Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

February 2006

Europe

Bulgaria

Next year, the government will establish a reserve fund to enhance the financial stability of the first-pillar pay-as-you-go pension system. According to the 2006 budget passed by parliament at the end of 2005, the new Silver Fund will be financed by proceeds from privatization and 50 percent of any general budget surplus. The cabinet must submit specific operational regulations to the parliament by June 30. It is presumed that either the Bulgarian Finance Ministry or the Bulgarian National Bank will manage the reserve fund, subject to oversight by an executive board composed of representatives from various sectors including trade unions, employers, citizens, and pensioners' groups.

The public pension system is predicted to face future shortfalls because of increased life expectancy and the growing migration of younger workers to other countries. Currently, the worker-to-retiree ratio is three-to-two, but by 2037, it is expected to decline to one-to-one. The government subsidizes the National Social Security Institute (NSSI), the public administrator that pays old-age, survivors, and disability; sickness and maternity; work injury; and unemployment benefits. Pension benefits represent about 88 percent of NSSI's expenses. In 2004, the government subsidy to NSSI amounted to about 2.6 percent of gross domestic product.

In 2002, Bulgaria introduced a three-pillar system with an earnings-related pay-as-you-go first pillar, mandatory individual accounts as a second pillar, and voluntary accounts as a third pillar. Since that time, the retirement ages have been raised by 6 months each year from age 60 for men and age 55 for women. The retirement age will reach 63 for men and 60 for women by 2009.

Sources: *Social Security Programs Throughout the World: Europe, 2004*; *Bulgarian News Digest*, March 17, 2004, and November 1, 2005; *Pari Daily* (Sofia), November 1, 2005; *Capital Weekly* (Sofia), November 17, 2005; "Annual Actuarial Report—2004," National Social Security Institute, 2005; "Report About the Execution of the State Social Security Budget for Year 2004," Hristina Mitreva, 2005; Sofiaecho.com, January 24, 2006.

Hungary

The government introduced a new pillar of voluntary individual retirement accounts (NYESZ) in January to broaden investment opportunities for workers and encourage greater retirement savings. The new fourth pillar, NYESZ, can invest in securities listed on the Budapest Stock Exchange as well as in bonds, mutual funds, and money market accounts—a much wider range of investments than those currently permitted in the second and third pillars of Hungary's retirement system.

The government provides workers with two incentives for setting up a NYESZ: an annual 30 percent matching contribution of up to 100,000 forints (US$490) and an exemption from capital gains on investments in stocks beginning in 2007, when a capital gains tax will be introduced. The head of the Budapest Stock Exchange expects about 70,000 workers to open these accounts in the first year with an average annual contribution rate of 150,000 forints (US$735). HVB Bank, the first company to offer the new accounts, charges workers an annual management fee of 1 percent of assets up to a maximum of 2,000 forints (US$10).

Hungary reformed its pension system and introduced mandatory individual accounts in 1998. The system provides a first-pillar earnings-related pay-as-you-go benefit; second-pillar individual accounts mandatory for new entrants to the labor force since 1998 and voluntary for workers under the age of 42 at that time; and third-pillar voluntary individual accounts. Some 2.4 million workers, about 57 percent of the labor force, have second-pillar accounts, and nearly 1.3 million workers have voluntary accounts. Second-pillar assets under management total 969 billion forints (US$4.75 billion) in 18 funds, and third-pillar assets total 512.4 billion forints (US$2.51 billion) in 76 funds. The portfolios for the second- and third-pillar funds are very similar, with between 75 percent and 80 percent of holdings invested in government securities and between 8 percent and 15 percent in equities.

Hungarian workers must contribute 8 percent of their earnings to the second pillar and 0.5 percent to the first pillar. Workers who did not choose to join the two-pillar system contribute 8.5 percent of their earnings to the public system. Employers are required to contribute 18 percent of payroll only to the first-pillar pay-as-you-go program. Minimum contributions to third-pillar accounts are determined by each investment fund. Workers receive a tax credit equal to 30 percent of their annual third-pillar contributions, but the employer's third-pillar contribution is tax-exempt.

Since the 1998 reform, Hungary has also been increasing retirement ages, which were age 60 for men and age 57 for women. Today, men can retire at age 62 and women at age 60, but by 2009, the full retirement age will be 62 for both men and women.

Sources: *Social Security Programs Throughout the World: Europe, 2004*; "Tax Treatment of Private Pension Savings in OECD Countries and the Net Tax Cost per Unit of Contribution to Tax-Favoured Schemes," Organisation for Economic Co-operation and Development, October 2004; European Pensions and Investment News, November 7, 2005; Dow Jones International News, December 15, 2005; MTI-EcoNews, December 27, 2005, and January 3, 2006; Reuters News, January 3, 2006.

Ireland

On January 17, the Minister for Social and Family Affairs released the Pensions Review Report, which recommended new government incentives to increase Ireland's low level of private pension savings. The report was prepared by the Pensions Board, which regulates occupational pensions and Personal Retirement Savings Accounts (PRSAs).

The PRSA, introduced by the Pensions Act in 2002 and available since 2003, is a voluntary, tax-advantaged investment vehicle for retirement saving available to workers and nonworkers. Employers that do not provide an occupational pension plan are required to make a PRSA available to their workers. Thus far, PRSAs have had a low take-up rate. At the end of 2005, 68,257 accounts were in force with assets totaling €451 million (US$540 million).

Worker's contributions to private pensions and PRSAs are tax-deductible up to the following limits based on age: 15 percent of earnings for persons under the age of 30, 20 percent of earnings for persons between the ages of 30 and 39, 25 percent of earnings for persons between the ages of 40 and 49, and 30 percent of earnings for persons aged 50 and older.

Today, only about one-half of Ireland's workers have private pension savings. To promote greater retirement security, the Pensions Board has recommended the following actions:

- Provide a government match of €1 for each €1 put into a PRSA, subject to a contribution ceiling;
- Increase the tax deductibility of employee contributions for all non-PRSA private pension funds to a rate of 30 percent for everyone, instead of the current range of 15 percent to 30 percent that is based on age;
- Reward workers who postpone receiving their public pension with a higher benefit;
- Waive the 23 percent withdrawal tax for individuals who roll over their Special Savings Incentive Accounts (SSIA) into private pensions. (SSIAs receive a government match of 25 percent and must be withdrawn 5 years from the time of enrollment. They were introduced in 2001 and will begin to reach maturity in May 2006.)

The Pensions Board discussed the prospect of making private pension coverage mandatory, but it was unable to reach a consensus. Although some members believe that making private pensions mandatory is the only way to provide adequate coverage, others fear the financial impact that such a mandate would have on the economy. The report also suggested several items for further review, including researching pension adequacy for women, continuing to promote financial literacy, reviewing funding standards for defined benefit pension plans, and projecting on a regular basis the financial sustainability of Ireland's public pension system.

To further enhance private savings, the government has proposed in the Finance Bill of 2006 to give a match of €1 for every €3 up to a maximum of €7,500 (US$8,980) to earners who roll over funds from their SSIAs to a private pension. The government match would be available to individuals earning €50,000 (US$60,000) per year or less. The parliament is scheduled to take up the Finance Bill in the coming weeks.

Ireland's public pension system consists of an old-age contributory flat-rate benefit supplemented by a means-tested benefit. The old-age benefit is payable at the age of 65 if an individual is no longer working or at age 66 whether working or not. The means-tested benefit serves as a safety-net for retirees whose income falls below the poverty level.

Sources: "National Pensions Review," Pensions Board, October 2005; Pensions Board press release, November 4, 2005; *Irish Times* (Dublin), February 3, 2006; IPE.com, February 10, 2006.

United Kingdom

Beginning April 6, British workers will be able to contribute more tax-free each year to their private pension plan, but those contributions will be limited to a lifetime total of £1.5 million (US$2.6 million). Workers will be allowed to put 100 percent of their annual earnings into their pension fund tax-free, subject to an annual cap of £215,000 (US$380,000). The lifetime limit on tax-free pension accumulations will increase incrementally to £1.8 million (US$3.2 million) by 2010. Pension accumulations exceeding the limit will be subject to a tax of 25 percent.

Until the new rules take effect, workers are permitted to contribute up to 15 percent of their pre-tax annual earnings to a defined benefit pension plan and, depending upon their age, between 17.5 percent and 40 percent of their pre-tax earnings to other types of private pension arrangements.

Another rule change will offer retirees with defined contribution pensions more options in annuitizing their retirement savings. Currently, on reaching the age of 75, individuals are required to purchase a lifetime annuity to guarantee a minimum retirement income. Under the new rules, 75-year-olds will have the option of making regular withdrawals from their defined contribution fund provided the payments do not exceed the amount that could have been received through the purchase of a lifetime annuity.

Sources: BBC News, January 6, 2006; FT.com, January 6, 2006; *Sunday Times* (London), January 15, 2006; *Observer* (London), January 22, 2006.

Asia & the Pacific

Australia

Since January 1, workers can reduce their future tax liability at retirement by shifting a portion of their superannuation contributions to a spouse's account. The new law will benefit households with a non–working spouse and those in which one spouse has substantially larger superannuation contributions than does the other spouse. Under the current law, the first AU$129,751 (US$97,100) of a superannuation account that is withdrawn at retirement is not taxed. By allowing contributions to be split between two accounts, married couples will now be able to shelter more accumulations by building up the size of the second account. In addition, the tax-free threshold is indexed to increases in earnings so the tax benefit from contribution splitting will rise accordingly.

Contribution splitting is intended for workers with defined contribution accounts, not defined benefit accounts. However, defined benefit account holders will be allowed to split any contributions they make to their account. The amount of contributions that may be split will depend upon the tax status of the contribution. Workers will be allowed to split 100 percent of their untaxed contributions, but only 85 percent of their employer contributions. (Employer contributions are subject to a 15 percent tax, deducted from the gross contribution amount paid. The 85 percent limit will prevent employees from diverting more than their actual account balance.)

Australia's public pension system consists of the employer-based Superannuation Guarantee (SG) supplemented by a means-tested benefit (Age Pension). The SG is a system of mandatory individual accounts that are funded primarily through employer contributions equal to 9 percent of an employee's wages. Superannuation accounts are invested in diversified portfolios of equities and bonds by licensed fund managers. Accumulations may be withdrawn after the age of 55 if an individual is no longer working (this age limit will rise to 60 by 2025) or at age 65 whether working or not. The Age Pension is a means-tested benefit funded through general tax contributions that serves as a safety-net for retirees whose income falls below the poverty level. (See also the June 2004 issue of *International Update*.)

Sources: Watson Wyatt, December 2005; Aviva.com, December 30, 2005; *Australian* (Sydney), January 14, 2006.

Singapore

In January, Singapore's Central Provident Fund (CPF) took steps to enhance the employability of older workers and boost returns on investment savings. The new policies lowered contribution rates for workers between the ages of 50 and 55, reduced the covered earnings ceiling for all workers, and tightened the approval criteria for CPF investment products. The lower contribution rates will make older workers more attractive to employers, and the lower earnings ceiling effectively reduces employer costs of hiring higher-earning workers. These measures are part of Singapore's ongoing effort to address an aging workforce, international competition, and retirement security.

The CPF is the state-run mandatory savings program that workers can use for retirement, housing, health care, and education. Each year, it pays a guaranteed nominal rate of return of at least 2.5 percent. Singaporeans in search of higher returns may invest in more than 400 CPF-approved investment funds. (See also the May 2005 issue of *International Update*.)

The following changes were implemented on January 1:

- The combined employer-employee contribution rate for workers between the ages of 50 and 55 was reduced from 30 percent to 27 percent. The employer contribution rate went from 11 percent to 9 percent and the employee rate from 19 percent to 18 percent. (Reduced contribution rates for workers over the age of 55 have been in effect since at least 1999.) The contribution rate for younger workers will remain at 33 percent.
- The maximum monthly salary for CPF contributions was lowered again from S$5,000 (US$3,067) to S$4,500 (US$2,764). The salary cap has been lowered from S$6,000 in 2003 to S$5,500 in 2004 and to S$5,000 in 2005.

In response to poor investment returns, the CPF Board tightened criteria to approve new investment funds and insurance products for the more than S$75 billion (US$46 billion) of CPF funds. Existing CPF-approved funds and investment products will not be affected by these measures. New funds or products must now rank among the top 25 percent in their particular asset class worldwide instead of the top 50 percent as previously required. In addition, a new fund's expense ratio must fall below the median of existing CPF funds in a particular risk category. Median expense ratios will be reviewed annually.

Singapore is also studying additional ways to improve retirement security. One proposal would establish a default pension plan for all 3 million CPF members. Individuals would be allowed to pool their CPF savings and select from among several portfolios with differing risk-reward characteristics. Workers would be allowed to opt out of the default plan. Another proposal would require members to purchase a lifetime annuity at the age of 62 rather than accept the current default arrangement of receiving payments from the CPF for a fixed 20-year period. In addition, on January 26 the Tripartite Committee on Employability of Older Workers released recommendations to increase the effective retirement age beyond the age of 62 by enhancing the employment prospects of older workers through training, job redesign, and wage restructuring.

Sources: *International Herald Tribune*, May 14, 2005; *Business Times* (Singapore), September 27 and December 16, 2005; *Financial Times*, October 3, 2005; *Edge* (Singapore), October 10, 2005; *Straits Times* (Singapore), October 20, 2005; Central Provident Fund Board press releases, December 15 and 29, 2005; AFX Asia, December 29, 2005; Reuters, December 29, 2005; *TODAY* (Singapore), December 30, 2005; Dow Jones International News, December 30, 2005; Xinhua News Agency, January 26, 2006.

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

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SSA Publication No. 13-11712