

Interpreting IFRS accounting standards on disability pension insurance: example from Finland

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Finnish Centre for Pensions
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About the speaker



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- Finnish Centre for Pension is a statutory developer, expert and joint service producer of earnings-related pensions in Finland



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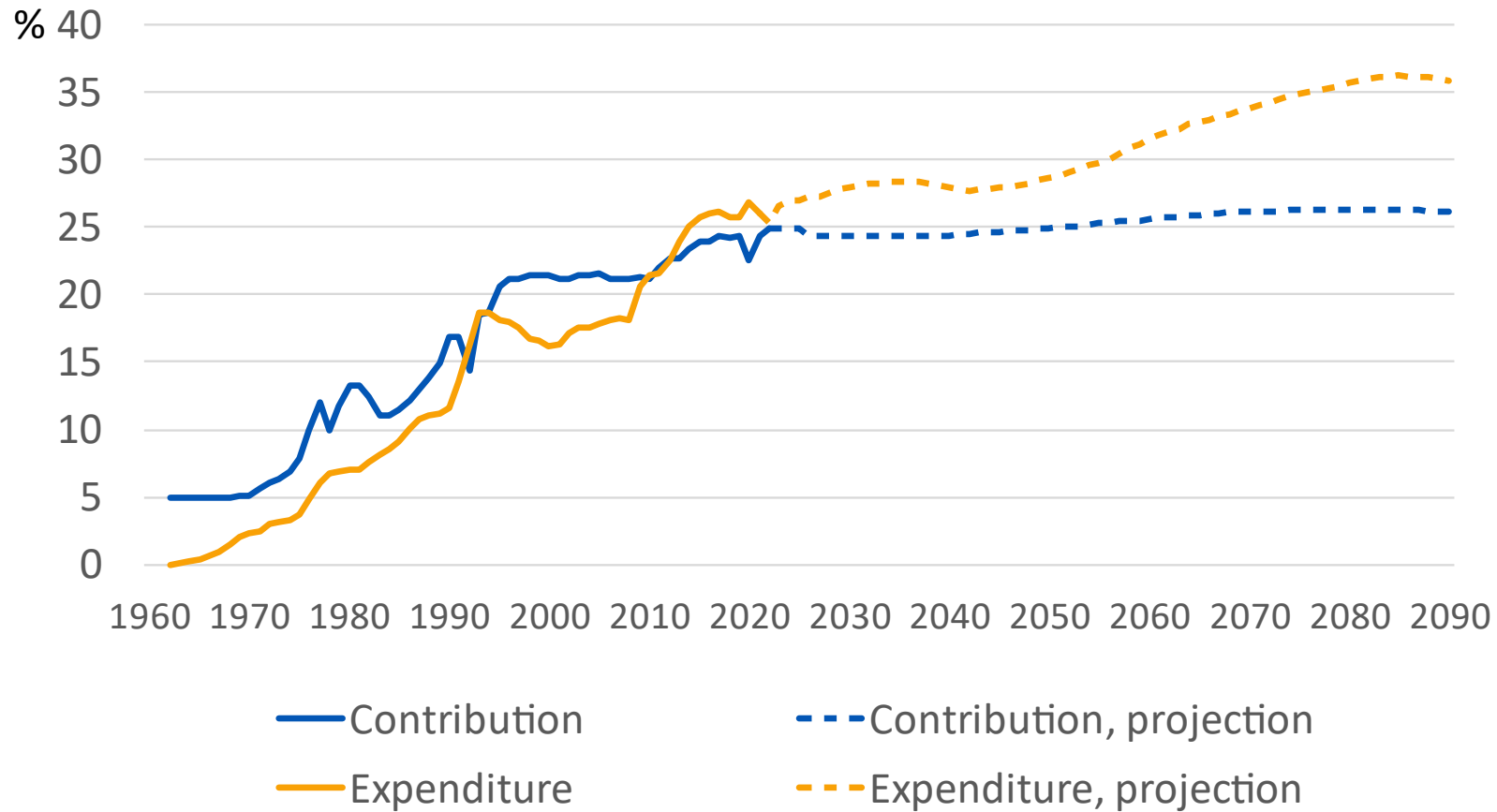


Finnish private sector employees and TyEL

- Finland's pension legislation consists of several pension acts
 - The largest acts are the Employees Pensions Act (TyEL), the Public Sector Pensions Act (JuEL) and the Self-employed Persons' Pensions Act (YEL)
- TyEL pension providers are private sector operators
 - pension insurance companies (4 working in 2023, 98%-share of insured wage sum)
 - company pension funds (7 in 2023) or industry-wide pension funds (4 in 2023)
- TyEL is implemented with a partial funding technique
- Benefits are old-age pensions, disability and rehabilitation benefits and survivors' benefits
 - For old-age pensions: Defined benefit with 1.5% accrual from total career



Pension expenditure and contribution rates in proportion to wage sum under the Employees Pensions Act (TyEL) in 1962–2090

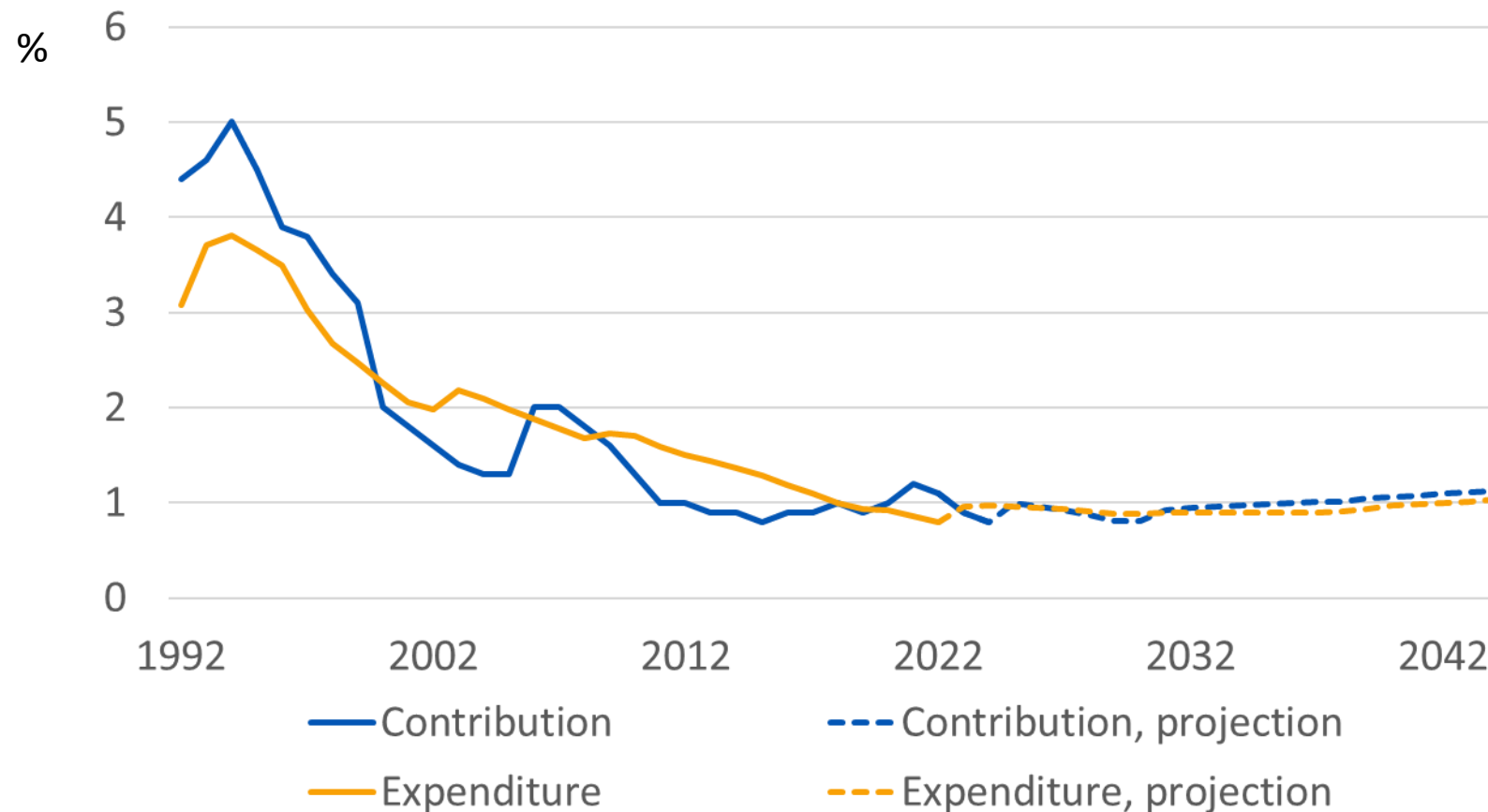


TyEL disability benefits

- Amount of disability benefit consists of two separate parts:
 - Accrued component is based on 1.5% accrual from past career
 - Projected component compensates the career loss due to disability and is calculated based on current earnings
- The liability of a pension provider is calculated at the time of disability
 - The amount is the capital value until old-age retirement
- The disability benefit can be temporary or part-time (50%)



Disability pension expenditure and disability tariff in proportion to wage sum under the Employees Pensions Act (TyEL) in 1992–2045



Experience rating – history (1/2)

- In many situations, the employer can reduce the impact of diseases and injuries on the worker's ability to work
 - Applies also in cases where the injury is not directly caused by working conditions
 - Employer can adapt work tasks or utilize vocational rehabilitation
- Experience rating dates back to the early days of TyEL
 - Pension companies mimicked employer incentives from company pension funds
 - The employer should have an incentive to prevent the disability of their workers
 - Larger employers participated in disability pension costs (coinsurance) until 2005



Experience rating – history (2/2)

- In 2006, implementing IFRS standards forced major changes to experience rating
 - The IAS 19 standard for employer benefits was interpreted so that the benefit depends on the length of service, and thus obligation arises during employment (currently article 157).
 - Additional liabilities for employers were approximated to be 15-20% of salary
- To avoid additional liabilities for employers, the defined benefit scheme was forced to transfer into a defined contribution scheme.
- Current contribution category model with 11 categories was introduced
 - Disability risk level of the employer determines the contribution category
 - The contribution category is calculated in advance based on history data
 - The link between benefit and contribution need to be cut; no more refund from rehabilitation



IAS 19 standard, article 157

- One form of other long-term employee benefit is long-term disability benefit. **If the level of benefit depends on the length of service, an obligation arises when the service is rendered.** Measurement of that obligation reflects the probability that payment will be required and the length of time for which payment is expected to be made. If the level of benefit is the same for any disabled employee regardless of years of service, the expected cost of those benefits is recognised when an event occurs that causes a long-term disability



Experience rating – Current model

Employer's size affects the experience-rated contribution

- Full experience-rated contribution for employers with an annual wage sum of over €36 million
- Partial experience-rated contribution if annual wage sum is over €2 million
 - Experience-rated component of the contribution increases linearly



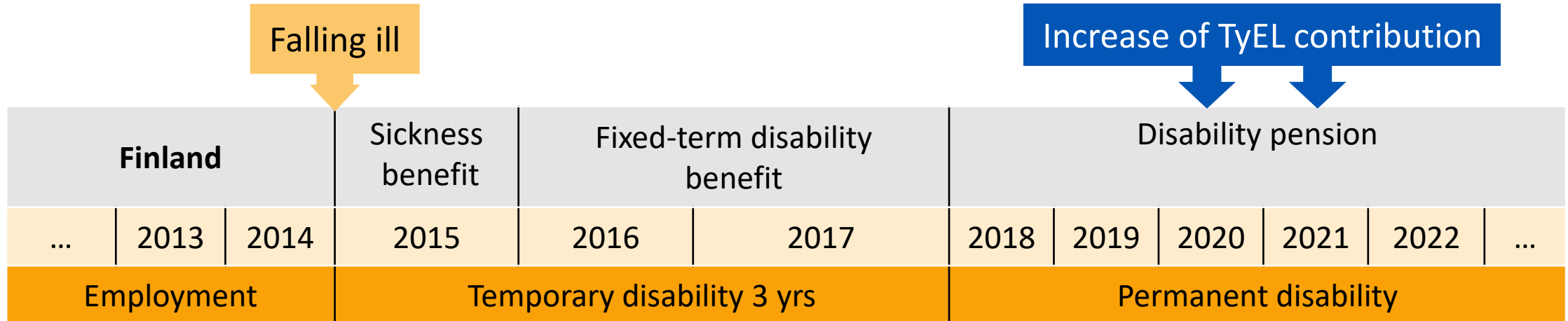
Until 2024, only permanent disability affected the experience-rated contribution

- Disability benefits are either temporary or permanent
- To encourage rehabilitation, temporary disability benefit does not yet affect the contribution category
- In case of permanent disability, the time interval between becoming disabled and affecting the employer's contribution can be several years

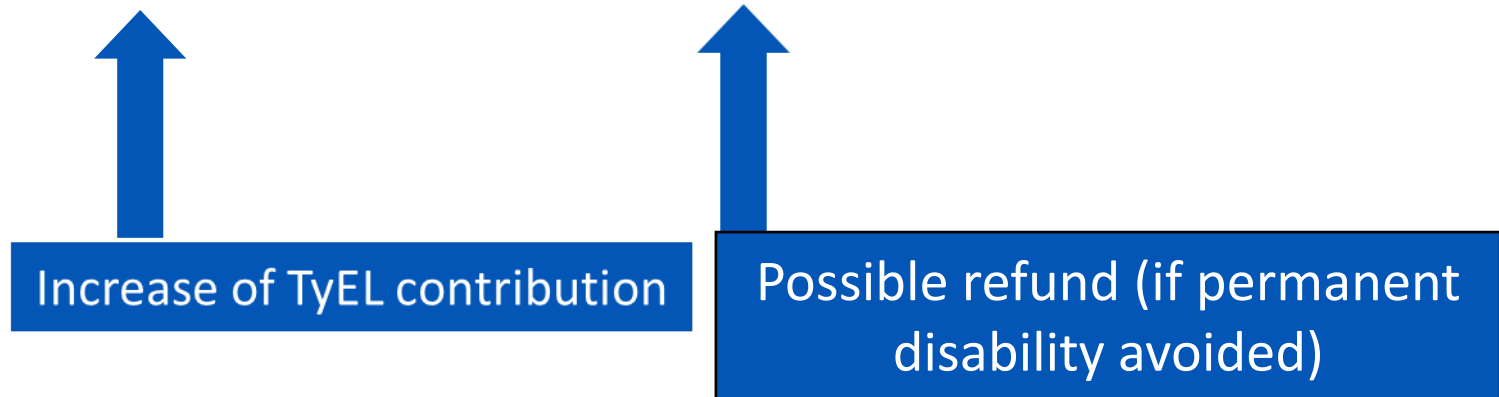


Timeline of effect of incentives (example)

Current model



Coinsurance model

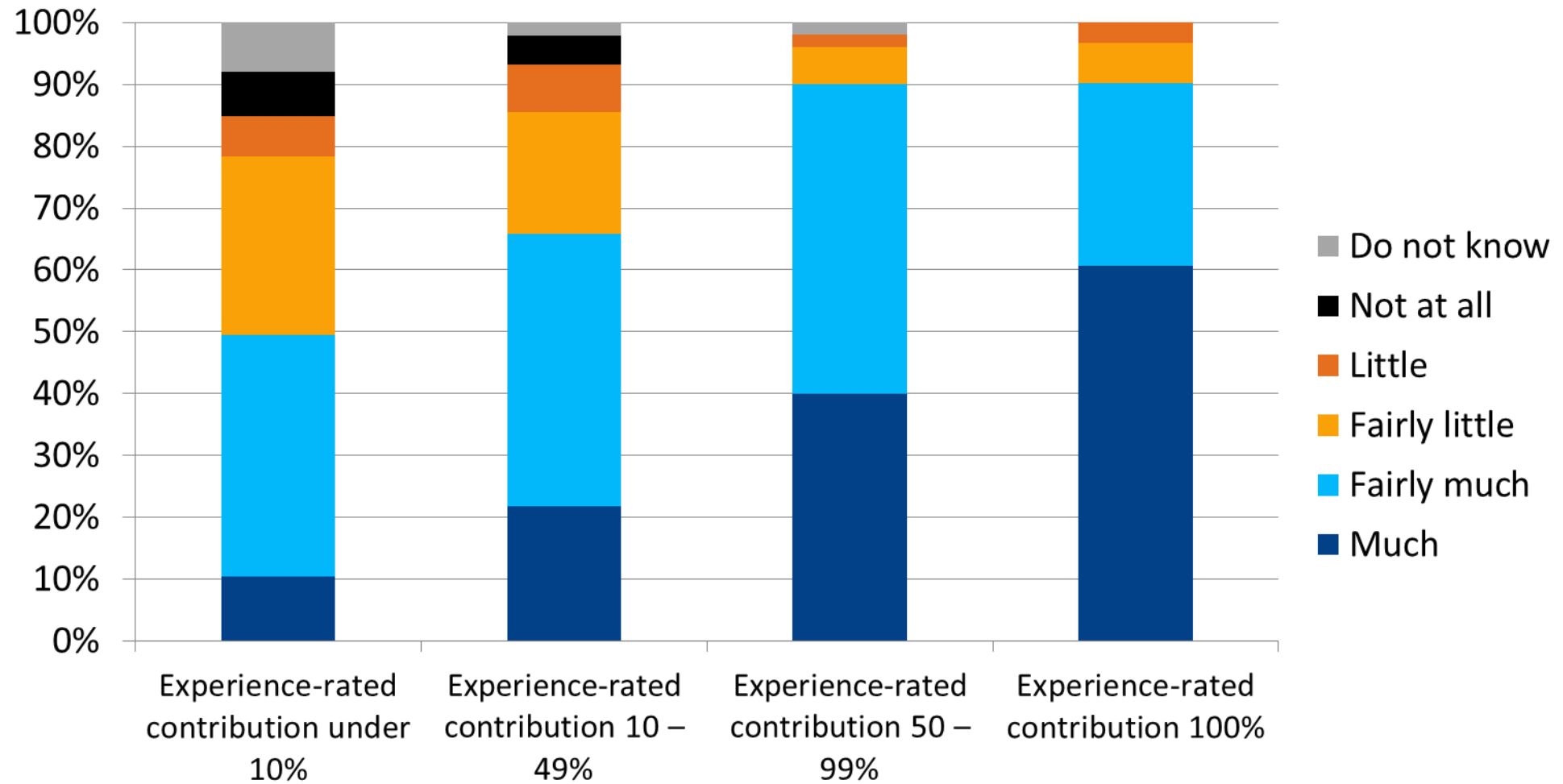


Incentive effects of the Finnish experience-rating model according to questionnaire

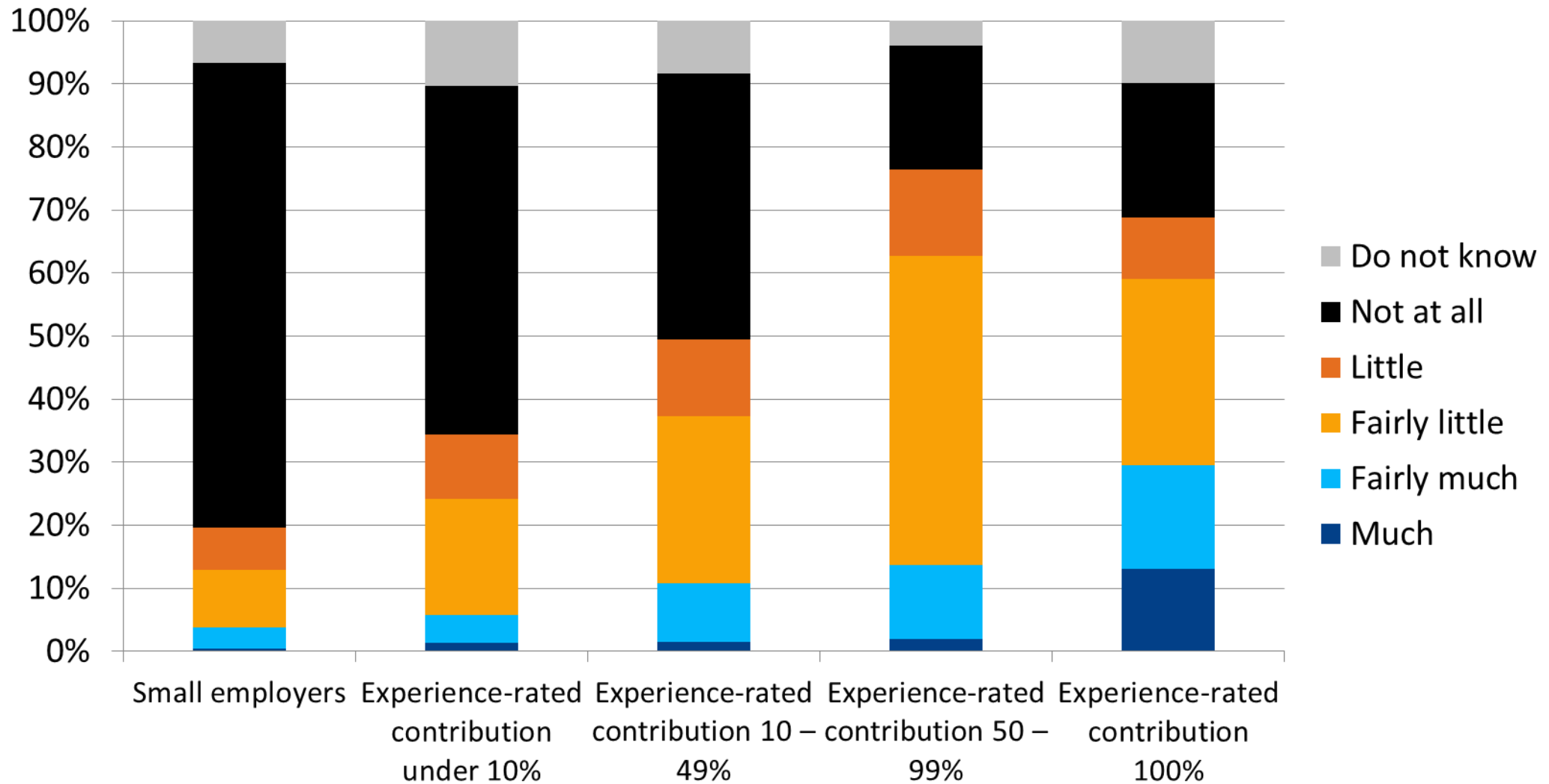
- Employer questionnaire conducted by the Finnish Centre for Pensions (Liukko & Polvinen & Kesälä & Varis 2017)
 - The larger the employer, the more often the experience-rating model spurs to taking care of workers' ability to work
 - Also unintended effects on recruiting risk groups
 - Experience-rating model perceived to be complicated and partly unfair



Does the experience-rating model spur your company to take care of your workers' ability to work?



Has the financing model of disability pensions (experience-rating model) affected how your company recruits?



Experience-rating for employers reduces disability inflow according to register studies



- Previous coinsurance model
 - Korkeamäki, Ossi and Kyyrä, Tomi (2012). Institutional Rules, Labour Demand and Retirement Through Disability Programme Participation. *Journal of Population Economics* 25 (2), 439-468.
- Current contribution class model
 - Kyyrä, Tomi; Tuomala, Juha. (2023) The effects of employers' disability and unemployment insurance costs on benefit inflows. *Labour Economics* 85: 102434.



A delicate balance between a defined contribution model and employer incentives

- Renewing the model based on feedback from employers was considered difficult
 - The 2005 reform was thoroughly discussed between auditing companies to achieve a joint interpretation
- No actual link between benefit expenditure and employer's contribution is allowed
 - A single incident of disability can affect the contribution category only once and no refund is allowed
 - Focus on risk level, not on single incidents of disability
- However, the pension providers can provide their clients with detailed calculations on the pension expenditure determining their risk category



2023 reform

- Exclude the following cases from calculating disability risk:
 - New employees hired at 55 years or older
 - Those employees whose work with the employer began as vocational rehabilitation through an apprenticeship program or work trial
 - Disability pensions with a gap of at least five years between becoming disabled and the contribution class calculation
- Include in calculating disability risk:
 - Temporary disability benefits when two years or longer and with no ongoing active rehabilitation
- Gradually reduce the employer's level of experience rating to 60% of the current level



References

- [Disability Pension Contributions - Finnish Centre for Pensions \(etk.fi\)](#)
- [The effects of employers' disability and unemployment insurance costs on benefit inflows](#). Kyyrä, Tomi; Tuomala, Juha. Labour Economics 85: 102434, 2023
- Employer incentives for reducing absence from work due to sickness and disability in Finland and the Netherlands. Liukko, Jyri; Kesälä, Meeri. Manuscript 2021
- [Effectiveness and incentive effects of experience rating in disability insurance: A questionnaire study on employers' views](#) (In Finnish, incl. Summary in English). Liukko, Jyri; Polvinen, Anu; Kesälä, Meeri; Varis, Jarno. Finnish Centre for Pensions, Studies 3/2017



Thank you

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