CONSEIL D'ORIENTATION DES RETRAITES
Plenary Session of July 11, 2018 - at 9:30
« Commitments, reserves and debts of the pension system »

Brief

Prepared by the General Secretariat of the Council, under the direction of the President of the COR

Summary: A Pay-As-You-Go system is based on confidence in its sustainability. The commitment of a pension system to provide future pensions can be assessed by evaluating the cost of this sustainability. The dossier proposes to supplement this assessment of commitments with a review of the devices making it possible to adjust the pension system in the event of deviations from financial equilibrium in the future: reserves on one hand and debt capacity on the other.

I. Pension system liabilities

- **What is the purpose of measuring liabilities?** The liability of a pension system is the sum of the entitlements it will be required to pay out, measured according to various methodologies and depending on the horizon of the liability. Applied to a private pension scheme, this liability represents the provisions to be made to guarantee the long-term payment of pensions.

- **Can practical meaning be given to pension system commitments?** As the French pay-as-you-go pension system is guaranteed by the public authorities, the financial equilibrium constraint takes precedence over the provisioning constraint. Future funding needs can then be estimated by relating them to resources or benefits. The tax gap (respectively, the pension gap) measures the amount in points of GDP of additional contributions (respectively, the reduction of pensions) that should be carried out sustainably to cover these needs. For example, the COR calculated that, over a 25-year horizon and assuming an average labor productivity growth at 1.3% per year, the tax gap would be + 1% and the pension gap -3.2% (*document n° 2*).

- **How sensitive are these measures of liabilities to demographic shocks?** The coverage of future pensions relies on the demographic dependency ratio, and so the commitments assessment depends crucially on demographic dynamics. The COR illustrates this sensitivity by reconstructing a population that had not experienced any life expectancy gains since 2006, nor any baby boom between 1946 and 1973. Comparing this fictitious population with the one actually observed, it is estimated that the aging of the population would explain approximately half of the growth of pension expenditure in GDP by 2070, of which two-thirds would come from life expectancy gains alone. (*document n° 3*).

II. Pension Reserve Fund

- **Where does the Pension Reserve Fund (FRR) currently stand?** Created in 1999 to cope with the expected rise in pensions linked to the upcoming retirement of the baby boom generations, the FRR has assets of more than € 35 billion and since 2011 has been financed solely by the income from its investments. It is intended to support the amortization of the social debt of CADES until 2024 with no further objective assigned beyond this date *(document n° 4)*.

- **Can scenarios be developed for the use of FRR after 2024?** FRR could be used to alleviate the projected deficits on which it would have only a minor impact. Even assuming a full depletion of its assets, it only allows a reduction of projected deficits by a few percentage points over the projection period. In any case, a clarification of its future objectives would allow the FRR to optimize its assets investment policy *(document n° 5)*.

III. Schemes reserves

- **Why have some schemes built up reserves?** The existence of a mismatch between cash inflows and outflows in the very short term sometimes requires the use of debt, unless schemes have chosen to build up a working capital. In the medium term, the desire to protect against cyclical economic shocks may justify the constitution of precautionary reserves. In the longer term, the constitution of reserves makes it possible to adjust to demographic fluctuations and to better distribute the adjustment of the schemes' parameters over time and between generations *(document n° 6)*.

- **Reserves are mainly built up by the mandatory supplementary pension schemes managed on a pay-as-you-go basis.** At the end of 2016, they amounted to € 118 billion (5.3% of GDP). The main amounts are held by AGIRC-ARRCO (€ 70.8 billion, including € 10.2bnin working capital), the supplementary schemes of the CNAVPL (€ 21.8bn, divided between the ten professional sections), the supplementary scheme for the self-employed (€ 16.4bn) and the IRCANTEC (€ 7.5bn).

- **How are the reserves of these schemes managed?** The reserves of the French pension system are mainly concentrated in the supplementary schemes and their management is differentiated according to the objective, cash flow or medium-long term financing. Depending on the size of the schemes and their capacity to pool economic and demographic risks, the reserves built up in the medium and long-term range from a few months to several years of benefits. The examples of AGIRC-ARRCO and IRCANTEC show the diversity of management horizons, the level of reserves, their breakdown between working capital and financing reserves, and the resulting strategic choices of asset allocation. Investment strategies frequently focus on socially responsible investing *(documents n° 7 à 9).*

- **In addition, there are other supplementary schemes that are managed on a funded basis**, such as the Additional Civil Service Pension Scheme (RAFP) and the Pharmacists' Old Age Insurance Fund (CAVP). The assets built up by these schemes differ in their objectives from the reserves of the pay-as-you-go schemes: they are intended to fully cover the commitments provisioned towards the affiliates.

IV. Debt management of French pension schemes

- **Has the use of debt changed over time?** Historically, social security debt remained relatively contained and in the form of short-term debt mainly managed by the Agence centrale des organismes de sécurité sociale (ACOSS). The emergence of more massive general scheme deficits in the 1990s, and then from 2004 to 2015, forced the system to adapt, notably through the implementation of a tool dedicated to the reduction of the social debt (the Caisse d'amortissement de la dette sociale (CADES)).

- **What are the amounts involved?** ACOSS has a liability of € 17.3bn at the end of 2016, managing the debts of all the branches of Social Security mainly by issuing short-term money market securities. CADES amortizes part of the accumulated deficits of the general scheme by issuing long-term securities. Since 1996, CADES has taken over € 260bn of debt, of which around 54% were amortized at the end of 2016. Its liabilities to be amortized by 2024, whenCADES is expected to be wound up, are estimated at € 121bn. The debt assumed by ACOSS or CADES includes the financing needs of the family, health and retirement branches. The COR assessed the long-term debt of the pension branch to be around €52bn at the end of 2016 (*document n° 10*).