The Changing Pension Landscape in Mauritius

Introduction

Whilst the full scale of the economic impact of the Covid 19 pandemic is yet to make its way into the official figures, the reality on the ground is that a lot of it is already being felt by individuals, companies employing those individuals and governments around the world. Mauritius is no exception and all segments of our economy are affected. In this article, we look at how this is affecting the pension landscape in Mauritius.

The New Normal

Indeed, the inter-connections that exist between the different sectors of our economy (informal, private and public sectors) mean that when one segment catches a flu, the rest is bound to sneeze. The sudden halt in economic activity in the travel and industry sector for example has created a significant shortfall in the revenue that the government collects in taxes. This no doubt will create a headache when it comes to balancing the books in the coming budget and it is inevitable that something else will give in. Companies, on the other hand, may have seen a significant fall in revenue as the effects of the lockdowns translate in lower sales and consumers remain cautious. Some companies are even facing financial hardship and this is having an unprecedented impact on recruitment, retention and also how they reward their employees going forward. The informal sector has also been seriously affected during the lockdowns and no one can deny the adverse negative impact this is having on the aggregate level of spending (and hence Value Added Tax receipts for the government).

At a macro-economic level, interest rates have fallen to historic lows and there are already talks about the impact that the reduction in foreign exchange revenues (from both exports and tourism) will have on the value of the Mauritian Rupee in the not too distant future.

This is inevitably creating an atmosphere of uncertainty, and in due course, there is fear that our decision makers may resort to austerity when it comes to managing the economy. In this article, we focus on how this 'new normal' is affecting private companies and how they are addressing matters in relation to employee retirement benefits. In particular, we describe how some are preparing themselves for the worse and look at how this is heralding a new era of retirement benefits provision in Mauritius.

Private pension schemes – the story so far

In order to fully understand how the private pension industry is evolving today, it is important to briefly review its historical development. For many decades up to around the mid to late 1990s, most private pension schemes were of the defined-benefit type. Under these schemes, the benefits promised at retirement are defined in the rules in a formula (typically, an employee's pension is calculated as 1/60 of his salary just before retirement for each year of service).

A good proportion of these schemes were set up as 'insurance contracts' with a private insurance company where all the responsibilities ranging from administration, investment of assets and all the actuarial and other management functions resided with the insurance company. They were known as 'insured arrangements' although, apart from the benefit payable on death, none of the benefits offered under such schemes were fully insured in the true sense of the word. This means that when such a scheme was in deficit, the employer had to pay more in contributions to improve the level of assets backing the liabilities (compared to a typical insurance product where the premium is fixed in advance and the insured has no further liability). To add to this, such arrangements tied the employer into buying an annuity with the service provider when members retire, and this has generally aggravated the funding position of those schemes as insurance company buyout terms are generally more expensive than the contributions paid into the schemes.

Other pension schemes were set up as associations (some still are today) and they are looked after by a management committee.

As sponsors of defined-benefit schemes became aware of the true 'beast' that they were dealing with, the idea of moving to defined-contribution (DC) schemes started to blossom. This was viewed as a way to mitigate or eliminate the risk of further deficits arising in the years ahead. In that vein, some well-known private pension schemes pioneered the move to DC schemes in an environment where there were few, if any, well-defined rules for such moves. Approval for conversion to DC had to go through the Mauritius Revenue Authority (MRA) and the Financial Services Commission, as we know it today, had not yet been formed.

In the new millennium, private companies had to comply with new accounting standards (IAS 19, renamed to MAS 25 in Mauritius) and they were forced to disclose their increasing pension scheme deficits in their annual accounts. In those days, the level of interest rates (and inflation) were still relatively high (compared to recent levels) and they stayed at those levels for some years. During that time, and up to around the end of the first decade of the new millennium, there was relative calm in the pace of change related to DB pension schemes. This allowed pension professionals in the country to work together with the new pension regulator, the Financial Services Commission (FSC), to focus on drafting the Private Pension Schemes Act (PPSA) which came into force in 2012 – with detailed rules on the application of this important act being published shortly after.

That was a turning point and it meant that the rules of the game were now set. Companies wanting to set up a pension scheme either had to establish a 'foundation' or a 'trust', although existing 'associations' could continue. The insured arrangements described above were also required to be admitted into a trust and we understand this process is still ongoing 9 years after the promulgation of PPSA. We believe that the PPSA has done a lot of good for the private pension industry in that the increased transparency and professionalism that the PPSA advocates mean that many pension schemes took appropriate action to correct their systemic issues, be it in terms of funding or investment strategy. In many cases, a significant review of the administration also led to other issues being uncovered and dealt with. Where an administrator or fund manager were not performing to the standard required by the trustees or management committees, they were either spoken to (and possibly warned) or simply replaced with a new service provider. Therefore, competition in all aspects of the management of pension scheme has gathered pace.

New pension schemes during that time were set up as DC schemes but many of the existing schemes remained defined-benefit in nature. Some sponsors have attempted to change to DC but failed in doing so for their existing DB members and so they introduced defined-contribution schemes for new employees only (and this did not require their consent to any change since they were being offered new employment contracts). Whilst deficits in the DB schemes have continued to increase as a result of various economic factors (and aggravated further by Covid 19), the annual cost of a DB pension has also increased further. Many employers have started to look at their DB schemes even closer in order to fully understand the sources of the risk that they face with their pension schemes. As an actuarial firm, we have assisted employers through this 'discovery phase' and carried out studies in order to help them better understand their pension scheme risks over the next 10 to 15 years. Interestingly, some of the scenarios considered as part of these studies come close to the reality we are witnessing today. Low interest rates, low inflation and depressed investment markets together with the prospect of even lower future returns. Another interesting feature is that these scenarios considered similar trends in the UK where interest rates had also been falling consistently some 10 years back.

The move from DB to DC

The decision to change a pension scheme from DB to DC is not a straightforward one. Different companies have different types of employment contracts and some have signed collective bargaining agreements with unions. So, before engaging with employees, companies have to look at all their employment contracts and must seek a legal opinion on them so as to establish whether or not a change to DC can be implemented. A change to DC can thus involve one of the following two things:

a) A 'shift' to DC – this is where the past entitlements to DB pensions remain and only pensions that will build up from the shift effective date is on a DC basis.
b) A 'Conversion' to DC – this is where, on top of future service being on DC, the past pension entitlements are also transformed into a DC pension.

The FSC recently published its guidelines on Shifts and Conversions to DC to assist employers and trustees of pension schemes with a move to DC. It sets out clearly all the important aspects to consider and all the procedures they should follow when attempting such a change. We produced a News Alert on this topic summarising the main features but we recommend that the Guidelines published by the FSC are read in their entirety as the FSC publication remains the authoritative version that all employers and trustees must comply with.

What employers are now thinking?

Another key aspect employers should consider when considering a move to DC is to review what their underlying philosophy is when providing pension benefits as part of their remuneration package. Some companies have decided that offering a pension in retirement to their employees is an important element of their remuneration package because they genuinely care about the financial security of their employees once they have reached retirement age.

The key issue that employers face today is that DB schemes have become too risky for their balance sheets. The different risks associated with a defined-benefit scheme can even tip a perfectly profitable company into insolvency. The key risk is that the liabilities of the pension scheme increase by more than the assets can support. This can arise for many reasons including higher than expected salary increases, asset underperforming targets, reduction in interest rates, improvement in life expectancy. None of those risks affect the employers in a DC scheme since a move to DC entails transferring (not eliminating) them to the employees and that is why shifts and conversions to DC have become the norm today. Whether this bodes well for the retirement security in the future is examined with some illustrations below.

How about State benefits?

For many years, state pensions were mostly ignored in the design of private pension schemes since the element of security provided by the state was fairly minimal. State pensions, namely the Basic Retirement Pension and the National Pension Scheme, provided only a bare minimum (a so called safety net) and a modest earnings-related addition compared to the last salary at retirement. The rationale for their existence has been the subject of many studies carried out by the World Bank and people in academia and we believe they play a very important role especially for those who are not fortunate enough to be part of a private pension scheme.

Other elements that make up the retirement system in Mauritius includes the National Savings Fund and the recently introduced Portable Retirement Gratuity Fund (PRGF). Whilst the NSF's key objective is not to provide for a pension but a lump sum, we can think of it as a means of retirement savings in the same way that a pension scheme provides for a tax-free lump sum. The PRGF itself requires an article on its own to explain, but in a nutshell, it is not a pension scheme. It has been set up by government to prevent employees who change employment in their careers from losing out on their retirement gratuity enshrined in the Workers' Rights Act. Therefore, we tend to view it as a financing vehicle for the retirement gratuity rather than another layer of state benefits on its own.

We have set out, at the end of this article, a very brief summary of all the elements that make up the current retirement landscape in Mauritius together with some figures to show how the recent changes in the level of state pension benefits are also acting as a powerful force in the move to DC schemes.

Pension or No Pension?

Considering all the elements of retirement savings that an employee may have at retirement, whether in the public or private sectors, sugar industry or in the informal sector, one can assess whether their pension savings will provide a decent living standard in retirement.

For employers in the private sector, the ballgame has changed, in particular since the abolition of the NPF and the compulsory contributions of the CSG. A review of all the elements of pension that employees will receive is necessary before any decision is made about the level of pension an employer should provide to its employees. For some employers, given the greater significance of state pension entitlements, providing a pension as has been the norm is simply too costly and participation in the PRGF is the only option. For other employers, there is a history of pension provision along with an underlying philosophy or culture of pension being included in the remuneration package. For such employers, the question is not 'whether to provide a pension', but rather 'what type of pension to provide'.

The future is DC …or is it?

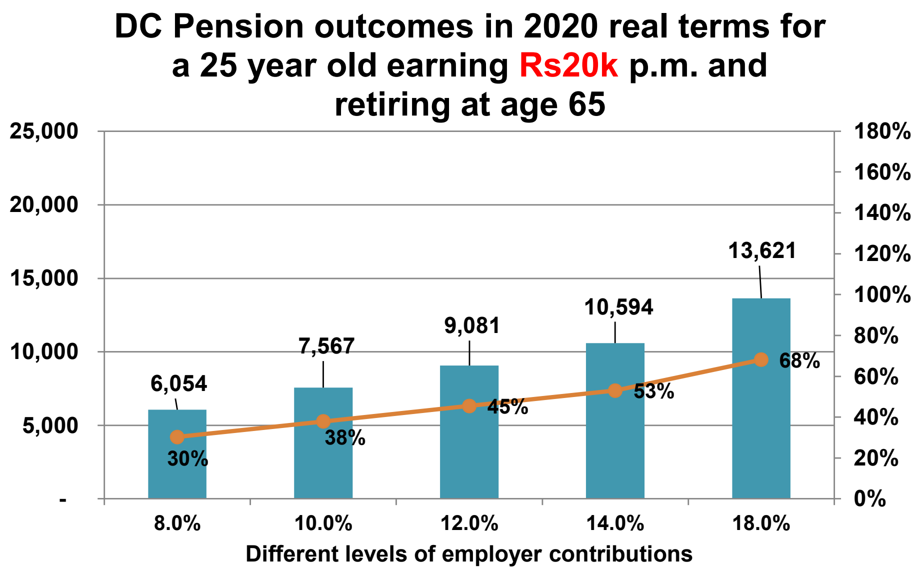
With this backdrop, employers with existing DB pension schemes are either looking to control their exposures to risks with their pension schemes or to eliminate those risks altogether by considering a conversion.

Employers willing to maintain their DB schemes for service already completed have a dual problem. On one hand, these schemes have potentially huge deficits that have arisen because of the reasons mentioned above. On the other hand, they face financial constraints in a difficult economic climate as well as having to pay compulsory CSG contributions to finance a lower target benefit.

The real question one should ask is whether DC schemes provide a panacea to all these issues. In our opinion, they don't and this will only become obvious after another 20 or 30 years when more and more employees retire on smaller pensions. This has already been observed in the UK where the move to DC cycle is some 20 years ahead of us. In order to illustrate this potentially scary future for some, we have estimated the pension that an employee, aged 25 years, who starts working today and is a member of a DC pension scheme with the employer contributing various levels of contributions. They all show a pension at age 65 expressed in today's money terms and are based on certain assumptions which we consider fairly, but not overly, prudent.

Illustrations of a pension from a DC scheme in 40 years' time

The chart below shows the estimated amount of pension from a DC scheme (ignoring state benefits) that a new employee may expect to receive at retirement, in 40 years' time, assuming the different levels of employer contributions. We have stripped out the effects of inflation and so the figures show the real income. We also show the replacement ratio – which is the pension divided by his monthly salary just before retirement (again in today's money terms). A word of caution here – there is no guarantee in a DC scheme and so there is a possibility that the figures are higher (which is all good) but they may also be lower (not so good news).



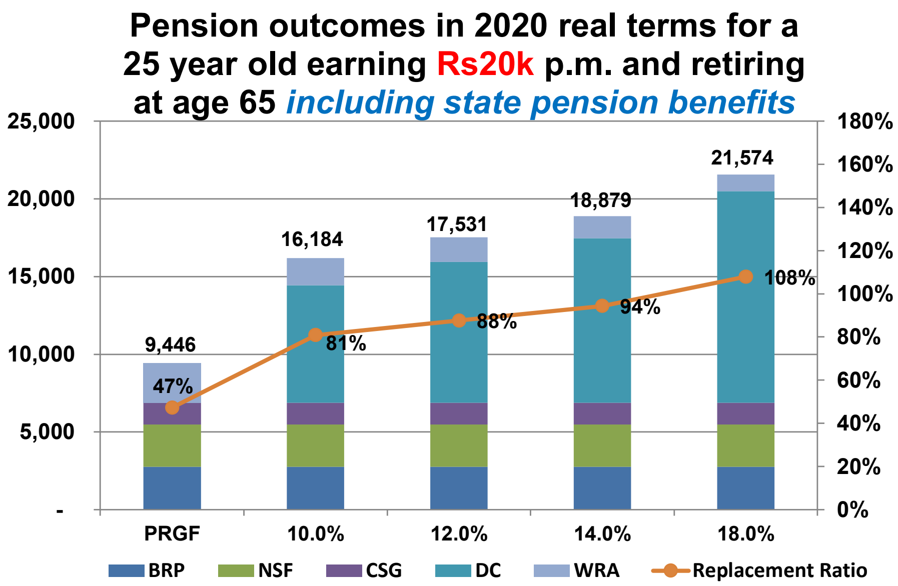
Note: The replacement ratio for all salary levels will be the same - only the amount of pension will vary proportionately.

Only pension schemes with contributions of 18% or more of salary are likely to provide a decent pension in retirement, ignoring state and other pension savings. For schemes with lower contribution levels, the position is not so rosy – for example, for pension schemes with 10% employer contribution (a typical level), the target replacement income is only around 38%.

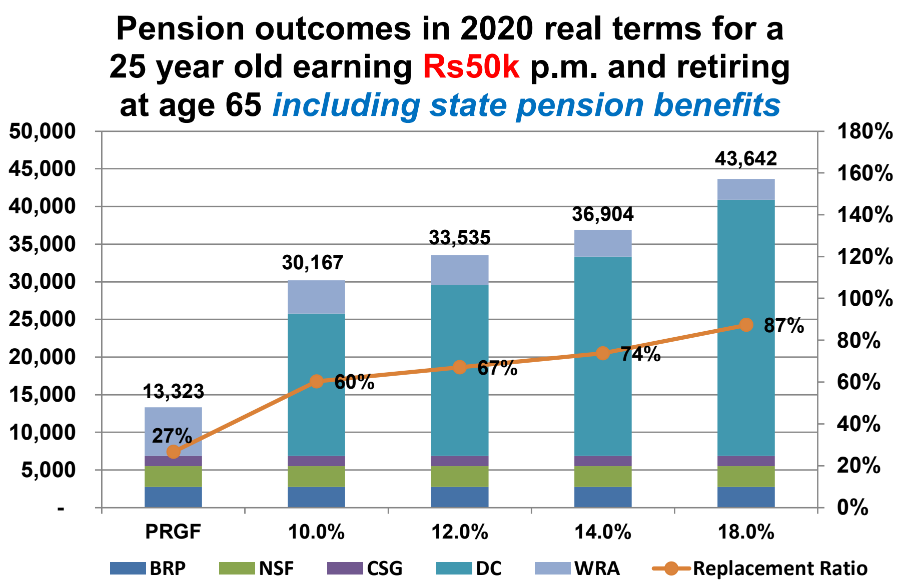
There are very few DC schemes in Mauritius with contributions as high as 18% and so we believe that many schemes will fail to provide sufficient income to their retired members, unless contributions are increased significantly.

Holistic view of retirement savings

If we adopt a holistic view and take account of all the pillars of retirement savings in Mauritius, the level of income in retirement effectively depends on salary levels. For low to middle income groups, it appears that the real pension as a proportion of salary is adequate even with a DC private pension component with a modest contribution of 10% of salary.



For middle income to high salary groups, the proportion that the state pension elements bear to total salary reduces significantly and the replacement ratio is likely to be much lower, as shown below.



For these categories of employees, higher pension contributions are needed. If government introduces means-testing for the BRP and CSG, then the replacement ratio will be even lower.

For employees not admitted into a pension scheme, the employer will be funding for the Workers' Rights Act gratuity in the PRGF. For them, the retirement pension equivalent shown above falls short of 50%. For higher income groups, the position is even worse.

Reliance on the State

One inevitable consequence of not admitting employees in a pension scheme is that these people will become completely reliant on the state pension elements in the future. It is a real policy issue and we believe that both the private sector and government cannot ignore this when planning for the future.

Conclusion

This paper gives a brief history of the evolution of our pension system and considered the factors currently at work that are bringing about a wholesale re-thinking of pension provision in general. We consider that there is a real risk that the pension outcomes from DC schemes will not provide a decent pension after retirement age for many people and this will put further pressures on the state pension pillars. The debate then must focus on whether the state elements (which are based on a Pay As You Go basis for both the BRP and the newly introduced CSG) will be able to sustain this pressure over the long-term.

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Noor Hotee is an actuary at Aon Solutions Ltd, an actuarial, employee benefits, investment, insurance broking and HR consulting firm in Mauritius and part of Aon worldwide. He has more than 23 years' experience advising trustees and sponsors of pension and provident funds, including 13 years spent with Towers Watson in the UK.

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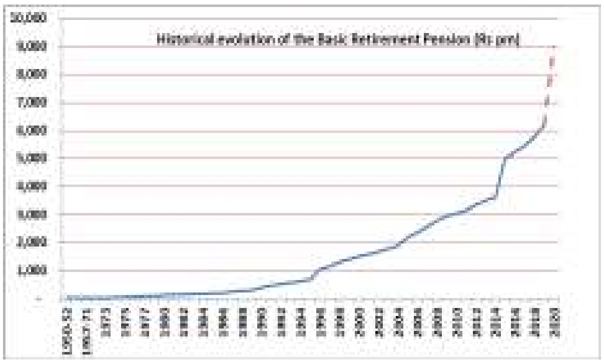
Summary of main Pension Pillars in Mauritius.

Pillar	Description	Purpose
One	**Basic Retirement Pension (BRP)**	To provide a safety net to those who have not saved for retirement and hence alleviate poverty in retirement. It is payable to those who reach age 60 and from the Consolidated Fund which means that it is not a funded scheme. However, in recent years, the BRP has increased by more than inflation as shown below and is now Rs9,000 a month for those between 60 and 90 years old. Recently, the government has committed for this to increase to Rs13,500 by the end of its current mandate in 2024. 
Two	• **National Pension Scheme (now replaced by CSG) for the private sector**	The NPF was providing a funded defined-benefit pension to private sector employees but based on the value of pension points purchased with contributions. It was replaced by the CSG in September 2020 to provide for the additional amount of Rs4,500 a month, compared to around 1/3 of national average earnings (cRs6,000 pm) for the NPF. Contributions are also now based on salary without any earnings ceiling.
	• **SIPF (Sugar Industry Pension Fund) for the sugar sector**	Provides a career-average revalued pension equivalent to around 40% of average earnings. Under the MSPA/SISEA Agreement, this is topped up to provide a pension of 2/3rd of final salary after 40 years of service (ie some 50% of national average earnings) for staff employees.
	• **Statutory Bodies Pension Fund for para-statal bodies**	Provides a DB pension of 2/3rd of salary at retirement after 33 1/3 years of service.
	• **Civil Service Pension Scheme for public sector employees recruited before 2013**	Provides a pension of 2/3rd of salary at retirement after 33 1/3 years of service.
	• **Civil Service Pension Scheme for public sector employees recruited after 2013**	Provides a DC pension with employer contributions of 12% and employee contributions of 6% for public sector employees recruited since 2013. Under a DC scheme, the pension at retirement depends on the level of contributions, the investment returns earned and the insure price of Rs1 of pension.

Three	• **National Savings Fund (NSF)** • **Portable Retirement Gratuity Fund (PRGF)**	The NSF was designed to complement the NPF in the provision of a lump sum at retirement and has a compulsory contribution of 3.5% of salary up to a ceiling for both the public and the private sector. Together with the NPF target of 1/3rd of national average earnings (NAE), the NSF was designed to bring the total retirement target pension equivalent to some 45% of NAE. The PRGF was introduced in order that the retirement gratuity payable to employee after employment under the Workers' Rights Act (WRA) to be preserved in a funded arrangement. Prior to the establishment of PRGF, employees who changed employment were only entitled to a retirement gratuity based on the service with the last employer only. The retirement gratuity payable under the WRA is 15/26 times the Remuneration for each year of service.
Four	• **Private Occupations Pension Plans (DB or DC schemes)** • **Personal Pension Plans (PPPs)**	A typical DB pension scheme provides a pension of 2/3rd of salary after 40 years of service. There are other scheme with a target pension of less than 2/3rd and some are based on a career-average salary rather than final salary. DC schemes vary widely both in terms of design and level of contributions. On average employers were contributing some 11% of salary on behalf of their employees. Many schemes are non-contributory by employees but some require employees to contribute. Some schemes have introduced an element of flexibility that allows them to vary their pension scheme contributions throughout their working lifetime. Personal Pension Plans are similar to DC schemes but they involves front end charges and the terms of conversion of the pension pot into a retirement pension are set by the PPP provider. Contribution levels vary widely depending on the affordability of the individual concerned. PPPs are mainly set up by the self-employed and by people in the informal sector.