Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

February 2011

Europe

Hungary

On December 13, 2010, the Hungarian parliament passed a law that automatically moves workers out of the second pillar of privately managed individual accounts and transfers their account balances to the first-pillar public pension program. Workers could have chosen to remain in the second pillar by declaring so in person at a pension administration office by January 31, 2010; however, workers who opted for individual accounts are no longer eligible to receive a public pension at retirement, even though they are required to continue to contribute to the first pillar. (Of the 3 million workers with individual accounts, only around 100,000 chose to remain in the second pillar.) As a result of this law, analysts estimate that the number of pension fund management companies could decrease from 18 (currently) to between 4 and 8. According to the government, transferring most of the 3 trillion forint (US$14.6 billion) of second-pillar assets under management will help reduce Hungary's state budget deficit from 3.8 percent of gross domestic product in 2010 to less than 3 percent in 2011.

The new law is the latest in a series of laws adopted in recent months that have significantly affected the second-pillar system. An October 2010 law temporarily suspended employee contributions to individual accounts for a period of 14 months (through 2011) and reallocated them to the first-pillar, pay-as-you-go (PAYG) program. A separate law (also passed in October) made the second pillar voluntary for new entrants to the labor force and allowed existing participants to opt out of the second pillar and transfer their account balances to the first pillar. Despite these measures, the majority of account holders chose to remain in the second pillar after the October laws were enacted.

In 1998, Hungary introduced a two-pillar pension system consisting of an earnings-related public pension and privately managed individual accounts. Until November 2010, participation in the second pillar was mandatory for new entrants to the labor force and voluntary for older workers who were part of the old PAYG system. Workers contribute a total of 9.5 percent of earnings, of which 8 percent was previously directed to individual accounts. (It is unclear when second-pillar contributions will resume for those who chose to remain in the system.) Employers contribute 24 percent of employee earnings to the PAYG program only.

Sources: "Hungary," *International Update*, November 2010, US Social Security Administration; "Defying Markets, Hungary Readies Pension Rollback," *Reuters*, December 13, 2010; "Hungary: Death by 1000 Cuts," *IPE.com*, January 4, 2011; "Hungary Met 2010 Budget Deficit Goal, Needs Debt Cap, Premier Orban Says," *Bloomberg*, January 6, 2011; "Pension Funds Keep Only 102,019 Members," realdeal.hu, February 2, 2011; "Vast Majority of Hungary's Second-Pillar Members Return to State System," *IPE.com*, February 3, 2011.

Norway

On January 25, the Financial Crisis Commission released a report analyzing the causes of the financial crisis as it affected Norway and proposing recommendations for how to better position the country against future economic shocks. The commission, appointed in June 2009, is made up of representatives from a variety of sectors—including the social partners, the financial sector, consumer groups, the government, and academic institutions. The report evaluates defined contribution (DC) plans, which cover nearly 1 million Norwegian workers, or close to half of the total labor force, finding that changes should be made to reduce workers' vulnerability in the event of future crises. In addition, it makes a series of broad recommendations—including the use of stricter capital requirements for financial institutions, more effective monitoring of risk, and the imposition of new fees and taxes to supplement financial market regulations.

According to the report, certain aspects of occupational pension plans that should be studied further are workers' and retirees' exposure to market risk as interest rates and investment returns fluctuate in response to worldwide market forces; the "level and predictability" of employer pension costs; and, the plan sponsors' financial health. To address these issues, the report proposes introducing alternative products that combine properties of both defined contribution plans and defined benefit (DB) plans.

Even though workers in DC plans may choose among different risk profiles, most of those workers do not make a choice and are placed in the default fund. For this reason, the report focuses on the default risk recommending better guarantees for workers to ensure that exposure to market risk is minimized, particularly as workers approach retirement age. Investigations by the commission concluded that participants in DC pension plans were overwhelmed by the growing complexity of financial products, leading in many cases to decisions that were not in line with their long-term retirement income needs. The report therefore recommends that information provided to consumers by financial institutions be better tailored to meet the needs of the plan participant, and that the terminology and format of the information should be standardized and rendered more comparable across different financial institutions.

Since 2006, employers are mandated to provide their employees with either a DB or a DC pension benefit, financed by a minimum employer contribution of 2 percent of earnings. Workers may make voluntary contributions. These employer-provided private pensions supplement the country's public pension system, which consists of a flat-rate basic pension and an earnings-related benefit.

The English summary of the report is available at http://www.regjeringen.no/nb/dep/fin/dok/nouer/2011/nou-2011-1/26.html?id=631406.

Sources: "Pensions at a Glance 2009: Retirement-Income Systems in OECD Countries," OECD, June 2009; "Bedre Rustet mot Finanskriser (English summary)," Ministry of Finance, January 2011; "Norwegian Government Must Reform DC System, Report Urges," IPE.com, January 25, 2011; Ministry of Finance press release, January 25, 2011.

United Kingdom

On January 12, the government introduced into Parliament the Pensions Bill 2011, building on pension reform legislation enacted in 2007 and 2008. Measures in the bill encourage people to work longer as the population ages and to increase retirement savings in employer-sponsored pension plans. Separately, the government announced that beginning April 6, 2011, the default retirement age (DRA) of 65 will be phased out to provide workers greater opportunities to remain in the labor market after age 65.

The Pensions Bill 2011 would implement measures contained in recent government reviews that address the rising cost of pensions that is due to increasing longevity in the UK. By 2031, almost a quarter of the population is projected to be over age 65—a 5 percent increase over what that population is today. Among the major provisions in the bill are those that would impact the following:

- *State pension age (SPA)*—accelerating the equalization of the SPA at age 65 for men and women by November 2018 (rather than by April 2020, as presently scheduled) and then increasing the SPA to 66 for men and women by April 2020. (The SPA is currently age 65 for men and age 60 for women.)
- *Automatic enrollment of private-sector employees into qualified employer-sponsored retirement plans*—raising the minimum annual earnings level at which employees must be enrolled in a workplace pension plan from the scheduled 5,000 pounds (US$8,057) to 7,500 pounds (US$12,086), introducing an optional waiting period of up to 3 months before employees must be enrolled and allowing greater flexibility for employers regarding reenrollment dates.
- *Revaluation and indexation of private-sector occupational pensions*—providing greater details about changing the measure of inflation from the retail price index (RPI) to the consumer price index (CPI); the CPI uses a more modern methodology, which is consistent across European Union member countries and should increase (on average) at a slower rate than the RPI.

Current DRA rules enable employers to force an employee to retire at age 65 or older, provided they follow a specific retirement procedure. In announcing removal of the DRA, the government noted that about two-thirds of employers already operate without fixed retirement ages, and many of them offer employees an option to work beyond age 65. According to the new policy, starting April 6, 2011, employers may not compel employees to retire using the DRA procedure; between April 6 and October 1, only employees who were notified before April 6 and whose retirement date occurs earlier than October 1 can be forced to retire under the DRA; forced retirements using the DRA will cease completely after October 1. Implementation of the new policy does not require further legislation and is scheduled for review in 5 years based on existing regulations.

Sources: “Pensions Bill Introduces Cost-Saving Measures,” *Pensions Digest*, January 2011; *Pensions Bill 2011: Summary of Impacts*, Department for Work and Pensions, January 12, 2011; “End of the Line for the Default Retirement Age,” Department for Business, Innovation and Skills, January 13, 2011; “Government Legislates on Auto-Enrolment Changes,” *Professional Pensions*, January 13, 2011; “Default Retirement Age to be Phased Out between April and October 2011, UK Government Confirms,” *Select News*, January 14, 2011.

Reports and Studies

World Bank Report

A newly released World Bank report, *Population Aging: Is Latin America Ready?*, examines Latin America’s rapidly aging population and the fiscal and policy challenges that these demographic changes will pose to governments throughout the region. The report covers a variety of topics including old-age poverty, pensions, health care policy, and living arrangements for the aged. According to the report, since 1950, the overall population in the region has tripled, and fertility and child mortality have decreased by more than 50 percent. In addition, life expectancy at birth has increased from 51.8 years in 1950 to 73.4 years in 2010 and is projected to reach 76.3 years by 2025.

The report indicates that almost all of the Latin American countries are currently in the “demographic window of opportunity,” when the proportion of the working-age population is temporarily higher than the population it supports (children and retirees). The window makes it easier for the country to invest in economic growth. However, in some countries (such as Cuba, Argentina, and Uruguay) the window is beginning to close, while in others (such as Bolivia, Guatemala, and Peru) the window is beginning to open.

The report analyzes the impact of pension systems on poverty in the region. Among the “pro-aging” countries (Argentina, Brazil, Chile, and Uruguay) where pensions are the highest in the region, the poverty rate for the older (aged 60 or older) population is much lower than the other segments of the population. In contrast, in Colombia, Costa Rica, and Mexico where benefits are low, the older segment of the population has the highest poverty rate. Also, despite pension reform throughout the region, generally less than 40 percent of the older population is covered by a public pension system. As a result, several countries are trying to increase coverage with reforms such as the introduction of noncontributory social pensions and minimum pension guarantees for those workers who have made some contributions.

The report makes a number of recommendations, which include—

- Promoting policies that encourage workers to remain in the labor force by eliminating incentives for early retirement and developing policies that expand labor market options for older workers in both the formal and informal sectors.
- Providing incentives to increase the participation of women in the labor force, especially in countries with low participation rates. These rates vary widely across the region.
- Continuing to reform pension systems to increase coverage and retirement savings. When developing noncontributory social pensions, countries are urged to recognize differences between the “old” (aged 60 to 79) and the “old old” (aged 80 or older).
- Considering long-term budgetary implications when making program decisions related to the aging of the population.

The publication is available at http://go.worldbank.org/Z7MBL2H0M0.

Source: *Population Aging: Is Latin America Ready?* World Bank, January 2011.

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