Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

March 2004

Europe

Russia

Russia's new system of individual accounts is off to a rocky start. Owing in part to poor administration, the take-up rate is very low. The recent reform requires that a portion of a worker's mandatory pension contribution be set aside in an individual account. (See also the November 2003 *International Update*.) A worker may choose between the government pension fund and a private company to manage the investments. Workers who do not make a choice will remain in the government pension fund.

To date, fewer than 2 percent of eligible workers have chosen an asset manager. According to Mikhail Zurabov, the chairman of the State Pension Fund (SPF), workers lack sufficient information regarding credit ratings or the track record of any of the more than 50 private fund management companies seeking to participate in the program. Critics contend that the SPF did not market the reform effectively and that the process for selecting a company is too complicated. According to news accounts, some workers did not receive the government letter informing them about their individual account and providing the documents needed to choose a fund manager. The government is not planning to send out another notification until the end of 2004.

Sources: *The Banker*, March 1, 2004; Gateway to Russia, February 2, 2004; *Financial Times*, February 22, 2004.

Switzerland

Opponents of recent reform to Switzerland's state social security pension system have forced a referendum this May on its rejection. The required 50,000 signatures were collected in record time, according to news accounts.

If upheld, the reforms, enacted in October 2003, would:

- Increase the retirement age for women from 63 to 65 by 2009. This follows an earlier reform that raises the retirement age for women from 63 to 64 in 2005. The retirement age for men will remain at 65.
- Reduce survivor benefits for widows without children. Reductions for widows with children would be offset by an increase in child benefits.
- Index pensions on the basis of consumer price inflation every 3 years rather than every 2 years.
- Enable some workers to retire early with reduced pensions.

Annual savings under the measure would be SFr787 million (US$612 million)—about half of what the government originally sought. Even with these changes, according to the Organization for Economic Cooperation and Development, the system could run short of funding as early as 2015.

In response, the government is readying yet another pension reform package. Interior minister Pascal Couchepin has proposed increasing the retirement age to 67 by 2025. In addition, reformers envision a more flexible retirement age up to age 70, with additional benefits to those who continue to work. A competing proposal would reduce the level of the state pension by severing the link between pensions and salaries.

Switzerland's retirement system is made up of three "pillars." Its state pension (first pillar), discussed above, is a pay-as-you-go system that replaces 33 percent of the average worker's income and covers all people living and working in Switzerland. Benefits are financed by employer and employee contributions of 4.2 percent each plus general revenues equal to 20 percent of program costs. The second pillar consists of employer-financed occupational pensions, which are compulsory for workers earning more than SFr25,000 (US$19,443) a year. The third pillar consists of voluntary, tax-favored individual savings plans.

Sources: International Business Information Service (IBIS) News, October 2003; *Economist Intelligence Unit Ltd*, February 23, 2004; *Financial News*, February 22, 2004; Mercer Investment Consulting, *European Pensions Overview—Switzerland, July 2003*, August 29, 2003; *Financial Times*, February 29, 2004; http://swisspolitics.org, February 17, 2004; Organization for Economic Cooperation and Development, *Economic Survey of Switzerland, 2003*, January 2004; Social Security Administration, *Social Security Programs Throughout the World: Europe, 2002*, September 2002.

United Kingdom

On February 12, the U.K. government unveiled its proposal to revamp the regulation of private pensions and update public pension law. A key provision of the bill would establish a Pension Protection Fund (PPF)—similar to the U.S. Pension Benefit Guaranty Corporation—which would insure participants in employer-sponsored defined-benefit "final salary" plans from losses caused by an employer's bankruptcy. (See also the December 2003 *International Update*.) The fund will be financed through fees levied on businesses. In the first year, this would consist of a flat fee, regardless of a pension plan's performance. After that, the fee would become a risk-based levy.

The bill also replaces the Occupational Pensions Regulatory Authority (OPRA) with a Pensions Regulator. The new authority will have enhanced powers to prevent under-funding, fraud, and maladministration of employer plans, including the ability to freeze pension fund assets and force employers to make up shortfalls. The measure also changes the funding standard for private pensions, replacing the current "Minimum Funding Requirement" with a "Statutory Funding Objective." Other provisions deal with protecting accrued pension benefits when workers change jobs and relations between pension plan trustees and members. In addition, the bill enables the state pension system to allow a lump-sum payment to workers who continue employment beyond the state pension retirement age (65 for men and 60 for women).

Critics of the bill, including opposition leaders, pension fund experts, and business organizations, contend that it lacks new incentives for individuals to save for their own retirement and for employers to expand pension coverage. Private savings are close to a record low. According to the Consumers Association, half of the population currently does not contribute to a pension, and 80 percent of them have no plans to acquire one in the future. The Trades Union Congress (TUC) is critical of the PPF because it does not compensate retrospectively workers already affected by failed employer plans.

Opposition leaders have formally requested more information about how the new Pension Protection Fund will operate, specifically in the area of how the risk-based levy will be calculated as well as definitional detail on the new "statutory funding objectives."

Parliament took up the bill in early March, and debate is predicted to continue for some time. As currently written, the act would take effect in April 2005.

Sources: Department for Work and Pensions, "The Pensions Bill—Simplicity, Security and Choice," press release, February 12, 2004; Mercer Human Resource Consulting, Update, February 2004; *Newcastle Chronicle & Journal Ltd*, February 13, 2004; *Scotsman*, February 13, 2004; Conservative Party Press Office, press release, March 1 and 2, 2004.

Africa

Kenya

Kenya has expanded coverage under its national provident fund. Changes to the National Social Security Fund (NSSF), enacted in February, allow workers in the "informal" sector—including farmers, traders, and the self-employed—to join the NSSF, a savings plan with a wide range of potential benefits. Until now, participation had been open only to most "formal" sector employees—those in regulated private business and nonpensionable employees in the public sector.

Under the new law, informal workers will be permitted to make monthly or periodic contributions (shared between employer and employee, if applicable) of as little as Sh400 (US$5.18). The NSSF contribution rate for formal workers will continue at 10 percent of the insured person's earnings, shared equally between the employer and employee. However, the current contribution ceiling on taxable income is being eliminated to obtain more revenue from the contributions of high earners. Also, new and existing retirees will now have an option for a monthly annuity in addition to the current lump-sum benefit.

As a result of these changes, following several years of discussion and study, the NSSF is gradually being converted into a universal social insurance program with a greater range of benefits. In addition to the NSSF provision for retirement, the range of benefits for the newly covered is expected to include unemployment relief, disability, and family allowances for children. Actuarial studies are being conducted to ascertain the fiscal impact of the conversion before further steps are taken.

Sources: *All Africa*, October 30, 2003, and February 26, 2004; *Trends in Social Security*, April 2003; *International Social Security Review*, 56(3–4), 2003; and International Business Information Service (IBIS) News, March and September 2003 and March 2004.

The Americas

Chile

Chile's recent pension reform, passed in February, changes the way retirement annuities are sold, creates a new type of annuity, and makes it harder to retire early. Implementation is set for August 2004.

Annuities, the most popular form of retirement benefit in Chile, are purchased either directly from an insurance company or through an intermediary. At retirement, the savings from the worker's individual account may be used to purchase either an immediate or deferred annuity or to make programmed withdrawals scheduled to guarantee income over the insured's expected life span.

The new law regulates the way the annuities are sold. It requires insurance companies and the pension fund management companies (AFPs) to set up an online system to provide information about their investments and projected payouts, calculated according to standardized, continuously updated mortality tables. This system will make it easier for workers nearing retirement to easily compare the products offered by each company. In addition, fees that insurance companies pay to brokers will be limited to 2.5 percent of the value of the annuity to discourage brokers from "sharing" their commissions with the workers. The Ministers of Labor and Social Security and Finance can change the fee cap every 2 years. (See also the November 2003 *International Update*.)

The new law also introduces another type of annuity, the "immediate annuity with programmed withdrawals," which combines the features of two existing separate options for retirement—an immediate annuity and programmed withdrawals. The advantages of this new benefit are that a worker is guaranteed a pension for life and, if the worker dies early, the balance of the account is inheritable.

As of September 2003, 51 percent of the workers who had retired under the system of individual accounts had retired early. A recent study found that for every year a worker retires early, the worker's pension decreases by 10 percent. The government was concerned that the earlier workers retire, the more likely that, over time, it will have to supplement the benefit with the guaranteed minimum pension. To avoid that outcome, the new law gradually raises the minimum requirements for an early retirement pension. Currently, a worker's account value at retirement must be equal to at least 50 percent of the worker's earnings over the previous 10 years and 110 percent of the current minimum pension. By August 2010, these percentages will rise to 70 and 150, respectively.

Sources: AGAFP, February 2004; SAFP, 2004; *Pensions International*, February 2004.

Uruguay

Some observers fear that the rapid aging of the population in Uruguay could bankrupt the country's social security system if no further changes are made. According to projections, in 20 years the number of Uruguayans aged 65 or older will be equal to the number aged 15 or younger and there will be more retirees than contributors to the public pay-as-you-go system.

Even though Uruguay already has the oldest population of any country in Latin America, with a lower birth rate and a longer life expectancy, emigration by many younger Uruguayans recently has accelerated the rapid aging of the population. In the past 3 years, about 2.6 percent of the total population has moved abroad.

These demographic changes will render the public system insolvent long before the individual accounts system, implemented in 1996, matures. According to the former head of Uruguayan social security, Rodolfo Saldain, the government is planning to raise the retirement age and reduce pension outlays during the coming decade.

The 1996 reforms set up a two-pillar pension system—a public pay-as-you-go first pillar plus individual accounts as a second pillar. The individual accounts are mandatory for the small portion of the labor force earning above US$400 a month and voluntary for all other income levels. In 2002, while nearly half (49 percent) of covered workers had an individual account, only about half of them were contributing to it on a regular basis. By comparison, the average ratio of active contributors to account holders for Latin American countries with individual accounts was about 43 percent. Total assets in the Uruguayan system of individual accounts reached 12.7 percent of gross domestic product in 2003.

Sources: *El País*, February 8, 2004; *Social Security Programs Throughout the World: The Americas, 2003*, March 2004; AIOS, *Boletín Estadístico*, June 2003; Carmelo Mesa-Lago, "Panorama de los sistemas de pensiones de seguridad social en iberoamérica," 2003; EFE News Service, February 9, 2004.

Other News

SSA releases Social Security Programs Throughout the World: The Americas

Social Security Programs Throughout the World, a four-volume series, highlights the principal features of social security programs in over 170 countries. Each volume focuses on a different region: Europe, Asia and the Pacific, Africa, and the Americas. The most recent volume—on the Americas—was released in March 2004. The next series begins with the volume on Europe in September 2004. The series is available at http://www.socialsecurity.gov/policy/docs/progdesc/ssptw.

The Office of Policy is developing an electronic notification system that will enable visitors to our Web site to sign up to receive notification of all of our publications. In the interim, if you wish to receive notification of future issues of *International Update*, please send your e-mail address to intl.update@ssa.gov. When the main system is put in place, we will transfer the *Update's* mailing list to it and you will receive notification of all OP publications.

International Update is a monthly publication of the Social Security Administration's Office of Policy.

Editor: Susan A. Carleson.

Writers/researchers: Rita DiSimone, Flan Fry, Barbara E. Kritzer, and David Rajnes.

Social Security Administration
Office of Policy
Office of Research, Evaluation, and Statistics
500 E Street, SW, 8th Floor
Washington, DC 20254

SSA Publication No. 13-11712