Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

December 2009

Europe

United Kingdom/United States Bilateral Agreement

On November 4, the Pension Benefit Guaranty Corporation (PBGC) in the United States signed a memorandum of understanding (MOU) with the Pension Protection Fund (PPF) and The Pensions Regulator of the United Kingdom to encourage and enable best practices in protecting retirement benefits. Under the MOU, agencies will share nonconfidential information that seeks to improve the financial security of defined benefit (DB) plans sponsored by private-sector companies in their respective countries.

The agreement reflects the mutual interests of these agencies and the global reach of corporate entities that sponsor pension plans in their respective jurisdictions. As rising bankruptcies and stock market losses in both countries have left an increasing number of employers in financial difficulty, the MOU signatories indicated the need for regulating agencies to keep pace with how employers and pension providers manage their retirement obligations to help safeguard pension promises.

In the United States, the PBGC protects the pension benefits of workers and retirees covered by qualified private-sector DB pension plans in the event a plan sponsor files for bankruptcy or when a pension plan is terminated. The PBGC receives its funding from insurance premiums (paid by companies whose pension plans are insured), investments, assets of pension plans taken over by the PBGC as trustee, and from the recovery of assets of companies formerly responsible for terminated plans. In the United Kingdom, the PPF, modeled on the PBGC, pays compensation to members of eligible DB plans when a plan sponsor becomes insolvent or is unable to pay benefits. The Pensions Regulator supervises private-sector DB plans in order to reduce the risk of claims for compensation from the PPF.

The MOU is available online at http://www.thepensionsregulator.gov.uk/pdf/MoUTPR-PPF-PBGC.pdf.

Sources: "PBGC Expands Cooperation with UK's Pensions Regulator and Pension Protection Fund," States News Service, November 3, 2009; "US and UK Pension Regulators in New Pact," *Financial Times*, November 4, 2009; "UK and US Industry Bodies Link Up," *Professional Pensions*, November 5, 2009; "PBGC and UK Agencies Sign Memorandum of Understanding to Share Information," CCH Pension, November 24, 2009; "PBGC Expands Cooperation with United Kingdom's Pension Regulator, Pension Protection Fund," *US Fed News*, November 29, 2009.

The Americas

Canada

On October 27, the Minister of Finance announced a reform plan to strengthen the regulatory framework for federally regulated private pension plans. The plan is the culmination of months of consultations following the release of a Department of Finance discussion paper in January. According to the government, the proposed reforms—which will be introduced through changes in regulation and through new legislation—will increase the security of benefits for workers and retirees while allowing pension plan sponsors to better meet their funding requirements.

The reform plan has five principal objectives:

1. *Enhance protections for plan members*. Proposed measures require plan sponsors to fully fund pension benefits upon plan termination and prohibit contribution holidays for pension plans with solvency ratios—the ratio of total assets to total liabilities—less than 105 percent.
2. *Reduce funding volatility for defined benefit (DB) plans*. A new standard for establishing minimum funding requirements will be introduced that uses average solvency ratios over a period of 3 years, rather than only the current year.
3. *Resolve plan-specific problems*. A new "workout scheme" will be established to assist distressed pension plans that are unable to meet their funding requirements. The scheme will allow plan

sponsors, members, and pensioners to negotiate changes to their pension arrangements that do not conform to existing rules.

4. *Improve the framework for defined contribution (DC) plans and negotiated contribution defined benefit (NCDB) plans*. New rules will clarify the responsibilities of the parties involved in DC plans and in NCDB plans. (NCDB plans combine aspects of DB and DC pension plan arrangements and are common in multiemployer pension plan arrangements.)

5. *Modernize pension fund investment rules.* New rules will relax certain restrictions on pension fund investments.

In Canada, private pension plans supplement the public retirement system made up of a noncontributory universal old-age pension and the earnings-related Canada Pension Plan. (The province of Quebec opted out of that plan, but has a similar earnings-related plan called the Quebec Pension Plan). Private pension plans are voluntary, but must be registered with either federal or provincial authorities. Approximately 7 percent of all private pension plans in Canada are federally regulated.

Sources: *Social Security Programs Throughout the World: The Americas, 2007; Complementary and Private Pensions throughout the World, 2008*; Department of Finance Canada press release, October 27, 2009; "Communiqué: Modernization of Federal Pension Rules," Mercer, October 30, 2009.

Asia and the Pacific

Australia

On November 6, the Australian government announced that a superannuation clearing house for businesses with fewer than 20 employees will begin operation in July 2010. Employers who choose to participate will be able to submit their superannuation contributions for all employees to one source to process the transactions and distribute the contributions to the appropriate superannuation funds. Currently, many small employers use checks and a manual process for their contributions, which involves sending them to a separate fund chosen by each employee. According to the government, the goal of the clearing house is to save employers time and money and improve the processing time and quality of the data.

Medicare Australia, one of the government's key service delivery agencies, will run the clearing house free of charge for employers and will initially be financed by A$16.1 million (US$14.75 million) from the government budget for a 3-year period. Employers will be able to sign up online beginning in May 2010. Larger businesses that are excluded from participation can continue to utilize a number of privately run superannuation clearing houses, which charge fees for processing contributions.

In the early 1990s, Australia introduced the employer-based retirement savings program known as Superannuation Guarantee. This program consists of mandatory personal accounts that are funded primarily through employer contributions equaling 9 percent of employees' wages. Employee contributions are voluntary. Employees may choose between a private pension plan (either occupational or personal) and a retirement savings account. Private institutions approved by the government, such as savings and loans, banks, credit unions, and life insurance companies, may offer retirement savings accounts. If an employee does not choose either option, the employer must pay the contribution into a default fund chosen by the employer.

Sources: "Introduction to Super," Australian Tax Office, October 15, 2009; Minister for Finance Services, Superannuation and Corporate Law and Minister for Human Service, Media Release, November 6, 2009; "First steps Taken for Super Clearing House: Medicare to Deliver Facility," *Investor Daily*, November 12, 2009; "Superannuation Clearing House Service," Taxation Institute of Australia, November 24, 2009.

Azerbaijan

On October 27, Azerbaijan's parliament passed legislation that amends the country's social insurance program by gradually increasing the retirement age for a full earnings-related pension. Starting January 2010, the retirement age will increase by 6 months every year until reaching 63 for men and 60 for women. Currently, men retire with a full pension at age 62 and women at age 57. According to the State Social Protection Fund—the government agency responsible for the social insurance program—increasing the retirement age is a necessary step in reducing the financial burden of a rapidly aging population. The United Nations projects an increase in the percentage of the population aged 60 or older from 8.9 percent in 2005 to 25.2 percent in 2050.

In addition, the government announced that there will be no statutory indexation of pension benefits in 2010 because of the anticipated negative rate of inflation for 2009. Benefits are adjusted annually to changes in the consumer price index for the previous year.

The pension system in Azerbaijan consists of two components: (1) a notional defined contribution (NDC) social insurance program and (2) a noncontributory social assistance program. The NDC program, which was implemented in 2006, is financed by an employee contribution of 3 percent of gross earnings and an employer contribution of 22 percent of payroll. The social assistance program is funded by general revenues and provides benefits to nonworking men aged 67 or older and women aged 62 or older who are not eligible for the earnings-related pension.

Sources: *Social Security Programs Throughout the World: Asia and the Pacific, 2008*; *World Population Prospects: The 2008 Revision*, United Nations, 2008; "Azerbaijan Parliament Ratifies Amendments to Increase Retirement Age," Trend News Agency, October 27, 2009; "International Headlines," Mercer, November 4, 2009; "Azerbaijan Adopts Unpopular Amendments to Pension Legislation," abc.az, November 9, 2009.

New Zealand

On October 29, New Zealand Treasury released a report on the long-term fiscal prospects of the country, projecting national revenues and expenditures 40 years into the future. *Challenges and Choices: New Zealand's Long-term Fiscal Statement, October 2009* devotes significant attention to the need for future adjustments to New Zealand Superannuation (NZS), the universal program which provides the principal source of retirement income to the majority of New Zealand citizens. Since 2006, when the first report in the series was published, the national budget has gone from a projected 25-year surplus to a deficit. Half of this deficit is attributed to the slowdown in economic growth caused by the worldwide economic recession; the remainder is attributed to increased costs in existing public programs, including the NZS program.

NZS is paid to all residents aged 65 or older, and it is indexed annually according to changes in average weekly earnings. Currently, the NZS benefit amounts to about 66 percent of average weekly earnings for a couple. NZS is noncontributory and is financed by general revenues. There is no income or asset test to receive the benefit and no requirement to retire from paid employment. Eligibility to receive a NZS benefit is unrelated to any previous earnings history.

The Treasury report states that changes in NZS will be needed to cope with the demographic aging of the population, which is expected to drive NZS expenditures from the current 4.3 percent of gross domestic product to 8 percent in 2050. The report points out that 25 percent of government spending currently goes to the population aged 65 or older who represent only 12 percent of the population. Further projected increases would, according to the report, raise questions about intergenerational fairness and the "crowding out" of other public expenditures on health and education.

The report recommends taking steps earlier rather than later to adjust the NZS to the projected aging of the population. Three possible options include—

1. raising (gradually) the eligibility age to 69 by 2040;
2. changing the indexation of NZS benefits to inflation-only rather than the current wage-indexing; and
3. introducing income or asset testing in the eligibility conditions.

Future adjustments to the NZS will also necessarily take into account the role that KiwiSaver will play in increasing retirement incomes for participants. KiwiSaver, a type of subsidized retirement savings plan, was introduced in July 2007. Currently about 50 percent of New Zealand workers have KiwiSaver accounts.

The full report can be found at http://www.treasury.govt.nz/government/longterm/fiscalposition/2009.

Source: "Challenges and Choices: New Zealand's Long-term Fiscal Statement, October 2009," New Zealand Treasury.

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