

# **Civil Service Pension Regime & Fiscal Challenges**

***(An Interactive Discussion & Presentation)***

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# Understanding the Civil Service / Government Pension Scheme

- The pension scheme across different tiers of Government (Federal, Provincial, Local / District Government & municipal service etc) is almost identical and in fact several government owned corporations, autonomous bodies, universities, boards and other state affiliated entities have also adopted the same scheme. As such, the problems and challenges are also the same.
- Civil Servant / other government employees get pension as an end-of-service benefit and it is administered as a 'defined benefit' scheme (where the benefit/entitlement is defined but not the source of funding or contribution).
- Pension payments are made on 'pay as you go' basis i.e., payments are made from the regular government budget and not from any investment/pension fund.

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# Understanding the Civil Service / Government Pension Scheme

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- The pension schemes across the various tiers of governments tend to adopt the decisions of the federal government on pension related matters, though not legally obliged to do so. This has resulted in huge fiscal challenges for some organizations where there are revenue shortfalls or where the organization isn't a going concern / has been closed. There are some 'discontinued' entities that are being run only to manage pensions of retirees.
- There is no separate legislation to govern the matters pertaining to pensionary benefits. However, there are some Rules and a series of executive orders to govern entitlements and procedure. This has created room for several pension reform related initiatives being 'undone' when challenged. As such, this area largely remains a 'regulatory / legislative orphan'.

## **Main 'Pools' of Pensioners**

The largest 'pools' of government pensioners are as following:

- Armed forces (early entry and early retirements),
- Provinces (largest number of employees but proportionately lesser pensioners),
- Pre-partition legacy entities (e.g Railways, Postal Services),
- Federal government (comparatively less employees and pensioners),
- Local governments, municipal services and other entities not having own-source revenues (comparatively less employees and pensioners but financially the most challenged).



# **Fiscal Challenges: Pension Cost is Growing**

- **'Measuring' Pension Costs:**

Pension costs can be measured in four separate ways:

- As a percentage of revenues (where revenues are sufficient enough to cover costs of running an establishment, e.g. provinces),
- As a percentage of costs (where deficit financing is the norm, e.g. federal government),
- Absolute amounts (where the organization is purely a service related entity e.g. armed forces),
- In comparisons with the past trends of the organization / pool of pensioners (where huge subsidy / budgetary grants from the governments are needed).

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# **Fiscal Challenges: Pension Cost is Growing**

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- **Rapidly Growing Pension Cost:**

- Since the provinces represent the largest collective number of employees and pensioners, it is best that the fiscal challenges be explained in relation to the provinces.
- Approximately **4%** of revenues in **2004-05** to about **15%** in **2021**.
- Expected to rise to about **18%** of revenues by **2030**, **22%** of revenues by **2040** and **27%** of revenues by **2060** at current pace and under current policy regime.

# Pension Expenditure - Growing Faster than Revenues

While trends are the same across provinces, the details of the last eleven years are being present in the context of the province of Punjab as an example:

*Rs in billion*

Year	Annual Pension	General Revenue	Pension Expense as % of Revenue	Current Expenditures (Non-Development)	Pension Expense as % of Current Expenditure
FY10-11	36.4	539.0	<b>6.7%</b>	370.0	<b>9.8%</b>
FY11-12	50.1	606.0	8.3%	444.0	11.3%
FY12-13	67.4	703.0	9.6%	534.0	12.6%
FY13-14	76.4	815.0	9.4%	569.0	13.4%
FY14-15	88.8	902.0	9.8%	670.0	13.3%
FY15-16	113.8	1,108.0	10.3%	730.0	15.6%
FY16-17	141.0	1,405.0	10.0%	900.0	15.7%
FY17-18	172.9	1,387.0	12.5%	961.0	18.0%
FY18-19	205.2	1,426.0	14.4%	1,129.0	18.2%
FY19-20	233.1	1,477.9	15.8%	1,258.0	18.5%
FY20-21	255.7	1712.7	<b>14.9%</b>	1,314.9	<b>19.4%</b>

# Projected Pension Expenditure

*Rs in billion*

Year	Commutation *	Annual Pension	Total Pension Payments	Projected Revenue**	Pension Expense as % of Revenue
2021-22	46.9	247.8	294.7	1,884.0	15.6%
2022-23	51.9	280.9	332.9	2,072.4	16.1%
2023-24	60.2	318.8	379.0	2,279.6	16.6%
2024-25	67.3	360.8	428.1	2,507.6	17.1%
2025-26	70.7	406.3	477.0	2,758.4	17.3%
2026-27	74.1	455.4	529.5	3,034.2	17.5%
2027-28	86.3	511.1	597.4	3,337.6	17.9%
2028-29	85.3	570.0	655.3	3,671.4	17.8%
2029-30	80.3	635.2	715.5	4,038.5	17.7%

\* Commutation means lump-sum upfront payment of a part of future pensions.

\*\*It has been assumed that long-term growth in Government Revenue would not be less than 10% per annum from FY2021-22 onwards. Revenue estimates of the Govt. of Punjab are used for FY21-22.

# **Main Causes of Increase in Pension Expenditure**

In order of impact, the main causes are as following:

- Large benefit increases in real terms (ad-hoc increases), over & above the pension formula,
- Generous pension increases to retirees,
- 2015 decision providing retroactive restoration of commutation benefits,
- Increase in family pension benefits/ multi-generation pensions,
- Rapidly retiring workforce.

## Generous Ad-hoc Increases – Over & Above the Pension Formula

- Pension increases attributable to past retirees being given to future retirees as well (ad-hoc measure since 2010).
- ‘Medical Allowance’, is being given as part of pension since 2010.
- ‘Replacement rate’ (pension as a % of pay) has increased from 70% in 2010 to 157% in 2021.
- ‘Old’ pensioners (retired prior to 2010) are at considerable disadvantage to ‘new’ pensioners (retiring after 2010). Their disparity has been increasing year after year, resulting in ‘old’ pensioners emerging as a vocal lobby group for higher pension increases.

## Adhoc Pension Increases Created Disparity among New vs Old Pensioners

Pension Comparison of Grade 17 employee who retires at stage 15

Pensioner Retired in the Year	2021 (‘New’ Retiree)	2010 (‘Old’ Retiree)
Basic Salary at Retirement	Rs 64,870	Rs 20,950
Pension at Retirement <u>without</u> commutation	Rs 101,761 (157% replacement)	Rs 14,665 (70% replacement)
Pension at Retirement <u>with</u> commutation	Rs 66,145 (102% replacement)	Rs 9,532 (46% replacement)
Commutation Amount – If opted	Rs 2,359,542	Rs 762,022
Pension in 2021 <u>without</u> commutation	<b>Rs 101,761</b>	<b>Rs 46,062</b>

# Generous Pension Increases to Retirees

Again, figures are based on data of Government of Punjab

*Rs in billion*

Year	Annual Pension Expenditure	CPI (YoY) %	*Pension Increase %
FY10-11	36.4	13.1%	15.0%
FY11-12	50.1	11.3%	15.0%
FY12-13	67.4	5.9%	20.0%
FY13-14	76.4	8.2%	10.0%
FY14-15	88.8	3.2%	10.0%
FY15-16	113.8	3.2%	7.5%
FY16-17	141.0	3.9%	10.0%
FY17-18	172.9	5.2%	10.0%
FY18-19	205.2	8.0%	10.0%
FY19-20	233.1	8.6%	10.0%
FY20-21	255.7	9.7%	Nil
<b>Annual Growth</b>	<b><u>21.5%</u></b>	<b><u>6.6%</u></b>	<b><u>8.8%</u></b>

\*Certain other increases beyond the above standard increases have also been given from time to time, such as, minimum pension increases and extra increases to those pensioners beyond a certain age threshold.

# **'Restoration' of Commuted Value of Future Pensions**

- 'Commutation' means lump-sum upfront payment of a part of future pensions, whereas 'restoration of commutation' means the adding back of commuted value of pension into the monthly recurring pension.
- Restoration of commutation was disallowed until 2015, where after the Government had to allow such restoration as a result of litigation. Change is required through legislation.
- Pensioner gets approximately 60% higher recurring monthly pension after restoration of commutation.
- Pension bill increases each year by about 8% due to restoration of pension.

# Pension Benefit is Much Longer than Service

- Since 2015 onwards, 'widowed and divorced daughter' has been included in the definition of 'unmarried daughter' for the purpose of family pension. This extends the family pension benefit by at least 10 years even by the most conservative assumptions (though actual data for the same doesn't exist at present). The actuarial assumptions for the pension benefits extended to single pensioners is as follows:

<b>Average Pension Duration of Superannuating Pensioner (life expectancy of 82 years)</b>	<b>22 Years</b>
<b>Average Pension Duration of Family Pension: Wife (estimated 5 years younger than husband; Life expectancy of 87 years)</b>	<b>10 Years</b>
<b>Minimum Pension Duration of Family Pension: Other (especially for widowed/ divorced daughter)</b>	<b>10 Years</b>
<b>Estimated Average Pension Duration</b>	<b>42 Years</b>

# Early Retirement Trend is Worrisome

While figures are based on data of Govt of Punjab but figures are very similar across provinces but not so much across other 'pools' of pensioners.

<b>Year</b>	<b>Early Retirees as a % of Total Retirees for the Period</b>
<b>1971-80</b>	<b>8.26%</b>
<b>1981-90</b>	<b>20.51%</b>
<b>1991-00</b>	<b>32.90%</b>
<b>2001-05</b>	<b>37.31%</b>
<b>2006-10</b>	<b>22.21%</b>
<b>2011-15</b>	<b>25.48%</b>
<b>2016-18</b>	<b>47.88%</b>
<b>2019-21</b>	<b>60.00% Approx.</b>
<b>2021 onwards</b>	<b>Early retirements projected to reduce by 30% in the first couple of years (due to 55 years age restriction applied in the 2<sup>nd</sup> half of FY 2020-21. The benefit shall gradually reduce going forward.</b>

# Analyzing the Retirement Trends

- No of pensioners as % of active employees are on increasing trend, as follows:

<b>Year</b>	<b>Pensioners as % of Employees</b>
<b>1970</b>	<b>1.66%</b>
<b>1980</b>	<b>3.08%</b>
<b>1990</b>	<b>7.50%</b>
<b>2000</b>	<b>21.80%</b>
<b>2010</b>	<b>33.11%</b>
<b>2019</b>	<b>49.65%</b>
<b>2030 (Projected)</b>	<b>56.65%</b>

- This trend shows that going forward, recurring monthly pension expenditure shall consume the bulk of total end of service/retirement related expenditure.

# Recruitment Trend

## Based on Current Payroll & Pension Data

Year	Total Recruitments	Male % of Total Recruitments	Female % of Total Recruitments
Until 1970	129,943	84.86%	15.14%
1971-90	452,893	80.97%	19.03%
1991-00	181,162	77.26%	22.74%
2001-05	81,332	82.90%	17.10%
2006-10	170,454	80.39%	19.61%
2011-15	194,492	56.88%	43.12%
2016-19	234,321	67.68%	32.32%

Rising proportion of female recruitments, while reflective of improved gender equality, also indicates towards longer pensionary benefits due to higher inherent female longevity (these are very long-term implications).

# Recruitment Trend

## Based on Current Payroll & Pension Data

Year	Average Yearly Recruitment	Net Increase in Working Strength*	Average Age at Recruitment**
Until 1970	-	9.34%	22.53
1971-90	8.08%	7.50%	24.02
1991-00	3.06%	1.49%	25.16
2001-05	2.60%	0.70%	26.64
2006-10	4.96%	3.30%	25.92
2011-15	4.88%	2.27%	28.09
2016	5.58%	1.91%	26.72
2017	5.72%	1.99%	26.88
2018	13.20%	9.71%	26.27
2019	2.06%	-0.70%	25.59

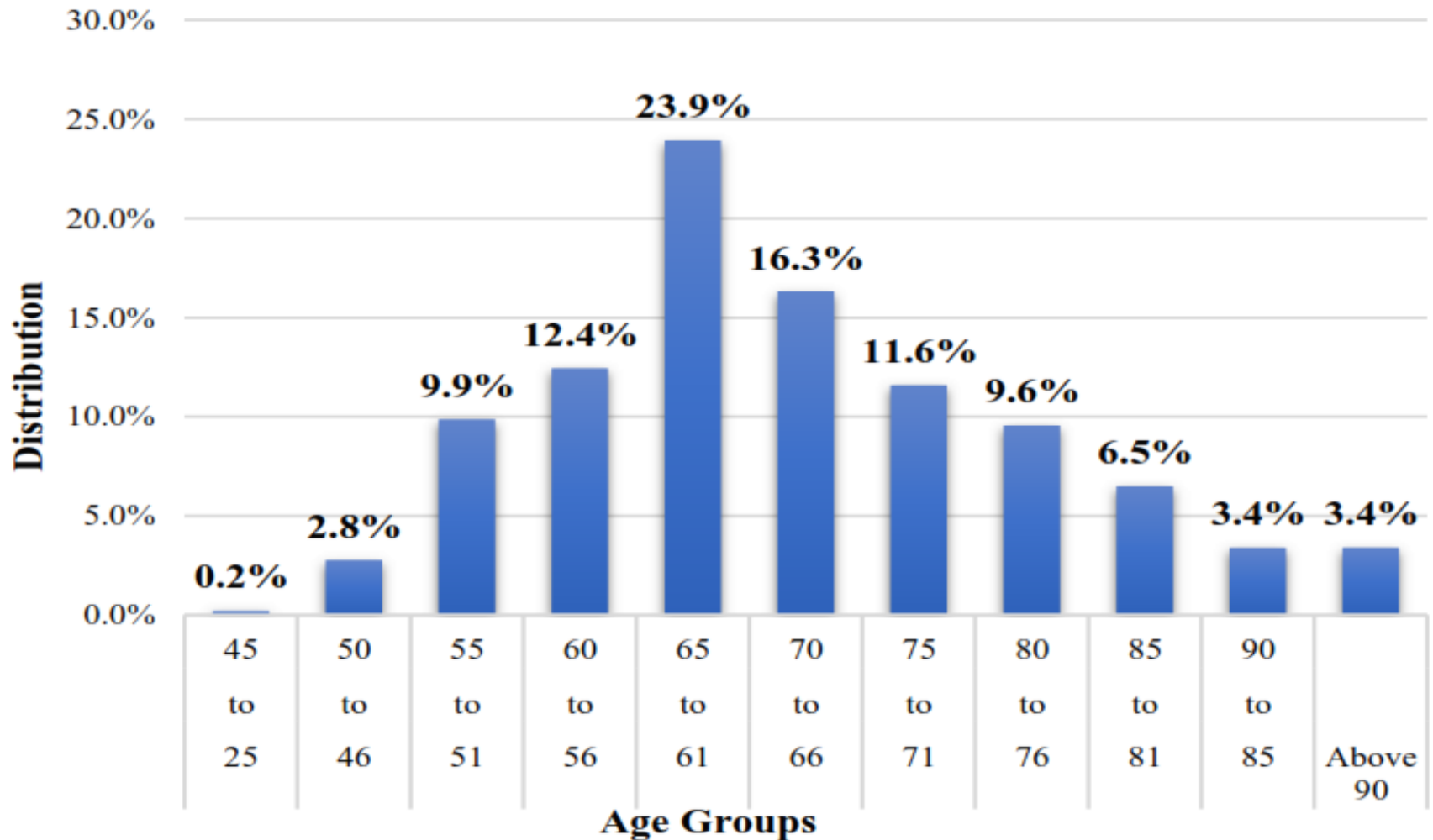
\* Net of retirements,

\*\* The average age at the time of recruitment has remained low, allowing employees to accrue full pension benefits well before retirement.

# Early Retirement Trend – Age Analysis

<b>Year</b>	<b>Average Retirement Age of Early Retirees</b>
<b>1971-80</b>	<b>46.85 Years</b>
<b>1981-90</b>	<b>49.75 Years</b>
<b>1991-00</b>	<b>50.42 Years</b>
<b>2001-05</b>	<b>50.77 Years</b>
<b>2006-10</b>	<b>51.52 Years</b>
<b>2011-15</b>	<b>52.57 Years</b>
<b>2016</b>	<b>53.09 Years</b>
<b>2017</b>	<b>53.17 Years</b>
<b>2018</b>	<b>53.50 Years</b>
<b>2019</b>	<b>53.57 Years</b>

## Age wise Distribution of Pensioners



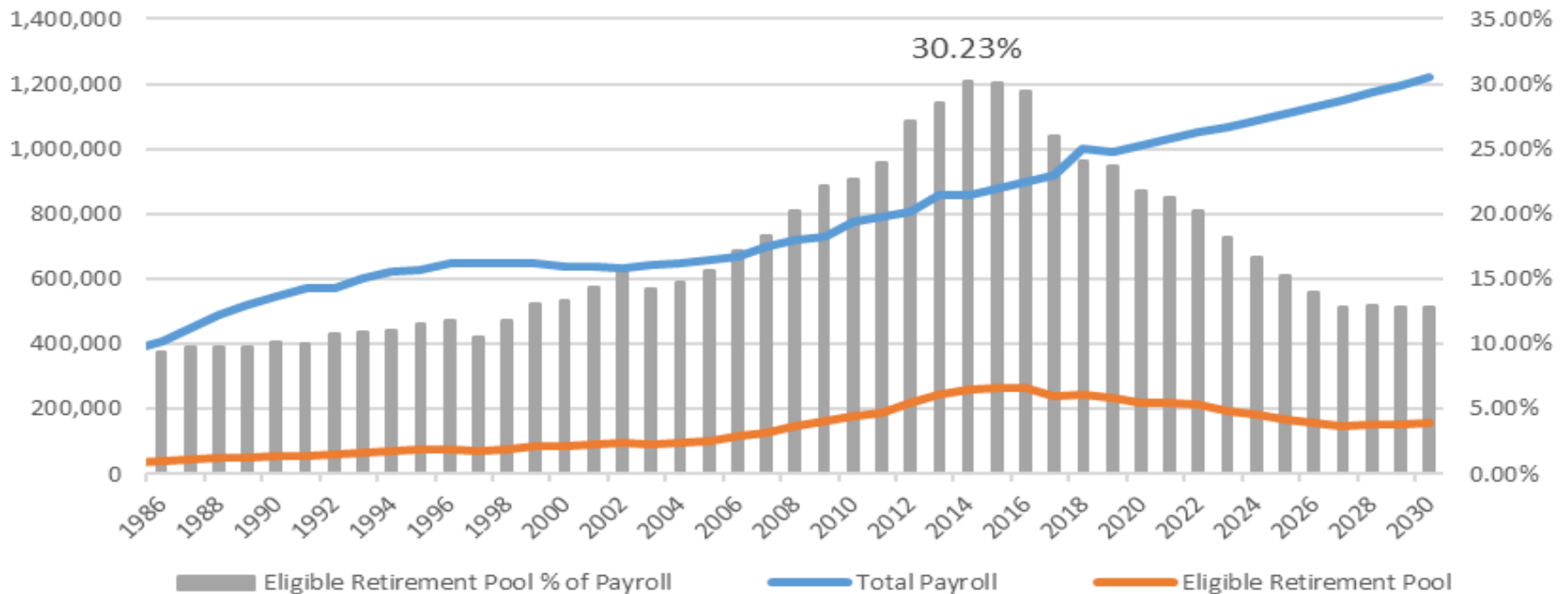
# Early Retirement Trend – Years Served

<b>Year</b>	<b>Average Years Served Early Retirees</b>
<b>1971-80</b>	<b>28.60 Years</b>
<b>1981-90</b>	<b>29.39 Years</b>
<b>1991-00</b>	<b>29.26 Years</b>
<b>2001-05</b>	<b>28.95 Years</b>
<b>2006-10</b>	<b>28.94 Years</b>
<b>2011-15</b>	<b>29.67 Years</b>
<b>2016</b>	<b>30.29 Years</b>
<b>2017</b>	<b>30.56 Years</b>
<b>2018</b>	<b>31.16 Years</b>
<b>2019</b>	<b>31.03 Years</b>

# Pool of 'Eligible to Retire' Employees

- Presently, 23.73% employees are 'eligible to retire' (completed qualifying service) against 5 year average of 26.66%. This is projected to reduced to 14.68% by 2030 (2% increase in working strength is assumed each year.)

## Payroll Vs Eligible Retiree



# REMEDIAL MEASURES/ REFORM OPTIONS

# Reform Options (Immediate/ Possible within 30 Days)

Parameter	Remarks	Remedial Measure
1. Adhoc/past pension increases given to future retirees	Adoption of Federal Government notification	Government notification for removal shall suffice
2. Controlling early retirements	Incentivized retirement	Punjab & KPK have effectuated this reform (restricting retirement age to 55 years) but not the others.
3. Pension formula linked to the last drawn basic pay	Changed in 1986 from average of the last three years	Change in Rules: Revert to old pension formula
4. Huge cash outlay of commutation of pension (more than 20% of annual pension expense)	Lump-sum payment may be reduced	Change in Rules: Reduction in commutation rate from 35% to 25%

# Reform Options (Medium Term/ Possible in 90 Days)

Parameter	Remarks	Remedial Measure
5. Restoration of commutation	Not justified economically. Result of court decision	Pension Act:  Removal through a 'Pension Act' to give legal sanctity
6. Long family line and increase in life expectancy	Result of increased Government's benevolence over the years	Change in Rules:  Limit family pension to spouse & children up to the age of 21 years
7. No penalty on early retirement	Government employees retire at their most productive years due to pension attractiveness	Change in Rules:  Discount factor may be introduced for real cash saving & discouraging early retirement

# ***Reform Options (Long Term/ Requires more than 90 Days)***

<b>Parameter</b>	<b>Remarks</b>	<b>Remedial Measure</b>
8. Rationalized pension scheme of new entrants	The Government can introduce a 'Defined Contribution' or a reformed version of the existing pension scheme	Separate legislation is required
9. Generous pension increases	Resulted in pension increases considerably higher than inflation	Policy framework to link pension increases with certain percentage of inflation
10. Review of retirement age	Retirement age is not changed despite considerable rise in life expectancy	Change in Law: Deliberations are required to assess pros and cons
11. Other reforms	Pension disbursement issues, rationalizing end service benefits	Automation of proof of life

# INVESTMENT RELATED CHALLENGES

- *Need of Greater Variety of Investment Products to Cater to the Needs of Pension Funds:*

Pension Fund Requirements	Investment Product
Long-Term Nature of Pension Liabilities	Market of a long-term investment products is still not fully developed, be it government bonds, corporate bonds or bank deposits.
Longevity Risk	Very few life insurance companies offer annuity products and those who do, don't offer competitive terms.
Inflation Hedging	Inflation linked products are not available. Long-term zero coupon bonds are also not available.
Diversification Constraints	Absence of alternative investment avenues.

## Constraints Towards Outsourcing

- **VPS Doesn't Substitute for a 'Defined Benefit' Pension:** VPS does not adequately cater to future pension increases, nor addresses longevity risk.
- **Need for More Robust Legislation to Address Social Welfare Gaps:** In the absence of adequate national level social safety nets, the burden of sustaining multiple generation of beneficiaries of government employees falls on the pension scheme. Hence there is a need to strengthen social welfare initiatives.



Thank you