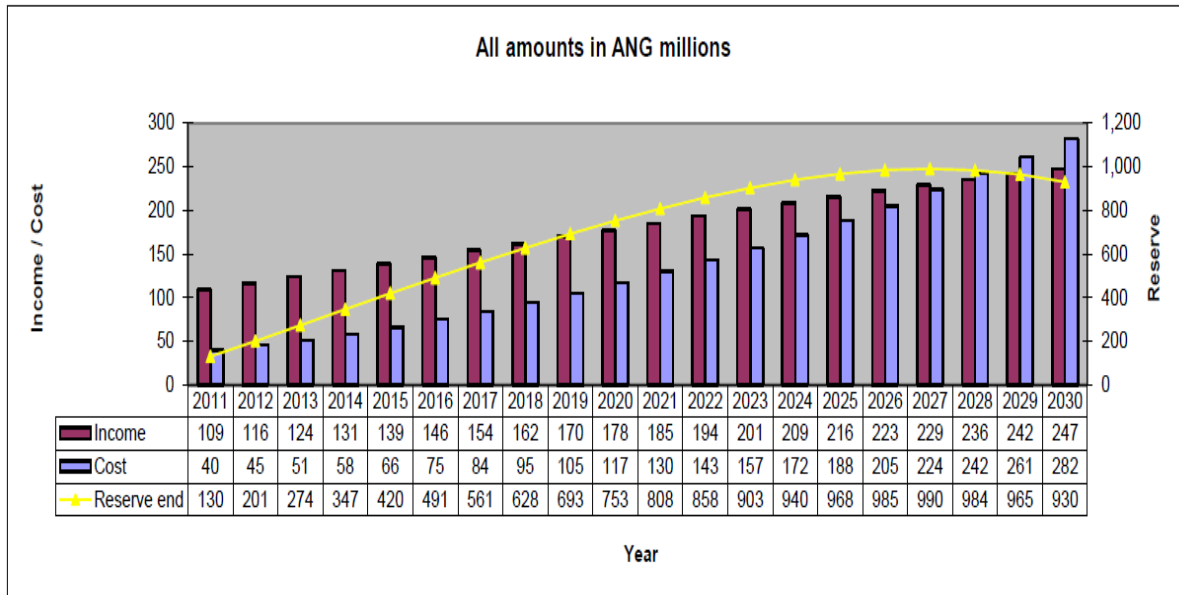
2.1 Characteristics of the present AOV system

The current Sint Maarten AOV insurance is inherited from the Netherlands Antilles system with the same name. As the Sint Maarten population is considerably younger than the Antilles average, the proportion of insured, or contributing employed persons (2009; 40,917) to AOV-entitled retirees (2009; 3,195) is much more favorable than in the previous Antillean situation. Consequently, the 2009 figures for Sint Maarten show an income of Naf. 84 million against benefits paid out of 20.1 million.⁴ The revenues exceeding the direct costs by a factor 4 constitutes an enormous surplus for the AOV system. It turns a nominally ‘unfunded’ or pay-as-you-go system into a de facto funded system.

Under the ‘unchanged policy’ scenario outlined in the report of the steering committee⁵, the fund’s reserves will accumulate to a maximum of just under a billion guilders in 2028. In that year, demographics will have changed to such an extent that revenue and costs will break even, and withdrawals from the fund will slowly deplete it in the years after.

Under the ‘changed policy’ scenario, with measures outlined in the next chapter, the fund will accumulate reserves somewhat slower, but to an even slightly higher level, breaking even in 2030 with an accumulated equity of just over a billion guilders. In practical terms therefore, the changes proposed to the AOV system in the report are chosen in such a way as to be budget neutral.

Figure 1. Baseline scenario; development of AOV fund under unchanged policies 2011-2030⁶



⁴ Steering committee 2012, p. 11

⁵ Steering committee 2012, p. 14

⁶ Steering committee 2012, p. 14

3 SER advice on the AOV report

The total package of recommended changes to the AOV system, as proposed in the Keesen report ‘A sustainable Pension System for country Sint Maarten’ in 2010 and further assessed by the Steering committee in 2012, is aimed to have minimal overall financial consequences for the AOV fund. This is a useful starting point, but by no means necessarily the final outcome.

For instance, it is entirely feasible to trade off lower premiums against a quicker depletion of the fund, or a higher retirement age against a longer lasting AOV fund. The scenario model provided by Keesen actuarissen permits to calculate the effects of each possible scenario, which every possible value of premium percentage, retirement age, premium wage level, etc.

3.1 Relevant parameters of the AOV system in the report

In this section the relative weight of the different parameters in the AOV scenario will be clarified. It concerns an increase in premium income, a decrease in the premium percentage, an increase in the AOV benefit, raising the entitlement age, and the question of skipping the reduction in AOV for persons living on Sint Maarten for over 10 years. To be able to assess the relative importance of each parameter, the impact of each of these measures is calculated on the reserves in the benchmark year 2030.⁷ The result of this exercise is shown below. Clearly, increasing the premium income will increase reserves, raising the entitlement age even more so. On the cost side, skipping of the AOV reduction for those living on Sint Maarten for more than 10 years is the least costly, while reducing the premium percentage or increasing the AOV benefit will decrease reserves in 2030 more.

Figure 2. Impact on the 2030 reserves of each parameter separately

	Scenario	Reserves 2030	Differential	Break even year
0	BASELINE (UNCHANGED POLICY)	930		2028
1	Premium income 100,000	1112	182	2028/9
2	Decrease premium 1%	273	-657	2024
3	Decrease premium 1.5%	-47	-977	2022
4	Increase benefit to 1,000	74	-856	2023
5	AOV age to 62	1635	705	none
6	AOV age to 65	2340	1410	none
7	Modified skipping	559	-371	2025

The table above gives a good impression of the relative impact and importance of each parameter and related measure. However indicative, this impression is very useful in assessing and comparing measures to be taken in each scenario. The green scenarios are those that found consensus among stakeholders consulted by the steering group. The blue scenarios are brought into consideration by the SER.

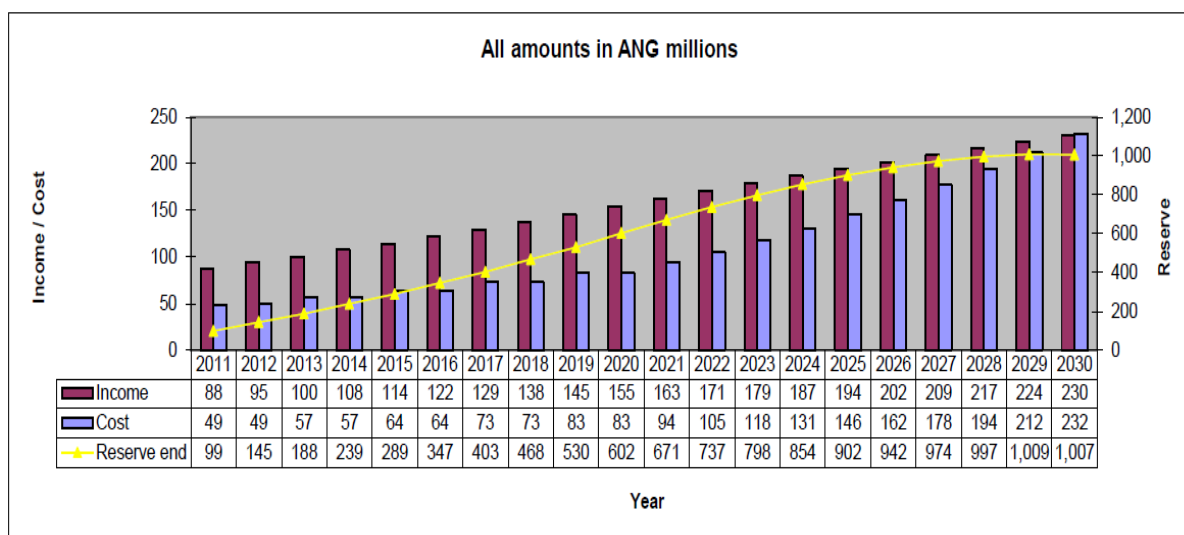
⁷ These calculations were made with the aid of the scenario model supplied by Keesen actuarissen with the report “A sustainable Pension System for country Sint Maarten”, the same model used to generate the scenarios included in the AOV report. For the sake of comparison, the starting year for implementation of the measures under consideration is kept at 2011 and the time horizon is kept at 2030.

For the sake of comparison, the same base year is used as the Keesen report and the AOV report, assuming introduction of measures starting in 2011 and reviewing the 20 year period up to 2030. In reality however, measures pertaining to AOV will not be implemented realistically before 2014. All years mentioned in the scenarios should be increased by at least three to adjust the time horizons of the predictions involved.

3.2 Overall impact of the Keesen report and the AOV report “Towards a Sustainable and Affordable AOV pension System”

In the original actuarial report by Keesen, the overall effect of all recommendations was as good as neutral. Reserves of the AOV fund and the moment at which the break-even point between revenue and cost would be reached, remain the same. The AOV fund would still accumulate reserves to the level of Naf. 1 billion in 2030, an extraordinary amount for a fund that is essentially of the ‘pay-as-you-go’ variety.

Figure 2. The Keesen scenario.⁸



Differences between the Steering committee and the Keesen report are:

Negatives for the financial position of the fund;

- The Steering group raises the AOV entitlement not to Naf. 900 but to Naf. 1,000;
- The Steering group limits the retirement age to 62 instead of 65.

On the positive side financially;

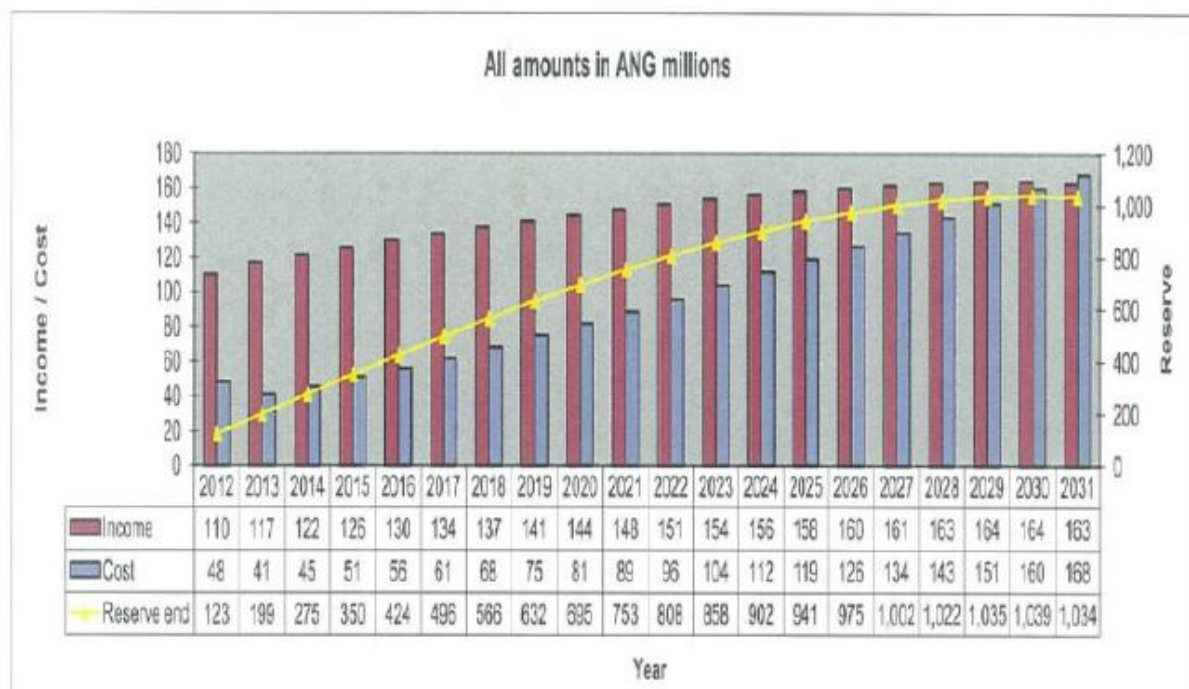
- The Steering group rejects skipping of the reduction for missing years of residency.
- The Steering group does not reduce premium percentages with 1.5% for employers and employees.

The SER agrees with the extra increase in the AOV entitlement. However it is deemed better to rise the retirement age gradually to 65, while modified skipping of the missing years is seen as affordable as well as socially beneficial. Reduction in the premium percentage is also advisable. The SER rejects the Steering group effectively financing the lower retirement age by continuing the high premium

⁸ Steering group 2012, p. 15

percentages. The graph below shows that the Steering group scenario has roughly the same overall result as the baseline scenario and the Keesen scenario. It should be noted that this graph shows the starting year at 2012 and therefore the period under review runs up to 2031, one year later than the other scenarios.

Figure 3. The Steering group AOV report scenario⁹



3.3 SER advice on the recommendations in the report “Towards a Sustainable and Affordable AOV pension System”

All elements of the SER advice in this section were reached unanimously.

STEERING GROUP RECOMMENDATION 1
Increase premium wage from Naf. 80,336 to Naf. 100,000
Consequences
Positive impact on the fund’s finances; larger basis for premium income. Socio-economic impact; larger burden on higher income households (offset by lower premium %)
Stakeholder assessment
Accepted
Remarks:
<i>Keesen: Recommendation 4. Increase premium wage from Naf. 80,336 to Naf. 100,000</i>

⁹ Steering group 2012, page 35

SER advice (unanimous):

Follow the recommendation of the steering group; increase the premium wage to Naf. 100,000

Elucidation:

Increase in the wage level subject to AOV premium is in line with the solidarity principle. Also, if the premium percentage would be decreased, the higher incomes would not feel the consequences of this wage level increase.

STEERING GROUP RECOMMENDATION 2
Further research into consequences of reducing the penalty for missing years.
Consequences
The original Keesen recommendation would have a negative impact on the fund's finances; benefits to insured with less years of residency would go up. Positive socio-economic impact, retirees in question generally have little or no other sources of income. It rewards the choice of immigrants to settle in Sint Maarten and contribute to society.
Stakeholder assessment
Original Keesen recommendation rejected
Remarks: The measure to entitle retirees with missing years – under certain conditions – is socially advisable. Many stakeholders feel that those who were not a resident of Sint Maarten for the full 45 years, should not receive a full entitlement either.
<i>Keesen: Recommendation 2. Skip reduction in AOV benefits for missing years if insured was resident for over 10 yrs.</i>

SER advice (unanimous):

Introduce skipping of the reduction of the AOV entitlement for cases in which the retiree has lived in Sint Maarten for 10 years or more.

Provisions:

- **The financial consequences should be approximately such as the Keesen report predicts, i.e. this measure would make the average reduction go down from approximately 24% to 16% of total AOV entitlements.**
- **Measures should be taken to ensure that entitlements that retirees have built up in other countries will be deducted from the AOV entitlement.**

Elucidation:

Currently, residency for 45 years (15-60) entitles to full AOV. If a person did not live on Sint Maarten (Antilles) for some of these years, there is a 2.22 % penalty for each missing year. The Keesen report calculates that total reductions on AOV benefits would be 1/3 less, if persons who lived on Sint Maarten for 10 years or more would get full AOV. Such a measure is justifiable in principle.

The AOV is a pay-as-you-go system (Dutch: omslagstelsel) based on inter-generational solidarity, not based on 'saving' for one's own retirement. In other words: at any given moment, the younger generations are paying for their parents' and grandparents' AOV.

If we look at the ‘missing years’ question in this way, it concerns immigrants who came to Sint Maarten, paying into the AOV system for a number of years, in effect paying for Sint Maarten retirees’ AOV, thereby exercising inter-generational solidarity. This phenomenon is actually one of the main reasons why the Sint Maarten AOV system is currently ‘overfunded’.

Reaching retirement age, these immigrants, now settled in Sint Maarten for a decade or more, are penalized for not having lived on Sint Maarten for the first part of their working life, and they cannot benefit from the premiums their (grand)children are now paying into the system.

It should be noted that entirely skipping the reduction for missing years is too costly a proposition.¹⁰ However, if a minimum of 10 years would be implemented as a basis for full AOV, total reserves by 2030 would be reduced by approximately 40% compared to the base scenario.¹¹ Moreover, a number of persons with insufficient AOV receive social welfare (onderstand) to ensure them a minimum standard of living. Broadening full AOV to all who have lived for more than 10 years on Sint Maarten would make most of these supplemental welfare benefits redundant. These savings are not included in the calculations.

Further research should ensure that the cost of introducing full AOV for those who have lived 10 or more active years in Sint Maarten are indeed in the order of magnitude the Keesen report predicts. Flanking measures should ensure that entitlements stemming from the retiree having lived in other countries are deducted from the AOV.

It should be noted as well, that this measure will greatly reduce the need for financial assistance (onderstand) currently granted to retirees with insufficient AOV and no other sources of income. This positive effect is not included in our calculations.

STEERING GROUP RECOMMENDATION 3
Raise retirement age to 62
Consequences
Positive impact on the fund’s finances; each insured receives less years of entitlement, and contributes to the fund during more years. Mixed socio-economic impact, retirees will be forced to work more years, however this is in line with international trends and is not perceived as an overall threat to well-being.
Stakeholder assessment
Original Keesen proposal (65) rejected by labor unions. Civil servants and business associations connect it to affordability of the AOV plan. Insurance companies are in favor.
Remarks: The current age of 60 is very low when compared internationally ¹² . Currently, none of the compared countries is still at 60 without plans for increase.
<i>Keesen: Recommendation 3. Raise retirement age gradually to 65 in 2020</i>

¹⁰ Keesen 2010, page 16, see table

¹¹ See figure 2: reserves would go from Naf. 930 to 559 million in 2030, amounting to a 40% reduction.

¹² Steering committee 2012, page 10

SER advice (unanimous):

Gradually raise the retirement age to 65 over a period of 10 years.

Elucidation:

Consensus was already reached on raising the entitlement age to 62 over a 4-year period. However, it is the feeling of the SER that after reaching the retirement age of 62, the process should be continued until the retirement age of 65 is reached. This will release considerable funds, enabling among others the reduction of the AOV premiums, while still keeping the AOV system financially healthy.

STEERING GROUP RECOMMENDATION 4
Increase the AOV benefit to Naf. 1,000 monthly
Consequences
Negative impact on the fund's finances; all benefits go up. Positive socio-economic impact; current AOV level is universally seen as insufficient for subsistence level.
Stakeholder assessment
All in favor of increase to Naf. 900, some deem this too low. A larger increase is suggested.
Remarks: Socially advisable and financially still feasible even under a conservative growth scenario.
<i>Keesen: Recommendation 1. Increase the AOV benefit from Naf. 800 to Naf. 900 monthly</i>

SER advice (unanimous):

Follow the recommendation of the steering group; increase the AOV benefit to Naf. 1,000 monthly.

Elucidation:

Adaptation of the AOV entitlement level is long overdue, and the proposed level of Naf. 1,000 brings the AOV more in line with what is recognized as a socially acceptable income (compare to the minimum wage level of Naf 1,379.- per month). In 2008 the poverty line on the Netherlands Antilles level was established by the CBS at Naf. 1,045.- per month¹³ for a single person.

STEERING GROUP RECOMMENDATION 5¹⁴
Further research the financial consequences, conditions and constraints of a 'mandatory' second tier pension plan and then decide on: 5.1 Decrease AOV premiums for employers and employees with 1.5% each 5.2 Introduce a compulsory pension savings plan with 0.75% premium contribution by employer and employee

¹³ Steering group 2012, page 23

¹⁴ Steering group 2012, page 24, 25

5.3 Increase tax deductibility (for third tier plans) from Naf. 1,000.- to Naf. 12,000.- per year.

Consequences

5.1 Sizable socio-economic benefits; costly in terms of AOV financing

5.2 No consequences for the AOV system as such.

Socio-economic consequences: Introduction of a second tier pension plan would in the long run decrease dependence on AOV only and is therefore favorable.

5.3 No consequences for the AOV system as such. Socio-economically important tax incentive for tertiary pensions, also reducing dependency on AOV alone.

Stakeholder assessment

5.1 Premium reduction is postponed and tacitly traded off against keeping the retirement age at 62

5.2 Mixed. Insurance companies and half of the business associations against compulsory character, all others in favor.

5.3 Decision on tax deductibility is postponed with points 5.1 and 5.2 for reasons unknown.

Remarks:

5.2 Some parties in favor of mandatory plan, others want only to encourage through tax incentives.

Keesen: Recommendations 6+9.

Compulsory pension savings plan with employer + employee contribution of 0.75% each calculated over income up to Naf. 42,500 p/a

Let private parties (e.g. insurance companies) execute the plans, within government-set rules.

SER advice (unanimous):

According to the SER, the three parts of recommendation 5 of the steering group should be addressed separately.

5.1 Decrease AOV premiums for employers and employees with 1.5% each (after further research the financial consequences, conditions and constraints of a 'mandatory' second tier pension plan)

SER advice (unanimous):

Decrease of the premium percentage should be implemented as soon as possible.

Decrease the employers' premium from 7% to 5.5% and the employees' contribution from 6 to 4.5%

Elucidation:

The relatively high premium percentage (13% of gross income) that we have now is a remnant from the Netherlands Antilles situation, based on a demographical structure very different from that of Sint Maarten. In the more favorable Sint Maarten situation – reflected in the extremely high reserves in 2030 under unchanged policies - there is no reason to keep this high burden in place. The economic stimulus resulting from the increased purchasing power for the employed (practically 1.5% for every employed person) added to the decrease in labor cost for employers (also practically 1.5% of the total cost of wages for every company) will cause a very welcome boost to our economy.

The report puts off the decrease in premium percentage to tacitly finance the smaller increase in entitlement age (62 instead of 65) and the higher increase in AOV entitlement (Naf 1,000 instead of Naf 900). According to the SER, this is a favorable trade-off.

5.2 Introduce a compulsory pension savings plan with 0.75% premium contribution by employer and employee (After further research the financial consequences, conditions and constraints of a 'mandatory' second tier pension plan)

SER advice (unanimous):

Follow the recommendation of the Steering group. Conduct a comprehensive follow-up study into the desirability, consequences and possible characteristics of a mandatory second-tier pension plan for all employed residents.

Elucidation:

A mandatory second tier pension plan merits further research. The percentages and amounts of the Keesen report don't need to be guiding in this assessment. It is beyond doubt that second tier pension provisions should be promoted among the employed population, as AOV is not intended to, nor will it be able to guarantee the formerly employed a quality of life that bears any relation to the level experienced during his or her active career. The disadvantages of classic second tier pension plans, that are connected to a certain employer, and therefore severely reduce labor market mobility, should be avoided. It also stands to reason that such a plan should be of the 'defined contribution' variety. An example of a plan that takes these factors into account is the mandatory pension scheme recently introduced in Aruba.

5.3 Increase tax deductibility (for tertiary plans) from Naf. 1,000.- to Naf. 12,000.- per year (After further research the financial consequences, conditions and constraints of a 'mandatory' second tier pension plan)

SER advice (unanimous):

Introduce an increased deductibility of private pension premiums (third tier plans) as soon as possible.

Conduct the necessary research to determine the desired (maximum) level of deductibility and prepare the changes needed to the income tax code. This should be done without delay, unrelated to the introduction of a mandatory second-tier pension arrangement, and unrelated to any decisions on the AOV system.

Elucidation:

There is no direct connection between the decision to introduce a mandatory second tier pension scheme and the tax deductibility of third tier pension (insurance) premiums. Contrary to the recommendation of the Steering committee, this matter should be decided upon separately. This issue is a clear matter of our tax code lagging behind current developments. For a decision to change the tax code only an assessment of the consequences for government finance and an assessment of interrelations with other fiscal and related legislation is necessary. Given the outcome of those assessments, the level of maximum tax deductibility should be determined and introduced as soon as possible.

3.4 Summary of the SER advice and overall effect on the AOV system

In summary, the SER unanimously advises the following:

- Increase premium income to Naf. 100,000;
- Skipping of reduction for missing years for those with more than 10 active years on SXM;
- AOV entitlement age is raised to 65 gradually over a period of 10 years;
- Increase the monthly AOV benefit to Naf. 1,000 per month;
- Reduction of premium percentages with 1.5% for employers (from 7% to 5.5%) and employees (from 6% to 4.5%).

In this scenario, break-even between annual cost and income for the AOV fund would occur in 2027, no different from the scenario under unchanged policy.

The reserve position of the AOV fund in 2030 (the benchmark year for the AOV report) would be Naf. 598 million, down from Naf. 930 million in the present situation. This is still a very sizable reserve fund, far exceeding the necessary financial cushion to absorb any adverse effects the fund might encounter in the 20 year period under review.

Figure 4 shows the values of the parameters preferred by the SER. Additionally, figure 5 shows the results of the SER scenario in graphical form.

Figure 4. SER scenario - parameters¹⁵

Parameters (all amounts in ANG)

Premiums

Min income / year	6,847
Max income / year	100,000

Increases with income increase parameter

	Under Min	Over Min
% income ER	5.50%	5.50%
% income EE	0.00%	4.50%
% income retiree	0.00%	0.00%

Note: no premiums over max

Fixed amount	0
Annual increase	3.00%

AOV benefit

Benefit per month	1000
1 time increase	0.00%
Annual increase	3.00%
Avg reduction	16.00%
Avg extra abroad	15.00%
Avg extra partner	1.00%
Retirement age	
	2011 60
	2013 61
	2015 62
	2017 63
	2019 64
	2021 65

Other

1 time increase inc distr	0.00%
Annual increase income pp	3.00%
Intrest on reserves	3.00%
Intrest on deficits	6.00%
Start Year	2011
Start Reserve	60,623,397
Flat Adm Cost / year	0
Annual increase	3.00%
Adm Cost as % Benefits	6.00%
Mortality: GBMV8590	
Birth per year	500

¹⁵ Figures as inserted in the mathematical model provided by Keesen actuarissen.

Figure 5. SER scenario - results¹⁶

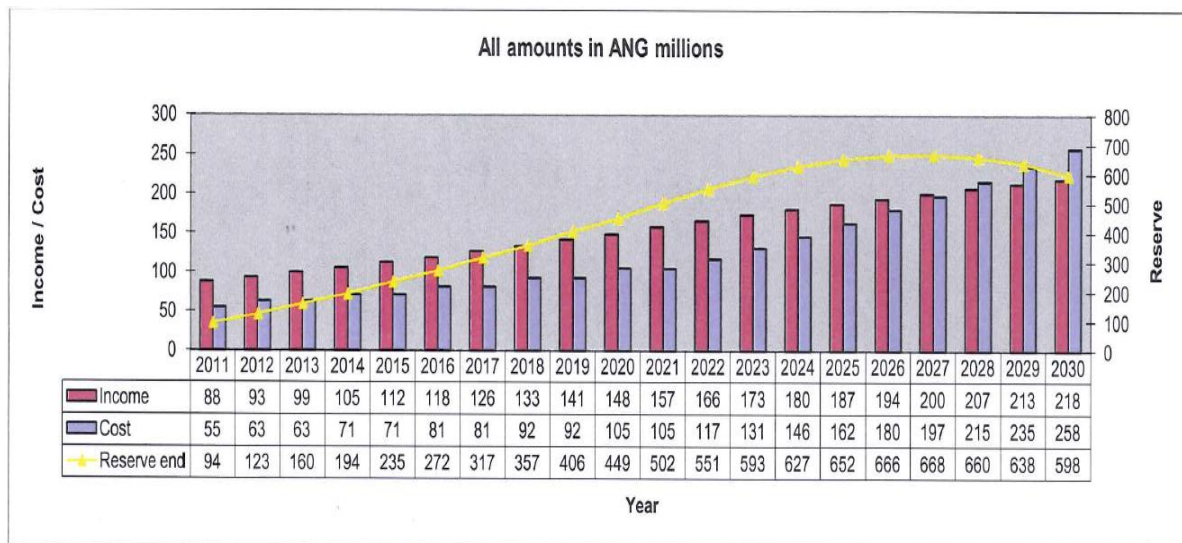


Figure 5 shows that following the SER recommendations, the AOV fund would still be in excellent shape in 2030 and for many years thereafter, while at the same time taking some important measures that will not only make the AOV system more equitable but will also decrease the premium burden on employee and employer alike.

The scenario proposed by the SER is fairly low-risk. The break-even moment remains unchanged, while the reserve buildup is still considerable. Moreover, it leaves room for quick future adaptations, in case important external shocks would take place, or if demographical developments would be less favorable than expected. For instance, under extremely adverse conditions the premium percentages could always be increased again. In the meantime however, our economy would have benefited considerably from the economic stimulus stemming from the lower AOV contributions.

¹⁶ Results as produced by the model provided by Keesen actuarissen.

4 Sources

- **Steering committee 2012**

Towards a Sustainable and Affordable AOV Pension System, Steering Committee Social Security and Pensions, Sint Maarten 2012

- **Keesen 2010**

A sustainable Pension System for country Sint Maarten (Exploratory Policy Report), Keesen Actuarissen, Sint Maarten, December 22, 2010. Includes a mathematical model allowing different scenarios to be calculated based on certain input parameters.