Confidence must be earned

Amundi ASSET MANAGEMENT

Thematic paper | CROSS ASSET Investment Strategy

September 2019

French pension reform (an update)

Research & Macro Strategy

French pension reform (an update)

VALERIE LETORT
Fixed Income Strategy

Finalised on 13/09/2019

The essential

In the previous paper "The French pension reform; a Trojan horse for a better control of the state budget", the many difficulties that the reform had to overcome were listed. At the present time of the publication of Jean-Paul Delevoye's report, these one haven't faded away. The constraint of seeking a new financial equilibrium has even been added, while transport strikes or demonstrations of other professions seem to be only beginning.

Introduction

At the time we were writing the Thematic Paper entitled "French Pension Reform: A Trojan Horse for Better Control of the State Budget?"[1], the financial sustainability of the French pension system looked certain. Since then, the government has set a new savings goal, with the aim of achieving financial equilibrium by 2025, and in doing so has prematurely ejected from its Trojan horse... This adds a whole new challenge to an already high-risk reform. For the most part, not only are the obstacles listed in our previous Thematic Paper still blocking the way, but also governance of the pension system has been called into question, in direct relation with the stakes and challenges to financial equilibrium in the public and private sector already discussed. First, we would reiterate that the primary goal of the Jean-Paul Delevoye Report was to converge the 42 current pension schemes into a single universal pension system, where one euro saved towards retirement has the same value for everyone, thus making it easier for workers to transfer from one sector to another.

The main purpose of this Thematic Paper is to take stock of the proposals made by the report, and to provide some current background information on the pension reform with its provisional timetable.

Main recommendations of the Jean-Paul Delevoye report for the universal pension system

The new single, universal distribution-based pension system would be mandatory for all workers.

A single contribution, but adjusted for independent workers

Payment rate

The payment rate would be 28.12% of the basic salary, including bonuses, with 60% paid by the employer and 40% by the employee. This rate is close to the current rate in the private-sector pension scheme, in the interest of preserving competitiveness.

"A payment rate of 28.12% of the basic salary, including bonuses, with 60% paid by the employer and 40% by the employee."

[1] *"French Pension Reform: A Trojan Horse for Better Control of the State Budget?", Valérie LETORT – August 2018 – Available from the Amundi Research Center*

Only independents would see the scale adjusted in order to maintain their financial equilibrium. They would only pay the employee share of the capped payment in excess of 1 "PASS"[2]. However, a minimum annual contribution (600x hourly "SMIC"[3]) would guarantee validation of a full career, thus ensuring eligibility for 100% of the minimum pension. This measure primarily targets independent workers, farmers and micro-entrepreneurs.

1 euro saved would have the same value for everyone whatever his professional activity

To that end, the idea is to simplify the calculation base for non-salaried workers and to bring it in line with the calculation base for salaried employees. That base could consist of reported income before social security charges and after a lump sum deduction. This would put an end to the overweighting of the CSG for the self-employed workers (which is calculated on social contributions, unlike employees), who would see in return an increase in their pension contributions.

Implementation period

The recommended implementation period for this contribution is 15 years, which is how long it is expected to take to converge contribution rates due to the elimination of supplementary schemes (e.g. AGIRC-ARRCO[4], IRCANTEC[5], etc.), to establish lower contribution rates (24.75% for civil servants), and to converge the employee/employer distribution rate to 60/40 in the public sector, as bonuses will be included in the calculation base. A similar gradual convergence in rates, scales and ceilings is also recommended for independent professionals (e.g. lawyers), taking as long as 20 years.

A number of special benefits (artists, maritime workers, journalists) would be maintained by taking over from the state budget the points not assessed, and would be revised by consultation.

Regulated healthcare professionals would continue to see part of their pension contribution covered by health insurance.

Pension calculation reference period

The reference period for pension calculations would cover the individual's entire career (instead of the 25 best years for private-sector employees or the last six months for civil servants).

Entitlements earned in the new universal pension system

Capped entitlements

A ceiling would be set on pension entitlements at €120,000 (3 "PASS") for 90% of the contribution (i.e. 25.31%). Past that limit, an un-capped contribution of 2.81% (i.e. 10% of 28.12%) would result in no additional pension entitlements.

...tallied in a point-based system, with points converted into € at retirement

Workers would earn pension entitlements in a point-based system, the valuation of which would follow the evolution of wages throughout their career (ie the evolution of the average income per capita), until the moment of retirement and when the points are converted into euros. Subsequently, the pension in euros would be indexed to inflation.

"Workers would earn pension entitlements in a point-based system."

When the system is implemented on 1 January 2025, one point will correspond to €10 in contributions, converted into €0.55. Accordingly, €100 in contributions would give rise to an annual pension of €5.50.

[2] PASS = "Plafond Annuel de Sécurité Sociale" *(Annual Social Security Cap), €40k per year in 2019*
[3] SMIC = "Salaire MInimum de Croissance" *(Minimum Wage); the hourly minimum wage in 2019 stands at €10.03 (gross) and €7.72 (net)*
[4] *"AGIRC-ARRCO" is the supplementary pension scheme for private-sector executives*
[5] *"IRCANTEC" is the supplementary pension scheme for civil servants*

Plus solidarity entitlements

The report **recommends an increase of 5% per child, allocated to one parent (as decided by both parents).**

It also recommends a surviving spouse annuity in the event of a spouse's death (for legally married couples), guaranteeing at least 70% of the sum of the couple's pensions. This entitlement would be available when the surviving spouse reaches 62 years of age.

Points would be earned during periods of paid unemployment, based on the amount of the allocation paid. This measure also applies to maternity leave and sick leave. Points would also be earned during disability periods, with the 10 best years taken as the calculation base. Points would be awarded when work is interrupted or for a transition to part-time work in the first three years following the birth of a child. Lastly, points would also be awarded for family caregivers (subject to discussion, with the idea being to compensate the caregiver for leave taken from work).

A minimum pension in excess of minimum welfare is recommended at 85% of the net minimum wage[6] (SMIC), if 600 hourly SMIC are validated per calendar year.

The legal minimum retirement age would be maintained at 62

Retirement age

Open retirement age, governed by a legal minimum age and a "pivot" age

Under the new system, workers will be able to choose their retirement age, subject to a legal minimum age (still 62) and a pivot age (64) giving entitlement to full point conversion. The conversion rate would be adjusted by 5% per year from the full pension age (5% less for each year before the legal minimum, 5% more for each year after).

The established pivot age is near the average retirement age observed in 2018 (63.4) and the average retirement age projected for 2025 (64), with the current discount cancellation age being 67 for private-sector employees in supplementary schemes.

Plan members would be free to liquidate a portion of their pension and continue working to earn entitlements (this measure is closely associated with the organisation of working hours and is currently subject to negotiation with the social partners). They can also work after retirement, generating pension entitlements if they liquidated their pension after the full-rate pension age.

The report recommends holding a consultation in order to better incorporate the transition from university to employment in the pension system, which currently penalises younger generations due to the length of time required to earn a university degree and the challenge of joining the workforce.

Scheduled extinguishment of special pension schemes

Early retirement under special pension schemes for civil servants would be progressively eliminated by gradually raising the retirement age from 57 to 62 for 1986 to 1982 generations. (Public-sector workers having validated 17 or 27 years, depending on the case, as at 31/12/2024 would not be affected).

Arduous work

However, **arduous work would be incorporated for all workers through the "C2P"** ("*compte professionnel de prévention*" or arduous work account), **allowing workers to retire up to 2 years early with their full pension**, to switch to part-time work or, for positions with the least exposure to arduous work, giving entitlement to professional training. The report recommends holding a consultation on risk factor exposure thresholds (e.g. night-shift work).

[6] *The net monthly minimum wage stands at €1171,34 in 2019*

Similarly, workers suffering a permanent disability (caused by an accident at work or an occupational illness) would be entitled to retire at 60 with their full pension.

Early retirement still an option in some cases

Early retirement would still be permitted:

- at 60 for individuals with a long career, who began working before the age of 20,
- or disabled workers between the ages of 55 and 59, depending on the disability and the period of time worked with a disability,
- at 52 or 57 **for certain hazardous public-sector professions** (policemen, prison wardens, firemen, military personnel, etc.). The new pension system calls for an additional employer contribution for these professions.
- For maritime workers, the report recommends basing the retirement age on time spent at sea.

A single universal pension system replacing the **42** current pension schemes

Transition to the new universal pension plan

Workers affected by the new plan

The new universal system is scheduled to begin on 1 January 2025. Generations born before 1963 are not affected by the new universal pension system, nor are workers less than five years away from retirement at 1 January 2025. However, this choice is likely to be subject to a consultation (the report mentions the possibility of choosing another generation or opening the plan to new job market entrants).

"The national universal pension scheme should be created as of 1 January 2020."

The Process

1. For Pension Schemes

The national universal pension scheme should be created as of 1 January 2020 and will be responsible for the convergence process over the next 10 to 15 years. Once established, the national scheme is set to absorb all existing teams under all existing schemes, with the goal of merging all current national structures by 1 January 2025 (CNAV[7], AGIRC-ARRCO, IRCANTEC, CNAVPL[8]). Then, by 2030 it is expected to form a unified network covering the entire country (by merging local desks, or delegating management where this is not possible[9]).

The universal pension scheme will also be tasked with setting up the new system, with the goal of conducting all formalities online, posting pension entitlements earned each year, plus simulations, and providing special assistance to workers without access to digital tools.

2. For Pension Plan Members

Under the proposed system, pension entitlements earned under previous schemes would be guaranteed. A snapshot of these entitlements would be taken at 31 December 2024, for conversion as follows:

- An equivalence scale, between points for point-based systems, would be applied,
- Annuity-based systems would be liquidated, with the period worked under previous schemes pro-rated relative to the required period, without incorporating surcharges or discounts.

[7] CNAV = "Caisse nationale d'assurance vieillesse", *i.e. the pension scheme for private-sector employees*

[8] CNAVPL = "Caisse nationale des professions libérales", *i.e. the pension scheme for independent professionals*

[9] *For example the MSA (Mutualité Sociale Agricole, i.e. farmers' pension scheme), which also covers the healthcare branch, or the special pension schemes for independent professionals*

A Social Partners Committee would be formed to examine appeals during the transition phase.

Entitlements would be earned in accordance with new system rules starting on 1 January 2025.

Governance of the future system

Governance would be entrusted to:

- a Board of Directors, comprising 13 employer representatives and 13 member representatives designated by the representative trade unions,
- a representative General Assembly made up of no more than 80 persons,
- and a 30-person Civic Pension Board.

A Board of Directors overseeing system parameters in conjunction with the government

The Board of Directors is responsible for overseeing the main parameters of the universal pension system, with the goal of balancing the system over the medium/long term: pension revaluation, determination of point value, change in the full-pension retirement age, contribution rate, use of financial reserves in the Universal Pension Reserve Fund. With the help of 40-year simulations performed every five years, the Board will have one golden rule to follow: the total balance must be either positive or zero for each 5-year period.

The Board's deliberations are to be transmitted to the government. Oversight of system parameters would be defined in the Draft Social Security Funding Act. The government would be able to submit changes to the legal retirement age, early retirement and solidarity mechanisms to Parliament. The Board of Directors will be able to issue an opinion on the government's choices, and make proposals for modifications, to which the government will duly respond. The government would be free to initiate draft reforms at any time.

Helped by an Independent Expert Committee

An independent committee of pension experts, drawn from the merger of the COR[10] and the CSR[11], will submit an assessment and outlook report, and may notify the Board of Directors of any identified problems.

Subject to a General Assembly

The General Assembly would issue an opinion once a year on the guidelines recommended by the Board of Directors.

And assisted by a Citizen Council

The Citizen Council (half of all members to be re-appointed each year) would issue an opinion containing proposals, and may also be solicited by the Board of Directors. The Board of Directors and the government will duly respond to the opinion issued by the Citizen Council.

Financial components

Integration and Creation of the Universal Pension Solidarity Fund

In addition to the financial integration necessary for the merger of pension schemes, the report calls for financial transparency. Solidarity expenses (for the purpose of attributing points for unemployment, illness, disability, minimum pensions, early retirements under common law, and family entitlements) **would be funded through the Universal Pension Solidarity Fund, funded in turn by tax revenues or transfers** (from other branches or organisations funding certain mechanisms).

[10] *COR =* "Conseil d'Orientation des Retraites" *or Pension Advisory Board*

[11] *CSR =* "Conseil de Suivi des Retraites" *or Pension Oversight Board*

The report recommends that a single organisation be responsible for collections, i.e. URSSAF[12], and that treasury duties be centralised by ACOSS[13].

Integration and Creation of the Universal Pension Reserve Fund

Lastly, a Universal Pension Reserve Fund would be created to ensure the sustainability and financial equilibrium of the new pension system despite any economic fluctuations. The fund would be built up from any surpluses recorded by the pension branch and, at the time of establishment from some or all current supplementary pension scheme reserves. As stated in the report, "It would not be ideal for the system to achieve financial equilibrium each year strictly by making excessively harsh adjustments…Oversight of the system should instead be approached from a multi-year perspective," thus providing visibility to pension plan members. However, any reserves not needed to cover transferred pension obligations could be used at the discretion of the pension schemes holding them to benefit their members.

> "A Universal Pension Reserve Fund would be created to ensure the sustainability and financial equilibrium of the new pension system despite any economic fluctuations."

Key concerns: financial equilibrium and financial equity

More work needs to be done on the new pension system to recommend pathways to convergence towards equilibrium by 2025 because, as it stands, the pension system is expected to post a negative balance ranging from -0.3% to -0.6% of GDP by 2025.

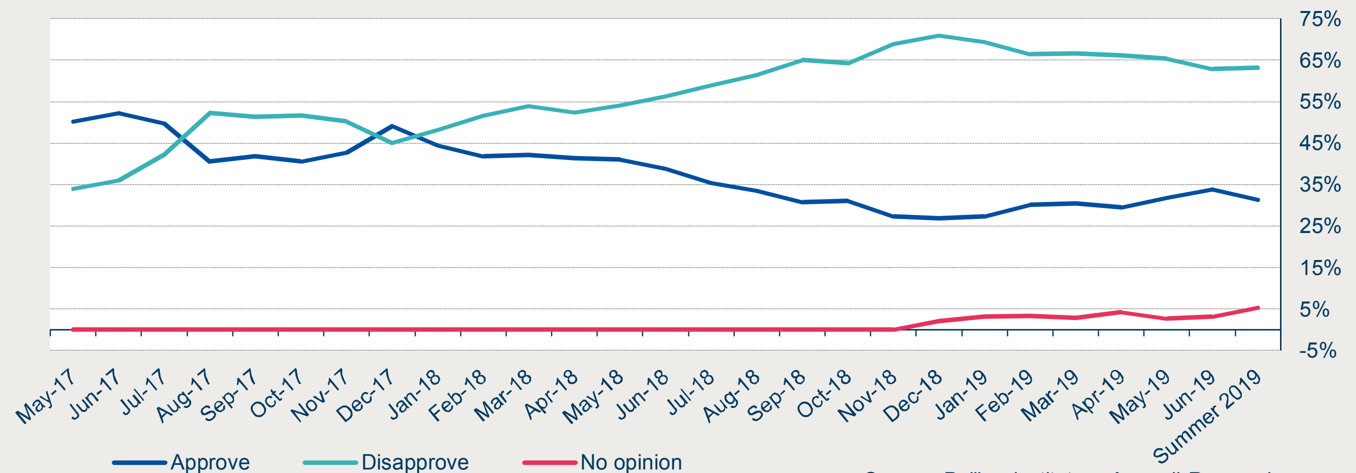
The report states that the universal pension system will be better-suited to shorter careers and careers interspersed with periods of unemployment, more favourable to women at retirement, and will significantly improve the pensions of 40% of workers with the weakest pensions.

Responses to the Jean-Paul Delevoye report for the Universal Pension System

Opinions of social partners and the French in general

Some trade unions have rejected the reform outright (CGT, FO, UNSA). Others (Cfdt, CFTC, CFE-CGC) are opposed to setting the pivot age at 64, and/or the fact that the system is supposed to reach equilibrium when the reform is implemented, which had initially been ruled out by the government. In his televised address, the President of the Republic appeared open to the idea of dialogue when he suggested using a contribution period as a benchmark rather than a pivot age.

1/ **Executive's popularity rating**



Source: Polling institutes, Amundi Research

[12] *URSAFF = "Union de Recouvrement des Cotisations de Sécurité Sociale et d'Allocation Familiales", which is the French agency responsible for collecting social security contributions and family allocations*

[13] *ACOSS = "Agence Centrale des Organismes de Sécurité Sociale", the Central Agency of Social Security Organisations*

Employer organisations have tended to come out in favour of the reform, although MEDEF is not willing to renegotiate arduous work conditions, and is worried about what will happen to actively employed workers earning more than €120k per year.

The French people are very divided over the reform (according to IFOP, 41% think a reform is not necessary).

All of which means the executive's approval rating will be the deciding factor on whether or not the reform is passed. The executive has been doing better in the polls, after hitting a low point in late 2018, but even so his approval rating was just above 30% in summer time[14].

Sticking points raised by various professions

Some independent professions want to maintain separate supplementary pension schemes (pharmacists, notary publics, chartered accountants, statutory auditors, veterinarians, dental surgeons, midwives, flight crews, civil aviation personnel).

Hospital workers are demanding improvements to the incorporation of arduous work conditions in light of the uniformisation of retirement ages.

Teachers want to receive better pay, particularly with respect to other civil service jobs, where bonuses will be better incorporated in pensions under the new system.

Lastly, RATP conductors held a massive strike on Friday 13 September in a bid to protect early retirement. Lawyers followed suit, and the SCNF is expected to do the same on 24 September.

Timetable

The Jean-Paul Delevoye report was submitted to the government on 18 July.

The second phase of consultation with the trade union organizations was launched on Thursday 5 and Friday 6 September, and should run through the end of the year. This consultation will address the implementation of solidarity mechanisms, the transition of the 42 pension schemes, and pension eligibility conditions, in addition to the new goal of achieving financial equilibrium by 2025. To that end, the government has called on the COR to present new 10-year projections by November.

Furthermore, employers are being consulted on employment of seniors.

The French people will be asked to take part in a survey on these issues via a digital platform.

The government will then prepare a bill. On 30 August, French Budget Minister Gérard Darmanin stated that a bill will be presented to the Council of Ministers after the municipal elections are held in March 2020.

The bill will then be debated in Parliament.

For his part, the French Prime Minister announced to the Economic and Social Council on 12 September that Parliament is expected to vote on the bill before the end of its summer session in 2020. The bill will mark the need for a transition to be made before the reform is implemented. This transition, to be negotiated after the bill is passed, will be tailored to each profession and will take place gradually, particularly as it pertains to contribution rates and the increase in retirement ages. He also promised that the salaries paid to teachers, scientists and caregivers would be re-examined. In other words, passing the bill is just the first step in a long and complex transition process.

[14] *Average taken from Prime Minister and President approval rating polls*

Last publications

THEMATIC PAPERS

French pension reform (an update)
Valérie LETORT — Fixed Income Strategy (2019-09)

France: the reform momentum stays alive after the Yellow Vest crisis
Tristan PERRIER — Economist, Macroeconomic Research (2019-07)

Turkey: inflation, exchange rate's pass-through and monetary policy
Karine HERVÉ — Senior Economist, Macroeconomic Research (2019-06)

Is Turkey really out of the woods?
Karine HERVÉ — Senior Economist, Macroeconomic Research (2019-01)

Global Macro: Outlook to 2020
Macroeconomic Research — Amundi (2018-12)

Morocco: moderate economic risks
Karine HERVÉ — Senior Economist, Macroeconomic Research (2018-11)

Central European countries: Outlook to 2020
Karine HERVÉ — Senior Economist, Macroeconomic Research (2018-11)

**Corporate earnings in 2019:
A fading momentum is in store!**
Ibra WANE — Equity Strategy (2018-10)

French pension reform: a Trojan horse for a better control of the State budget?
Valérie LETORT — Macroeconomic Research (2018-09)

Pacte Law: what changes lie ahead for savings in France?
Marie BRIERE — Head of the Investor Research Centre,
Xavier Collot — Director of Employee Savings & Retirement (2018-06)

France: significant promises kept, but the most crucial reforms will take time
Tristan PERRIER — Macroeconomic Research (2018-05)

Profit trend and cycle analysis: a long-medium-short term sanity check
Federico CESARINI, Lorenzo PORTELLI — Multi-Asset Strategy (2018-05)

Cross road the landscape of the fixed-income market
Valentine AINOUZ, Sergio BERTONCINI — Credit Strategy
Silvia DI SILVIO — Fixed Income and FX Strategy (2018-05)

CROSS ASSET
INVESTMENT STRATEGY

September 2019 | Thematic paper

DISCLAIMER

Document issued by Amundi Asset Management, "société par actions simplifiée"- SAS with a capital of €1,086,262,605 - Portfolio manager regulated by the AMF under number GP04000036 – Head office: 90 boulevard Pasteur – 75015 Paris – France – 437 574 452 RCS Paris – www.amundi.com

Photos credit: iStock by Getty Images - Images Source: ajt

Editor

ITHURBIDE Philippe, Global Head of Research

Conception & production

BERGER Pia, Research and Macro Strategy
PONCET Benoit, Research and Macro Strategy

Find out more about
Amundi research team
research-center.amundi.com

Amundi
ASSET MANAGEMENT