Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

June 2006

Europe

United Kingdom

On May 25, the government released a white paper detailing proposals to reform the United Kingdom (U.K.) pension system and encourage workers to save more for retirement. "Security in Retirement: Towards a New Pension System" is the government's response to the Pensions Commission's recently released series of recommendations for reforming Britain's pension systems. (See the April 2006 issue of *International Update*.)

The U.K. provides two public pension benefits—a flat-rate basic state pension and an earnings-related second state pension. Workers may opt out of the second state pension and enroll in either an occupational defined benefit pension or a defined contribution pension.

The government's white paper identified the reform's objectives to be personal responsibility, affordability, simplicity, sustainability, and fairness. The proposals include:

- Establishing a new, low-cost National Pension Savings Scheme (NPSS) through funded individual retirement accounts. Employees not participating in an occupational pension plan would be automatically enrolled in NPSS but may opt out. Employers would be required to contribute to the accounts of employees that remain enrolled and contributions would be phased in over a 3-year period. Employees would contribute 4 percent of earnings between £5,000 (US$9,195) and £33,000 (US$60,688) per year; employers would make a minimum matching contribution of 3 percent per year; and the government would provide an additional 1 percent in tax relief.
- Providing a more generous basic state pension and second state pension by indexing initial benefits to wages rather than to prices beginning around 2012.
- Raising the age of benefit eligibility from age 65 to age 66 between 2024 and 2026; from age 66 to age 67 between 2034 and 2036; and ultimately to age 68 between 2044 and 2046.
- Reducing the number of years of contributions required to earn the full basic state pension to 30 years for both men and women. The current requirement for men is 44 years and for women, 39 years. This provision is designed to assist individuals, women in particular, who have fewer years of contributions because they take time off from work to care for children or a disabled family member. This change is expected to increase the percentage of women receiving a full basic state pension from the current rate of 30 percent to 70 percent by 2010 and to 90 percent by 2025.
- Allowing workers to opt out of the second state pension into occupational defined benefit plans only. Workers who have opted out into defined contribution plans would be automatically reenrolled into the second state pension.
- Extending coverage by the Financial Assistance Scheme (FAS) to individuals who are within 15 years of retirement age as of May 14, 2004. This would benefit an additional 30,000 individuals who lost significant amounts when their employer pension plans became insolvent. The government proposes to pay 80 percent of the insolvent plan's promised benefits to those within 7 years of their plan's pensionable age, 65 percent to those within 8 to 11 years, and 50 percent to those within 12 to 15 years. Currently, the FAS covers individuals on a case-by-case basis. (See also the December 2004 issue of *International Update.*)

The government is soliciting comments on the framework of the NPSS. The reform is expected to be submitted to Parliament for a vote in the fall 2006 session. The entire white paper is available at http://www.dwp.gov.uk/pensionsreform/pdfs/white_paper_complete.pdf.

Source: "Security in Retirement: Towards a New Pension System," Department for Work and Pensions (press release), May 25, 2006.

The Americas

Argentina

In response to rising inflation, the government increased all retirement pensions under the public system beginning June 1, 2006. Since the devaluation of the peso in 2002, accumulated inflation has now reached 81 percent. According to Sergio Massa, head of the National Social Security Administration (ANSES), the cost to increase the pensions will be 2.0 billion pesos (US$666 million) in 2006 and 3.5 billion pesos (US$1.2 billion) in 2007. The additional cost will be financed by ANSES without general revenue funds.

The minimum monthly pension was raised by 20.5 percent to 470 pesos (US$154) and all other pensions were increased by 11 percent. (Argentina's official poverty line is 277 pesos or US$90). The maximum pension is now set at 3,441 pesos (US$ 1,127) and the average pension is 602.5 pesos (US$197).

Minimum pensions have been increased 8 times since 2003, by a total of 213 percent. However, all other pensions have lost value because those above 1,000 pesos (US$327) have not been adjusted since 1992, and those between the minimum and 1,000 pesos have been adjusted only once since then. Of the country's 3.3 million pensioners, more than 2 million receive the minimum benefit; about 850,000 pensioners receive between the minimum and 1,000 pesos; and 320,000 receive more than 1,000 pesos.

Workers contributing to the public pay-as-you-go pension system may also direct part of their contribution to an individual account. At retirement, they receive a combination of benefits from the public pension system and their account. (See also the July 2005 issue of *International Update*).

Sources: *Social Security Programs Throughout the World: The Americas, 2005*; ANSES, "Información de Prensa" 9 de mayo de 2006; Reuters News, May 9, 2006; *Clarín* (Buenos Aires), May 10, 2006; *La Nación* (Buenos Aires), May 10, 2006.

Canada

On May 2, the federal government issued *Budget 2006*, which includes temporary funding relief for some defined benefit (DB) pension plans. The proposed measures would give sponsors of pension plans that cover employees in sectors regulated by the federal government an additional 5 years to eliminate their unfunded pension liabilities.

Current regulations require certain DB plan sponsors to fund outstanding plan deficits over a 5-year period, but many sponsors are finding this funding requirement financially burdensome. The decline in long-term interest rates in recent years has significantly increased plan liabilities and created serious deficits for many DB plans. Higher life-expectancy estimates will likely increase pension plan liabilities further.

The temporary options outlined in *Budget 2006* would allow pension plan sponsors that cover employees in federally regulated sectors to select one of the following:

- Consolidate solvency payment schedules and amortize the entire plan deficit in five equal payments over a single, new 5-year period.
- Extend the period for making solvency funding payments from the current 5 years to 10 years provided that pension plan members and retirees are fully informed of the change and that at least two-thirds of the current plan members and retirees do not object.
- Extend the period for making solvency funding payments to 10 years when the difference between the 5- and 10-year payment amounts is secured by a letter of credit.

Similar funding relief would also be extended to state-controlled enterprises at the federal level, including an option to consolidate solvency payment schedules over a new 5-year period and an option to extend current solvency funding payments to 10 years. The 10-year payment option for state-controlled enterprises must be approved by the Ministry of Finance.

Relief would be made available only to sponsors that have filed their plan valuation report between 2005 and January 2, 2008 and are current with their solvency funding payments. (Plan valuation reports indicate the funded status of plans and must be filed by federally regulated DB plan administrators at least every 3 years.) Detailed funding relief provisions were published on June 10, as draft regulations for comment. They will be submitted to the Cabinet for consideration later this summer.

The measures contained in *Budget 2006* are derived from a May 2005 consultation paper on pension plan funding rules circulated by Canada's Department of Finance. (See also the August 2005 issue of *International Update*.) They are similar to provisions signed into law in the province of Quebec last year. In that province, more than two-thirds of the 950 registered DB plans reported solvency deficits in 2002.

The Office of the Superintendent of Financial Institutions (OSFI) has statutory jurisdiction over pension plans in federally regulated sectors, such as transportation, financial services, and communications. As of June 2005, 1,283 pension plans were regulated by the OSFI, including 428 DB plans. About 72 percent of those plans were underfunded at that time, and assets in the average DB plan were sufficient to cover only 91 percent of pension obligations—down from 100 percent at the end of 2004. Less than 10 percent of all registered private pension plans in Canada, covering about 15 percent of all plan assets, are regulated at the federal level by the OSFI. Provincial authorities regulate the remaining 90 percent of registered pension plans.

Budget 2006 and related documents are available from the federal Department of Finance Canada website at http://www.fin.gc.ca/budtoce/2006/budliste.htm.

Sources: Régie des rentes du Québec, May 2005; Watson Wyatt, *InfoFlash*, May 2005 and *Global News Briefs*, May 2006; Canadian Ministry of Finance, *Budget 2006*, May 2, 2006; CBC News (Canada), May 2, 2006; Mercer, May 2, 2006; *Toronto Star*, May 3 and May 11, 2006; *Business Insurance*, May 8, 2006; *National Post* (Ottawa), May 4, 2006; Bureau of National Affairs, *Pension & Benefits Daily*, May 5, 2006; *Mondaq Business Briefing* (Canada), May 19, 2006; Office of the Superintendent of Financial Institutions (OSFI) Canada, June 2, 2006; and personal communication, official in the Regulation Sector of OSFI, June 2006.

Asia and the Pacific

Australia

On May 10, the government released a plan to simplify the tax treatment of mandatory individual Superannuation pensions and provide additional incentives for workers to save and extend their working years. Under the proposed plan, the following changes to Superannuation would go into effect on July 1, 2007:

- Private-sector benefits for people aged 60 or older would not be taxed. Benefits would still be available at age 55; however, taxes on those benefits would be levied until age 60. Benefits for civil servants would continue to be taxed after age 60, but at a reduced rate.
- Workers would no longer be obligated to receive benefits when they retire from employment. Currently, Australians must begin receiving benefits at age 65, unless they worked 240 hours or more the previous year. Benefits must be received at age 75, regardless of employment status.
- Age-based restrictions on employee account contributions that are tax deductible would be removed. Instead, there would be one upper limit for tax deductible contributions of AU$50,000 (US$38,000) per year. Workers over age 50 as of July 2007 would be able to contribute a maximum of AU$100,000 ($74,000) per year until 2012. Today, workers under age 35 may contribute a maximum of AU$14,603 (US$11,000) annually. Workers aged 35–49 may contribute a maximum of AU$40,560 (US$30,500) and workers age 50 or older may contribute up to AU$100,587 (US$76,000).

Benefits under the means-tested noncontributory Age Pension would be increased by reducing the annual benefit offset under the asset test from AU$78 ($US59) for every AU$1,000 in assets and annual income to AU$39 (US$29) for every AU$1,000 in assets and annual income. This change would allow a single average earner to hold an additional AU$165,000 (US$124,000) of assets before being disqualified for the Age Pension. An average earning couple would be allowed to hold AU$275,000 (US$207,000) in assets before losing eligibility. The Age Pension is paid to individuals and couples whose income and assets are below the poverty line. (For further information about the government's efforts to encourage greater savings for retirement, see also the February 2006 issue of *International Update*.)

The government is soliciting suggestions and comments on its plan until August 9, 2006. The entire plan is available at http://simplersuper.treasury.gov.au/documents/outline/download/simpler_super.pdf.

Sources: Bloomberg, May 9, 2006; "A Plan to Simplify and Streamline Superannuation," Australian Government, May 10, 2006; *Sydney Morning Herald*, May 11, 2006.

Reports and Studies

United Nations

On March 24, The United Nations (UN) Commission on Latin America released an assessment of the effectiveness of social protection programs in Latin America and the Caribbean entitled "Shaping the Future of Social Protection: Access, Financing and Solidarity." The report examines health care, pensions, and social programs for the indigent population in the region where 4 out of 10 people live in poverty.

Though pension reforms were enacted in many countries over the past 25 years, the study concludes that pension coverage is still not adequate in the region. A large portion of the working population, including seasonal and informal workers, does not participate in any pension system and thus is not eligible for any pension benefits. Only two countries in the region have noncontributory programs that provide benefits to a large segment of the elderly poor—Brazil's rural pension program and Bolivia's universal pension. In addition, since many workers covered by social security do not contribute on a regular basis, they are underinsured.

According to the UN report, in some countries, the transition costs from a pay-as-you-go system to individual accounts have "generated considerable short-term fiscal pressure." The report concluded that the "mixed" model, which maintains a public pay-as-you-go pension system supplemented by individual accounts has lower transition costs and allows for some redistribution to lower earners. Most of the countries that have replaced their pay-as-you-go systems with individual accounts provide a guaranteed minimum benefit targeted at lower earners but not workers with a limited number of contributions.

The study recommends:

- Expanding noncontributory programs to provide basic subsistence benefits to needy older adults. (The cost is estimated at 0.05 percent of each country's gross domestic product (GDP), compared with 2.2 percent of GDP for universal pensions to the elderly.)
- Improving pensions for lower-income workers regardless of the type of plan. For example, in Colombia, higher earners contribute 1 percent of earnings to subsidize lower earners' contributions.
- Providing incentives to encourage more regular participation in the defined contribution programs. One proposal would offer a proportionately reduced pension for those workers who have insufficient contributions to qualify for the minimum pension.
- Establishing an integrated system of pay-as-you-go, fully funded and noncontributory pension programs as well as subsidies for low-wage contributors.

The full text of the report can be found at: http://www.eclac.cl/publicaciones/SecretariaEjecutiva/3/LCG2294ses313I/lcg2294i.pdf.

Source: United Nations Economic Commission on Latin America, "Shaping the Future of Social Protection: Access, Financing and Solidarity," March 2006.

On April 27, *Principles for Responsible Investment* (PRI) was endorsed by leading financial institutions from 16 countries with more than $2 trillion in assets under management. The principles were developed to encourage institutional investors to integrate environmental, social, and governance (ESG) *best practices* into their investment decisionmaking and ownership practices. The initiative, sponsored by the United Nations, is the result of a year-long collaboration of more than 20 pension funds, foundations and special government funds, supported by international experts from the investment industry, government, and academia.

The six principles recommend voluntary actions that institutional investors and their asset managers may take to integrate ESG *best practices* when managing pension fund and other assets. Signatories to the global PRI initiative pledged to:

- Apply ESG *best practices* to investment analysis and decisionmaking processes;
- Incorporate ESG *best practices* in active ownership policies and procedures;
- Request disclosures of ESG practices from companies in which they invest;
- Promote the acceptance and implementation of PRI principles within the investment industry;
- Collaborate with other PRI signatories to enhance effective implementation of the principles; and
- Report on their progress towards implementing the principles.

A second phase of the PRI initiative will focus on: promoting its adoption by institutional investors, asset managers, and organizations offering products or services to them; providing resources to help investors implement the principles; and facilitating collaboration among signatories.

The full text of the *Principles for Responsible Investment*, information about the global initiative, and a list of PRI supporters can be found at http://www.unpri.org.

Source: *Principles for Responsible Investment*, United Nations, April 2006.

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