Europe

Czech Republic

On June 22, the Czech government released a report that compares pension reform proposals presented by the country’s five political parties. The expert team that compiled the report was composed of representatives from all five parties, the Ministry of Finance, and the Ministry of Labor and Social Affairs. Following the report’s official release, Prime Minister Jiri Paroubek announced the goal of reaching consensus on a pension reform agenda by October 31. He acknowledged, however, that it is unlikely that full details of any pension reform will come before next summer’s general elections.

The report reveals that, while it is expected that the current pay-as-you-go system will be sustainable for the next 15 to 20 years, over the next 60 years the proportion of pensioners will increase from one-fifth of the population to more than one-third, and the ratio of workers to retirees will decline dramatically from 2 to 1 to 1 to 1.

The report highlights a wide range of options, including a notional defined contribution system (see the January 2004 issue of International Update), voluntary full or partial opting out of the public pay-as-you-go system to be replaced with some form of individual accounts, a flat-rate pension of between 20 percent and 30 percent of average pay, and adjustments to the current pay-as-you-go system. Most of the parties agree on the need for a gradual rise in the normal retirement age to either 65 or 67, while one party has proposed an increase to age 71.

The normal retirement age for both men and women has been gradually increasing since January 1996 and will reach 63 by 2013. However, women who have raised children may retire between the ages of 59 and 62, depending on the number of children raised. In 2006, the retirement age will be 62 for men and between the ages of 57 and 61 for women. Early retirement is possible up to 3 years before the normal retirement age.

Romania

The Private Pension System Surveillance Commission was established in mid-June in preparation for the introduction of new mandatory private pension funds in 2007. The commission, which will supervise the new funds, is expecting to issue regulations by the end of 2005.

Romania’s new multipillar pension system is structured as follows:

- First pillar—a mandatory public pay-as-you-go system;
- Second pillar—a privately managed personal savings account system that will be mandatory for all workers younger than age 35 and optional for all others under the age of 45 (the contribution rate will be set at 2 percent of wages initially and will increase to 6 percent within 8 years);
- Third pillar—voluntary employer-sponsored and privately administered occupational pension system (see the July 2004 issue of International Update).

Romania, which aspires to join the European Union in 2007, has gradually introduced reforms to its pension system to ensure its financial sustainability and to increase pensions for the elderly. It first reformed its public system in 2000 and later enacted laws to add mandatory and voluntary private pension funds.

The 2000 pension reform measures provided for

- equalizing benefits for retirees whose pension benefits were lower than those of other retirees with the same contribution levels;
• increasing the retirement age gradually from 55 to 62 years for women and from 60 to 65 years for men by 2014;
• increasing the years of service required to receive a pension, from 30 to 35 years for men and from 25 to 30 years for women; and,
• extending coverage of the public pension system to all workers, including the self-employed, farmers, and those with civil contracts.

In 2004, Romania legislated voluntary employer-sponsored occupational pensions (effective January 1, 2005) and a mandatory private pension savings account system to complement the public pension fund. It is anticipated that fund licensing, membership enrollment, and other aspects of implementing the private pension funds will begin by July 1, 2006, with contributions to the private savings accounts to begin in 2007.

Demographic and macroeconomic pressures are largely responsible for Romania’s growing pension deficit and, resultantly, the strain on the country’s general budget. Between 1995 and 2003, Romania’s pension expenditures averaged 7.2 percent of gross domestic product, and sources indicate that the country’s dependency ratio deteriorated to the point that today it takes between 1.3 and 1.5 workers to support 1 pensioner.


Switzerland

The Swiss Federal Council passed a third set of revisions to the mandatory occupational pension (BVG) law to permit greater flexibility in plan design and to reduce the potential for disproportionate employee tax advantages. The amendment was passed in June and, beginning January 1, 2006, pension funds will have 5 years to amend their rules and modify operations.

The BVG law is being amended in three stages during the period from 2004 to 2006. The first phase, implemented in April 2004, focused on improving transparency and reporting standards. The second phase, effective January 1, 2005, expanded coverage, raised retirement ages for women, lowered conversion rates for annuity calculation, and mandated certain new benefits. (See also the October 2004 issue of International Update.)

This final amendment will
• permit pension funds to offer up to three plan designs for each group of covered employees (employer contributions must be equal for each design);
• limit the maximum annual covered salary for supplemental plans to 10 times the current maximum covered BVG salary limit or CHF759,600 (US$603,768) (currently, employers may provide supplemental pension benefits for senior executives and other key personnel based on an employee’s total salary);
• increase the minimum age for early retirement from age 55 to 58 (an earlier proposal sought to raise it to age 60);
• apply special contribution rules for individuals, including the self-employed and foreign-born employees, who wish to purchase additional years of pensionable service but have not previously participated in an occupational pension plan; and
• require pension funds to expend at least 10 percent of their aggregate plan costs on death and disability benefits.

Switzerland’s multipillar pension system includes a universal pay-as-you-go public pillar; a mandatory, funded occupational pillar; and voluntary personal savings. The first two pillars are financed by tax-deductible contributions from employers and employees. Additional tax revenues cover about 20 percent of old-age and 50 percent of disability benefits under the first pillar.

Employers are required to either establish an occupational pension plan or join a multiemployer plan that covers all employees whose annual salary exceeds CFR25,320 (US$20,084). The self-employed and workers not covered by an occupational plan may voluntarily enroll in the system. Plan trustees, while
subject to minimum legal requirements, are free to set their own terms and conditions regarding plan design, the level and nature of benefits, contribution rates, vesting, and so forth.

Defined contribution plans cover 85 percent of private-sector employees and account for about 60 percent of the total number of occupational plans. These plans have a built-in capital guarantee and are required to grow by at least 2.5 percent each year.

The International Monetary Fund recently reported that, in 2003, 12 percent of Switzerland’s occupational pension plans were underfunded by approximately 6 percent of gross domestic product. While the report praised the ongoing reform agenda, it urged that action be taken to improve defined benefit plan actuarial and risk-based assessments and produce more timely disclosure of financial statements. It also recommended a lower minimum guaranteed interest rate for defined contribution plans.


Canada

Canada’s Department of Finance has undertaken a comprehensive review of the rules governing private defined benefit pension plans in an effort to improve benefit security and ensure plan viability. The Web-based initiative, which was launched on May 26, invites plan sponsors, unions, workers, retirees, and pension experts to submit their comments online by September 15.

Canada’s private defined benefit (DB) plans have suffered increasing liabilities and inadequate funding levels in recent years because of lackluster financial market returns and declining interest rates. It is estimated that some 70 percent of all registered Canadian DB plans are underfunded to some extent.

Private pension plans in Canada are voluntary but must be registered with either the federal or provincial authorities. The ongoing review considers only DB plans registered with the federal pension regulator, the Office of the Superintendent of Financial Institutions (OSFI), which has jurisdiction over 1,200 pension plans representing close to 10 percent of the asset value of all registered Canadian plans. Of those, 428 are DB plans, of which about half are underfunded. With combined assets of about C$89 billion (US$73 billion), these DB plans cover almost 500,000 employees.

The review is examining the following:

• The extent of regulatory disincentives or obstacles to adequate plan funding;
• Alternative financial vehicles to allow for greater funding flexibility;
• Extending the period required for plan sponsors to fund deficiencies from 5 to 10 years;
• Prescribing a solvency ratio threshold to define “underfunding”;
• Increasing plan sponsor disclosure requirements; and
• Establishing a national guarantee fund to insure benefits in the event of sponsor bankruptcy or underfunding of a plan; among the provinces, Ontario is the only jurisdiction that has pension plan insurance.

The finance department is also concerned about the impact of a decision by the Supreme Court of Canada in 2004 that required the distribution of surpluses to laid-off employees in a pension plan that was determined to be in partial windup. (See also the September 2004 issue of International Update.) Pension professionals have warned that plan sponsors may avoid building up surpluses because of uncertainty about ownership rights. The finance department has requested comments on the current treatment of pension surpluses and the dispute settlement mechanism for handling such distributions.


Ecuador

The Ecuadoran Congress passed legislation at the end of July that will allow Ecuador’s 2 million active workers to receive about $735 million from the social security reserve fund within the next 6 months instead of waiting until after retirement. Before this law, the reserve provided payments only to retirees to supplement their monthly retirement benefits.

The monies will be disbursed in three stages: between September 1 and November 30; between December 1 and January 31, 2006; and during February 2006. The law also permits future reserve fund assets, which are financed by part of the employees’ and the employers’ monthly contributions to the Social Security Institute (IESS), to be distributed to the workers every 3 years.

The law was passed to improve Ecuador’s very high poverty rate, estimated at 60 percent of the population. However, since the IESS is the largest purchaser of government debt, financial analysts fear that reducing its assets by 26.5 percent over the next 6 months will impede the government’s ability to borrow money and meet its financial obligations.

Ecuador’s retirement system provides benefits on a pay-as-you-go basis. Over the years, attempts to convert it to a partially funded two-tiered system have failed. In 2001, the Ecuadoran Congress approved the introduction of an individual account component, but the law was never implemented, and it was finally struck down by Ecuador’s Constitutional Court in February 2005. The following month, the Congress rejected former President Gutiérrez’s reform package, which included setting up a two-tiered system.