Social Security Administration
Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

September 2004

Europe

Poland

All Polish workers over the age of 16 may now set up a tax-free voluntary individual retirement account (IKE) to supplement the pay-as-you-go and mandatory individual account retirement systems. The new law also permits any employer-sponsored retirement savings plan to be converted to an IKE.

Since September 1, any worker may contribute annually up to 150 percent of the national monthly average earnings for that year (about US$900) to a single IKE. The contributions may go into any type of capital investment, life insurance policy, or investment fund. Benefits from these accounts will be paid at the age of 60 (or at the age of 55 if taking early retirement) with at least 5 years of contributions. A recent survey done by the Dutch investment fund manager, ING, indicates that more than 4 million workers are likely to set up an IKE.

Since 1999, employees have been contributing 9.76 percent of their gross salary to the public pension system—of which 2.46 percent goes to the pay-as-you-go first pillar and 7.3 percent is deposited into a mandatory second-pillar individual account. Employers contribute 9.76 percent to the first pillar only.

The combined assets of second-pillar pension funds have reached 50 billion zloty (about US$14 billion), or 6 percent of gross domestic product. Investments are restricted, because of the relative immaturity of the Polish capital market and the fact that only 5 percent of assets may be invested abroad.

The 1999 law also set up a third pillar composed of voluntary, employer-sponsored retirement savings plans. These can be set up as an employee pension fund, an investment fund, a group life insurance policy through an insurance company, or a contract with a mutual insurance society. Employers may contribute up to 7 percent of an employee's earnings to these accounts, and employees may make unlimited voluntary contributions. However, the take-up rate on the third pillar has been very low because employers have been reluctant to incur large start-up and administrative costs. By early 2004, less than three-quarters of 1 percent of Poland's 12 million eligible workers had set up voluntary accounts.

Sources: Organisation for Economic Co-operation and Development, "Comparative Tables on Private Pension Systems," (Paris: OECD, 2001); Watson Wyatt Worldwide, Global News Briefs, August 2003; Pensions International at http://www.pensionsinternational.co.uk, February 2004; International Benefits Information Services (IBIS), May 2004; Economist Intelligence Unit (EIU), July 30, 2004; *Polish News Bulletin*, August 11, 2004; PAP-Brief in English, August 24, 2004, Factiva–Dow Jones & Reuters; Social Security Administration, *Social Security Programs Throughout the World: Europe, 2004* (Washington, DC: SSA, September 2004).

Sweden

A special commission of experts will investigate the functioning of Sweden's mandatory premium pension system (PPM). A recent examination by the Swedish National Audit Office found that many savers had difficulty in selecting and managing their own portfolios, given the vast number of funds available—currently more than 650 funds and about 70 fund managers.

Sweden's individual accounts are self-directed, and participants can invest in up to five funds from among a vast array of domestic and international alternative funds. Contributions from workers not making an active investment decision are deposited into the government's default fund, which by law must invest between 80 percent and 90 percent of its portfolio in stocks.

When the PPM system was launched in the fall of 2000, roughly two-thirds of Swedish workers chose their own investment fund. Since then, however, only about 10 percent of new enrollees have done so. Stock market declines have caused most participants to lose money in their accounts since the PPM program began operations. The value of the average selected fund fell by 40 percent in the first 3 years of the program, while the value of the default fund fell by 30 percent. Although the average rate of return recovered to 17.4 percent in 2003, the average return on PPM funds since the program began was down 31 percent by the end of 2003.

The government has directed the review commission to

- evaluate the information and guidance provided to individual savers by participating fund managers and the Premium Pension Authority;
- assess the present system in terms of clarity, number of options, and risk and consider alternative ways for presenting this information to investors, such as grouping investments into different categories for participants;
- evaluate the system costs in terms of fees charged by participating fund managers; and
- evaluate moving from the current system of unit-linked funds (where the income payable will vary according to underlying investment performance) to a life annuity to minimize the risk for individual savers approaching retirement.

Sweden reformed its pension system in 1998 to boost returns and make citizens more responsible for their long-term savings. The new defined contribution system is financed primarily on a pay-as-you-go basis. An individual account component constitutes a relatively small portion of the new system.

Of the overall contribution rate of 18.5 percent, 16 percent is credited to a notional account that pays a benefit determined by a worker's lifetime earnings. Long-term financial stability of this part of the system is ensured by linking earned pension rights to economic growth and benefits to life expectancy. The remaining 2.5 percent is deposited in a funded individual account. The account balance must be converted to an annuity at retirement, which can begin as early as at age 61.

The commission, headed by Karl-Olof Hammarkvist, a professor at the Stockholm School of Economics, is expected to report its findings by October 31, 2005.

Sources: Annika Sundén, *How Will Sweden's New Pension System Work?* Issue in Brief No. 3 (Chestnut Hill, MA: Boston College, Center for Retirement Research, March 2000); *New York Times*, February 5, 2004; *Investment & Pensions Europe*, May 17, 2004; Swedish Finance Ministry, press release, June 23, 2004; *Investment & Pensions Europe*, on-line service at http://www.IPE.com, June 24 and July 20, 2004; Pensions International, July 2004; Reuters News, July 20, 2004; Annika Sundén, *How Do Individual Accounts Work in the Swedish Pension System?* Issue in Brief No. 22, August 2004; *Financial News*, August 1, 2004; and http://www.Bloomberg.com, September 6, 2004.

Africa

Nigeria

Nigeria has begun implementing a new compulsory system of fully funded retirement savings accounts. The Pension Reform Act of 2004 went into effect for public-sector employees on July 1. Implementation for private-sector workers is scheduled to begin in January 2005. The major provisions of the new law include the following:

- Mandatory Retirement Savings Accounts (RSAs) will be established for all public-sector employees as well as for private-sector workers in companies with five or more employees. RSAs will be portable in the event that the worker switches jobs.
- Joint employer-employee contributions will equal a minimum of 15 percent of employee salary (the employer may assume the full burden). Contributions will be tax-deductible and will be managed by a licensed pension fund administrator (PFA) selected by the employee. The PFA will maintain a comprehensive contribution and interest credit history for each client, provide investment advice, and administer retirement benefits. Account assets will be held by licensed financial institutions known as pension asset custodians, who will execute transactions for the participating employee.
- Retirement benefits will first be accessible at the age of 50 or upon retirement from employment, if later. Additionally, survivor and disability benefits (equivalent to 3 times employee earnings) will be provided by the employer through life insurance contracts and payable to the RSA in the event of the employee's death or disability.
- Benefits may be taken in programmed monthly or quarterly withdrawals, which are based on life expectancy, or in the form of an annuity purchased from a life insurance company. Recipients may take a lump sum withdrawal, where the remaining funds are sufficient to permit programmed withdrawals of at least 50 percent of preretirement salary.
- For the first time under Nigerian law, there will be uniform rules for payment terms, governance, investments, and administration of retirement benefits. These will be promulgated by the new National Pension Commission (NPC).
- Existing private-sector-defined benefit plans will be allowed to continue, provided that the fund managers have at least 5 years of experience and the plans are fully funded. The plans will have to satisfy licensing requirements, perform a yearly actuarial valuation, and operate satisfactorily under NPC supervision.

The new system replaces the noncontributory, pay-as-you-go, defined benefit pension plans in the public sector (including the military); the National Social Insurance Trust Fund (NSITF), a shared contributory private-sector system for companies with five or more employees; and voluntary employer-sponsored retirement plans (both defined contribution and defined benefit). Taken together, these plans cover roughly 10 percent of the population.

The public-sector pension system has been on the verge of collapse for some time, because of weak administration, restrictive investment policies, and widespread corruption. The 1999 Public Enterprises Act privatized nearly all public enterprises and caused a dramatic increase in pension liabilities, now estimated as high as 3 trillion naira (US$22.5 million). Although the various unregulated private-sector arrangements of some companies and the NSITF have operated effectively, their coverage is limited.

Nigeria has debated pension reform for more than a year. According to government spokesmen, private management of the system was adopted because of a general distrust of government enterprises and the better service delivery promised to workers through competition. Uniform rules, regulations, and standards for pension fund administration and management are expected to encourage saving and to better protect workers' retirement benefits. In addition to stemming the growth of public-sector pension liabilities, the new system is expected to increase fiscal discipline and create a pool of long-term funds available for economic development.

Nigeria is Africa's most populous country. The population is predominantly rural and very young, with roughly half under the age of 17. Only about 3 percent of Nigerians are over 65, a share that will rise to 4.3 percent in 2030, according to the United Nations.

Sources: Milliman Global, *Employee Benefits* (Seattle, WA: Milliman Global, November 2002); United Nations, *World Population Prospects: The 2002 Revision* (New York: UN Population Division, 2003); This Day on the Web, September 15, 2003, at http://www.thisdayonline.com; *Vanguard*, October 21, 2003; *The News*, December 15, 2003; Pensions International, February 2004; http://allAfrica.com, May 18, August 6, and August 12, 2004; ThisDay News at http://www.thisdayonline.com, June 23, 2004; IBIS, July 2004; Watson Wyatt Worldwide, Global News Briefs, July 2004; IBTC, "Pension Reform," *Stock Watch* (Lagos, Nigeria: Investment Banking & Trust Company, July 1, 2004); Mohammed Kabiru Ahmad, Director-General of the National Pension Commission, "An Overview of the Contributory Pension Scheme," presentation to the Nigeria Employers' Consultative Association, August 26, 2004; and Central Intelligence Agency, *The World Fact Book, 2004* (Washington, DC: CIA).

The Americas

Bahamas

In early August the Social Security Reform Commission released its preliminary proposals for ensuring the future solvency of the Bahamian public pension system. After a 10-month evaluation of the latest actuarial review, the commission recommended the following:

- a gradual increase in the required period of contribution, from the current 3 years to 10 years;
- a regular review of the level of insurable (covered) wages to reflect increases in either wage or price indexes (the maximum level has increased only two times in the program's 30-year history);
- a gradual increase in the retirement age from 65 to 67, while still allowing early retirement at age 60;
- mandatory private pensions—only about 30 percent of workers now have private pensions; and
- diversification of investments for the National Insurance Board (NIB) reserve fund to increase returns. At present, most of the assets are held in bonds, loans, and fixed deposits; foreign investments are prohibited.

The commission acknowledged that the current contribution rate—8.8 percent of earnings (1.7 percent for employees and 7.1 percent for employers), which has not changed since the program began, is no longer sufficient to fund benefits. However, it did not address this situation with a specific recommendation.

The government projects that the portion of the population aged 65 and over will increase from 5.2 percent currently to 22 percent in 2061, and the ratio of workers to retirees will decrease from 12.2:1 to 2.7:1. Even though the NIB reserves for 2001 were more than US$1 billion, if no changes are made to the system, they would be depleted by 2029. The commission will hold meetings between August and October to allow for public comment and will submit its final report to the government in December.

Sources: The National Insurance Board, *7th Actuarial Review of the National Insurance Fund as of 31 December 2001* (Nassau, Bahamas: NIB, 2002); Social Security Administration, *Social Security Programs Throughout the World: The Americas, 2003* (Washington, DC: SSA, 2004); *Bahamas News*, August 12, 2004; *The Nassau Guardian*, August 12, 2004.

Significant Court Decisions

Brazil

After months of deliberation, on August 19, Brazil's Supreme Court upheld the law passed by the Brazilian Congress last December that imposed an 11 percent tax on higher civil service pensions. The high court's decision included an adjustment to the law that raised the threshold for the tax from 1,500 reais (US$500) per month to 2,500 reais (US$830).

The government estimates that this change will lower the expected annual tax revenues by 25 percent, from about 2.5 billion reais (US$860 million in 2004) to about 1.875 billion reais (US$650 million).

The pension tax is the key element of Brazil's civil service pension reform. Other provisions include raising the retirement age and lowering benefits. (See also the January 2004 issue of *International Update*.) A parallel amendment to the December law—with no projected savings to the government—needs just one more vote in the lower house of the congress to be passed. That amendment includes new salary caps for government workers, transitional rules for current employees, a higher maximum benefit, and a tax exemption for disability pensions. Since civil service pensions (as well as private-sector pensions) are written into the constitution, it is very difficult to make changes.

Sources: EIU, March 24 and August 25, 2004; Reuters News, July 8, August 16, and August 19, 2004; Agence France-Presse, August 18, 2004; OsterDowJones CommodityWire, August 19, 2004.

Canada

Canada's Supreme Court has thrown the country's corporate pension community into disarray. On July 29, the high court upheld a lower court's decision to require Monsanto Canada Inc. to distribute a pro rata share of the company's defined benefit pension surplus to 146 former employees. The court found that the termination of the employees constituted a partial windup of the company's pension plan, from the employee's point of view. Under Canadian law, the company is required to distribute its pension surplus after a plan windup.

The court's decision will have profound repercussions for Canada's corporate pensions. Over 200 similar cases dating back to 1992 now stand to be reviewed, and many more may be reopened, resulting in millions of dollars in future claims. The ruling may also affect the actions of company fund managers who may become averse to building pension surpluses, driving many pension funds farther into deficit. Alternatively, companies may choose to switch entirely from defined benefit pension plans to defined contribution plans.

Sources: Canada NewsWire at http://www.newswire.ca/en, July 29, 2004, Toronto, Ontario; Financial Post and FP Investing of the *National Post* at http://www.canada.com, Toronto, Ontario, July 30, 2004.

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