Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

February 2004

Europe

Denmark

Denmark is taking the unusual step of lowering its official retirement age from 67 to 65, effective July 2004. This reform measure, passed in 1999, is intended to reduce public spending by shortening the duration of the more generous voluntary early retirement program (VERB). Introduced in 1979, VERB was designed to provide an early exit from the labor force for "worn out" blue-collar workers between the ages of 60 and 66—those who were not disabled but were not yet entitled to receive the old-age pension at age 67—and to free up room for younger people entering the labor market. The nearly 160,000 VERB recipients in 2001 represented 44 percent of the population between the ages of 60 and 67, and program outlays totaled roughly 1.5 percent of gross domestic product (GDP).

During the 1990s, according to the Organization for Economic Cooperation and Development, Denmark concluded that early-retirement programs were adversely affecting economic performance by reducing productive capacity and undermining the tax base. Several Danish programs providing pre-retirement benefits were subsequently either abandoned or restricted. However, because of its popularity and generous benefit levels, VERB managed to escape even modest reforms. As a result, new VERB recipients alone have accounted for more than half of the increase in the total number of recipients of non-old age public transfers since 1978.

To avert a financial crisis caused by the retirement of large post-World War II cohorts and a falling supply of younger workers to replace them, the government has proposed to reward near-retirees who choose to remain in the labor force past age 65 with higher pension benefits. The increased benefits would depend on the number of years worked beyond the new official retirement age of 65 up to age 70.

The Danish pension system consists of a basic universal benefit indexed to wages and a small earnings-related benefit in the first pillar plus significant funded second and third pillars based on collective labor agreements and private savings, respectively.

Sources: Agence France Presse, January 20, 2004; International Monetary Fund, May 2002; Organization for Economic Cooperation and Development, July 2003; *EU Business*, May 13, 2003.

Germany

The German Parliament recently approved a series of pension reforms contained in the government's Agenda 2010. The reforms are expected to generate one-time savings of about €8.1 billion (US$10.3 billion) in the current year and more modest savings in future years. Key changes include:

- *Benefit freeze.* Pensioners will not receive a benefit increase in 2004. Benefits are normally adjusted every July 1 for changes in the pension value in proportion to changes in earnings and the contribution rate. The usual increase totals about 1 percent.
- *Long-term care benefits.* Pensioners will be required to pay the full cost of long-term care insurance, half of which is currently subsidized by the state.
- *Payment delay.* Workers who retire after April 2004 will receive their benefits at the end of each month rather than at the beginning.
- *Reduction in reserves.* The legal reserve requirements of the pension system will be reduced from 50 percent to 20 percent of total monthly benefit payments.

Altogether these changes are projected to reduce the monthly benefit for the typical retiree by €10 to €15 out of a benefit that currently averages €1,000 (US$1,263).

The German pay-as-you-go pension system is financed by a 19.1 percent contribution rate split evenly between employers and employees earning in excess of €325 (US$410) per month. The system makes annual benefit payments of €220 billion which includes a government subsidy of €70 billion. (See also the November 2003 issue of *International Update*.)

Sources: *Life Insurance International*, November 27, 2003; http://www.IPE.com, January 2004; German News, February 4, 2004; http://www.pensionsinternational.co.uk, January 2004; *FIAP Bulletin*, December 2003.

Norway

In January, the Norwegian pension reform commission issued its long-awaited report calling for significant reductions in scheduled outlays. The commission was instructed to find ways to simplify the existing, complex social security pension system and encourage later retirement. The recommendations, which the commission said could be phased in over 15 years beginning in 2010, include:

- *Adjusting for longevity.* A "life expectancy adjustment ratio" would hold expected lifetime pension benefits constant, based on remaining life expectancy at age 67 for each cohort. If life expectancy increased, workers would have to postpone retirement to receive the same pension.
- *Benefit indexation.* Indexing annual benefit increases in line with the mean of wage and price changes rather than wages alone.
- *Initial benefit calculation.* Basing pension benefit calculations on lifetime earnings instead of the highest 20 years of earnings.
- *Fund management.* Establishing a new Government Pension Fund by combining the National Insurance Fund and the Government Petroleum Fund, in order to "establish a closer link between fund capital and government pension obligations."

The commission recommended introducing the new rules gradually. People born before 1951 would not be affected, while those born after 1965 would be entirely under the new system. Those born during 1951 through 1964 would receive a pension from both the old and new systems.

The government projects that the number of retirees will increase by 80 percent between now and 2050, during which time the ratio of workers to retirees is projected to decline by about 39 percent, from 2.6:1 to 1.6:1. Norway currently spends 5.9 percent of GDP on old-age pensions; without reform, that figure is projected to reach 15.2 percent by 2050. The commission estimates that its proposals would trim expenditures in 2050 by about one-fifth.

Sources: Pension Commission, *Modernising the National Insurance Scheme: Sustainable Pensions for the Future*; *Aftenposten*, January 13, 2004; Investment & Pensions Europe, January 19, 2004.

Slovakia

Beginning January 1, 2005, Slovak workers will be able to set up individual accounts administered by private asset managers as part of the reformed pension system. New entrants to the labor force will be required to join the new two-pillar system, but current workers will have until June 2006 to choose whether to join the new system or stay in the old one. Workers who are within 10 years of retirement will not be eligible for individual accounts and will remain in the reformed public pillar only. Depending on each worker's choice, combined employer and employee pension contributions—18 percent of earnings—will either be split evenly between the individual account and the public pillar or be allocated entirely to the public pillar.

Under the latest reform, a retired worker will receive a separate first-pillar benefit and have the option of using the funds from the individual account to purchase an annuity from an insurance company or receive programmed withdrawals scheduled to guarantee income over the worker's expected lifespan. Although legislation passed in October 2003 will gradually raise the retirement age from 60 to 62 (for men by 2007 and for women by 2016), a worker will be able to retire earlier if the combined benefit from the first and second pillars equal at least 60 percent of the minimum living standard determined by the government.

During the next 6 months, the Financial Market Office will begin issuing licenses for operating asset management companies. To be considered, a company must have a minimum of SKK300 million (about US$9.4 million) in assets and at least 3 years of experience in the financial market. Each asset manager will offer three types of pension funds with varying degrees of risk and must invest a minimum of 40 percent of assets in domestic capital markets. Workers will be allowed to transfer from one asset manager to another once a year.

The Slovak government has earmarked about US$2 billion, or about 4 percent of GDP, from the sale of nationalized companies to the private sector to finance the transition. The labor ministry estimates it will need another US$3.15 billion, or 3 percent of GDP until 2020.

Sources: TASR, December 16, 2003, and February 2, 2004; Reuters News, December 16, 2003; WMRC Daily Analysis, December 17, 2003; CTK Business News, December 16, 2003; SITA, January 5, 2004; *Pensions International*, January 2004; *FIAP Boletín*, December 2003; Central Intelligence Agency, *The World Factbook, 2004*.

Asia

Singapore

The Board of Singapore's Central Provident Fund has proposed the introduction of privately managed pension plans (PPPs) to provide higher long-term returns on retirement savings as early as 2005. PPPs would be offered as an additional investment option under the Central Provident Fund (CPF), the main component of Singapore's social security system.

The CPF is a mandatory, publicly managed defined contribution system that includes a variety of forced savings programs covering retirement, housing, medical savings, and other social objectives. PPPs are intended to provide long-term risk-adjusted returns for CPF retirement accounts.

Employees must contribute 20 percent of income to the CPF, and employers contribute 13 percent. Both employee and employer contributions are tax deductible, and the CPF pays a guaranteed rate of return of 2.5 percent to 4.0 percent. Currently, members may seek higher returns under an alternative CPF Investment Scheme (CPFIS) by moving some of their savings into approved investment vehicles that include listed stocks, insurance, and mutual funds. In recent years, the performance of these investments has been poor due to a combination of weak financial markets and high administrative fees.

Under the PPP proposal, a small number of new, low-cost private pension plans would be granted access to monies in the CPF retirement accounts. Limiting the number of such plans will allow for larger contribution pools, which are expected to reduce management expenses by as much as half compared with the existing CPFIS investment options. The PPPs would have no charges at point of purchase or for switching between investment options offered by the same PPP provider. In addition, they would use a central master administrator to handle all customer support and processing functions (recordkeeping, reporting, compliance, and so on). Each PPP would offer a handful of investment packages with varying levels of risk and return to address the needs and concerns of CPF members.

With a median age of 37.5, Singapore's population of 4 million is one of the oldest in East Asia. The number of people over age 65 is projected to grow more than threefold by 2030, to 1.3 million, with little growth in the working-age population to support them.

Sources: Reuters News, January 7, 2004; *Asian Wall Street Journal*, January 7, 2004; AFX Asia, January 6, 2004; *Straits Times*, January 5, 7, and 22, 2004; World Bank, 1999; Central Provident Fund, January 6, 2004; Dow Jones International News, February 12, 2004; *World Population Prospects* (2002, rev.).

South Korea

South Korea plans to introduce a corporate pension system as early as July 2004. Provisions of the draft law currently under review in Parliament would require employers with five or more employees to establish either a funded retirement plan, on a defined contribution or defined benefit basis, or continue to provide lump-sum severance allowances as under current law. Employers that have fewer than five employees and do not already offer a severance allowance plan would be required to establish one of the retirement plan options by July 2007. Employees would not be required to contribute to the plan, regardless of design, and would be fully vested after one month of service.

The new system would replace the country's existing corporate retirement system that requires firms with five or more employees to provide a lump-sum severance payment to departing employees after one year of service with the company. While this arrangement can provide a meaningful source of retirement income for those having long service with a single employer, individuals who are self-employed, temporarily employed, or working for a business with fewer than five employees—about one-third of the labor force—are not eligible to receive severance allowances. Meanwhile, with no requirement to pre-fund severance allowances, even long-time employees are vulnerable to employer bankruptcy.

Proponents hope that the new corporate system will take pressure off the National Pension Scheme (NPS) and replace the severance allowance system with arrangements that provide lifetime pensions. Under the new program, third-party asset management firms would help companies manage their employees' pension funds. According to the finance ministry, such a system could be expected to provide at least 1 trillion won (US$856 million) in new savings to the financial markets.

Sources: *Korea Now*, January 10, 2004; Pacific Bridge, Inc., *Asian HR eNewsletter*, December 9, 2002; International Benefits Information Service (IBIS) News, November 2003; Hewitt Associates, November 2003; http://english.donga.com, September 28, 2003; and *Benefits & Compensation International*, September 2003.

Other News

ISSA Profiles International Pension Systems

The Social Security Administration and the International Social Security Association (ISSA) cooperatively produce ***Social Security Programs Throughout the World***, which reviews the different ways of approaching social security challenges. A new ISSA publication complements this SSA/ISSA publication. Developed as a collaborative effort of ISSA and the International Network of Pension Regulators and Supervisors, ***Complementary & Private Pensions Throughout the World*** reviews private pension systems in different countries and how those systems complement, and in some cases supplement, social security systems in over 50 countries. The report provides reference tables highlighting key elements of national pension plans with details on regulatory and institutional frameworks, types of systems, plan profiles, coverage, financing and investment methods, benefit provisions, protection of rights, tax treatment, and regulatory and supervisory authorities. For more information on ISSA, see http://www.issa.int/engl/homef.htm.

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