Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

October 2004

Europe

Ireland

Ireland's National Parliament (Oireachtas) has approved a measure reforming the way retirement benefits are calculated for current civil servants and those who have left government service since April 1, 2004. Under the Civil Service Regulation Bill, passed in September, government workers who choose to retire early will receive actuarially reduced benefits. In addition, a new calculation formula, designed to benefit lower-income civil servants by better integrating social insurance with public service pensions, will be used to determine benefits for those who retired as of January 1, 2004. The Department of Finance estimates that the new benefits are cost neutral.

According to former Minister of Finance Charlie McCreevy, these reforms "continue the process of modernizing and improving the public service pension system for both existing and future public servants." The new law complements an earlier reform, passed in March, which increased the eligible pension age for most civil servants to 65 and either eliminated or increased mandatory retirement ages for new government workers.

Sources: Department of Finance, "McCreevy Announces Further Public Service Pension Reform," (press release, Dublin, September 14, 2004); and *Investment & Pensions Europe*, September 17, 2004.

Switzerland

Under a law passed last fall, Switzerland's mandatory occupational pension plans will be governed by new operating rules beginning in January 2005. Key changes to second-pillar pension plans include coverage of more workers, an increase in the retirement age for women from 63 to 64, a reduced conversion rate for calculating annuities, and a requirement for the plans to offer new types of benefits.

Many part-time and lower-income workers will be eligible for coverage under a reduced earnings threshold, which is due to be lowered from the current SFR25,320 (US$20,000) to SFR18,999 (US$15,000). At the same time, the new retirement age for women will conform with an earlier reform to the first-pillar pay-as-you-go system. The retirement age for men remains at 65.

The current 7.2 percent conversion rate, which is used to calculate the life annuity paid at retirement under defined contribution and cash balance plans, is set by law rather than by market forces. In recent years, increases in life expectancy and low bond yields have rendered this rate increasingly uneconomical. The new law will reduce this rate, depending on age and gender, to between 6.8 percent and 7.15 percent over a 10-year period. To offset the resulting reduction in benefits, minimum contributory earnings (the earnings level at which contributions begin) will increase from SFR22,155 (US$17,500) to SFR25,320 (US$20,000). Maximum contributory earnings will remain at SFR75,960 (US$60,000).

Certain types of first-pillar benefits will be mandatory for the second pillar as well. Widower's pensions will be required, and more degrees of disability will be permitted. Plans will have to provide 25 percent and 75 percent disability pension options, in addition to the current 50 percent and 100 percent options.

Pension plans will be subject to new operating rules for record keeping, liquidation of a pension institution (including how to distribute the reserves), and codes of conduct for asset managers concerning investment and conflicts of interest.

These reforms are the second part of a three-phase plan enacted last fall. The first phase, implemented in April, included new transparency rules and reporting standards, plus limits on the types of employer investments. The third phase, to take effect on January 1, 2006, will include the introduction of a limit on how much of the insured's salary can be contributed to the pension plan and restrictions on the repurchase of plan benefits and lump-sum withdrawals.

Sources: IBIS (International Benefits Information Services), July 2004; http://www.IPE.com (Web extension of *Investment & Pensions Europe*), July 5, 2004; http://mercerhr.com (Mercer Human Resource Consulting), August 2004; and Watson Wyatt Worldwide, Global News Briefs, August 2004.

Asia and the Pacific

Australia

Beginning July 1, 2005, Australian workers will be able to choose among competing superannuation funds to manage their individual account assets rather than having their employers select a fund for them. The new law will not apply to workers covered by a defined benefit plan, civil servants, or those with pension plans that are covered under specific awards or legislation that specify a certain fund.

The legislation requires workers to conduct their own research on the available funds that are regulated by the Australian Prudential Regulation Authority. Employers must direct employees' contributions to the employees' chosen funds within 2 months of their decisions. Employees failing to make a choice will have their contributions directed to a default fund of the employers' choosing. Employees will be allowed to switch plans, but only once a year, and employers will not be held liable for any losses that result from their employees changing funds.

The debate over who should have the responsibility for fund choice began when many participants became dissatisfied with underperforming funds, which they were unable to leave and which were chosen by their employer. Critics of the new law fear that unclear language in fund disclosure documents could conceal hidden fees that would erode retirement savings. There is also a concern that poor financial literacy among the public will lead to people taking unnecessary risks. Finally, many employers fear that they will be burdened with the need to acquire new software and training for their payroll departments to direct contributions to a variety of different funds at the same time.

Since 1992, employers have been required to pay the equivalent of 9 percent of an employee's salary into a privately managed pension (superannuation) fund. Australia's second pillar allows workers to receive tax incentives for making voluntary pension contributions, and its third pillar is a means-tested state pension.

Sources: Australian Labor Party, "Unsafe Choice: The Government & Democrat Deal," (media statement, Melbourne, June 21, 2004); *Pensions International*, September 2004; http://www.pensionsinternational.co.uk, "Australia: 'Choice of Fund' Arrives," September 14, 2004.

China

On September 7, the State Council released a white paper on social security, *China's Social Security and Its Policy*, outlining the many serious challenges facing China's retirement system. However, the report provides few details about how the government intends to address them. Highlights include the following areas of concern:

- *Promoting old-age insurance in urban areas*. Social security initially covered only employees at state-owned and collectively owned enterprises in urban areas. Under a 1997 reform, the basic old-age insurance system was unified, and personal retirement accounts were added. Coverage was expanded to foreign-invested and other private enterprises in urban areas in 1999 and then extended to those working less than full-time, beginning in 2002. An experiment carried out in Liaoning Province since 2001, which requires workers to set up funded personal retirement accounts, has been expanded to Jilin and Heilongjiang Provinces this year. These north-eastern provinces, which formed the old industrial base of China, contain the most state-owned enterprises (SOEs). Many SOEs are no longer profitable and, therefore, face serious problems for funding social security. The experiment initially got off to a bad start because the assets designated for the individual accounts were paid to current retirees. Despite the early problems, accounts for the 7.5 million workers in Liaoning, who represent about one-tenth of SOE employees, have accumulated more than 11 billion yuan (approximately US$1.3 billion) over the past 3 years, according to the report.
- *Broadening sources of funding*. Established in 2000, the National Social Security Fund (NSSF) has assets of over 150 billion yuan (US$18.1 billion) and invests contributions from individuals, employers, and the government along with proceeds from state share sales and the listing of state companies on domestic and foreign stock markets. Even though the NSSF provides a critical financial reserve for China's future pension payments, state and central government budgets have had to increase subsidies to make up for insufficient contributions from employers and employees, especially in the central and western provinces.
- *Promoting management and service delivery through social institutions*. The government has reduced the burden on employers by shifting responsibility for pension administration and payments from enterprises to social security agencies. At the end of 2003, all basic pensions were delivered by these institutions.

- *Establishing a multilevel old-age insurance system*. In addition to participating in the compulsory basic old-age insurance program, firms are encouraged to purchase annuities for their employees. (See also the June 2004 issue of *International Update*.) In 2003, nearly 7 million people participated in the enterprise annuity program.
- *Introducing old-age insurance into rural areas*. Most of the population live in rural areas where the level of economic development is low and where old-age security is traditionally provided by families. In the 1990s, China introduced old-age insurance in some rural areas. By the end of 2003, over 54 million rural participants contributed nearly 26 billion yuan (US$3.1 billion) to help nearly 2 billion farmers draw pensions.

Since China established a socialist market economy in the mid-1980s, a series of reforms have transformed social security into a multipillar system where the central and local governments share specific responsibilities. (See also the April 2004 issue of *International Update*.) Today, however, only about 25 percent of the workforce is actually covered by a pension. Only 45 percent of urban workers are covered under social security. The white paper and recent government pronouncements emphasize that population aging will place increasing pressure on the funding of the pension system. Today, 11 percent of China's 1.3 billion population is over the age of 60, and that proportion is expected to grow to 25 percent by 2030. During this period, spending on retirement will increase from roughly 3.5 percent of gross domestic product to a much higher level that is typical of more-developed economies.

In recent months, China has announced its intention to increase NSSF reserves to 1 trillion yuan (US$120.8 billion) over the next 5 years—a sixfold increase over current reserves. To this end, the government is considering several measures, including selling state assets, assigning a portion of property and telecommunications taxes, and adopting practices designed to improve investment performance. NSSF is hiring Chinese and outside fund managers to provide investment advice. It has also received permission to expand investments in stocks and to invest overseas.

Sources: *Pensions International*, March 2004; Richard Jackson and Neil Howe, *The Graying of the Middle Kingdom: The Demographics and Economics of Retirement Policy in China*, (Washington, DC: Center for Strategic and International Studies, April 2004); http://www.China.org.cn, September 7, 2004; Xinhua News Agency, September 7, 2004; *Business Daily Update*, September 8 and September 13, 2004; *China Daily*, September 8 and September 10, 2004; http://www.chinaview.cn, September 8, 2004; *South China Morning Post*, September 8 and September 11, 2004; *Toronto Star*, September 8, 2004; Voice of America, September 8, 2004; *WMRC Daily Analysis*, September 8, 2004; Xinhua Financial Network (XFN) News, September 8, 2004; *Guardian*, September 9, 2004; *Straits Times*, September 9, 2004; and Dow Jones International News, September 10, 2004.

The Americas

Jamaica

Jamaica's legislature has passed a bill designed to improve the regulation of voluntary pension funds. The legislation was passed by the House on May 11 and by the Senate on July 30. A special committee will prepare the final version.

The existing Financial Services Commission (FSC) will have the authority to approve and license pension funds, administrators, and investment managers. The FSC will also be authorized to impose fines of up to 5 million Jamaican dollars (US$86,000) for violations, such as operating without a license, breaching confidentiality, or failing to maintain adequate records. Details are not yet available on the transition process for the 1,500 existing, largely unregulated pension funds.

The legislation provides that the FSC will approve two types of pension arrangements:

- A superannuation fund, in the form of a defined contribution or defined benefit plan, will be available through a worker's current employment. Employers and employees may each contribute up to 10 percent of earnings annually.
- A retirement scheme, in the form of a defined contribution plan, will be available for the self-employed or workers who are not active members of an employer's superannuation fund. Total contributions may not exceed 20 percent of earnings annually.

These voluntary plans will be required to offer a range of retirement ages. Although full retirement must be between the ages of 60 and 65, early retirement will be allowed up to 10 years earlier, and deferred retirement up to 5 years later.

Among the items not addressed in the legislation are provisions for vesting and portability. The government plans to tackle these controversial issues in future legislation. Investment rules, meanwhile, will be issued by the FSC at a later date.

Voluntary pension funds supplement Jamaica's mandatory pay-as-you-go system that provides both a flat-rate and earnings-related retirement benefit for employed and self-employed workers at the ages of 65 for men and 60 for women.

Sources: Pensions Bill of 2003 (Superannuation Funds and Retirement Schemes); *Trends in Social Security*, February 2004, (Geneva, Switzerland: International Social Security Association); Social Security Administration, *Social Security Programs Throughout the World: The Americas, 2003*, (Washington, DC: SSA, March 2004); *Jamaica Observer*, August 1, 2004; and Jamaican Information Service, http://www.jis.gov.jm, August 3, 2004.

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

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SSA Publication No. 13-11712