Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

November 2006

Europe

United Kingdom

On October 30, 2006, the Department for Work and Pensions recommended simplifying the State Second Pension (S2P) by changing it from an earnings-related benefit to a flat-rate benefit based on years of employment and a credit for caring for underage children or disabled family members. Under the proposal, the initial flat-rate benefit would be indexed to wages, and benefit increases would be indexed to prices. This recommendation was included in the release of two white papers, *Response to the Fourth Report of the Work and Pensions Select Committee* and *Summary of Responses to the Consultation*, that respond to comments, questions, and concerns raised since the government's public pension reform proposals were announced on May 25, 2006. (See also the June 2006 issue of *International Update*.)

Response to the Fourth Report of the Work and Pensions Select Committee indicated that Parliament's Select Committee was generally in favor of the reform proposals as highlighted in the white paper. One of the few concerns raised by the committee was the proposed gradual increase in the retirement age from 65 to 68, between 2024 and 2046. The committee was particularly concerned about whether manual laborers and individuals with chronic health problems would be disproportionately affected. The government's response was that the proposed retirement age increases were in keeping with the overall trend in improved health and longevity and would not adversely affect any one segment of the population.

The *Summary of Responses to the Consultation* discussed the issues raised from May 25 to September 11, 2006, by individuals and organizations. Generally, the respondents agreed with the direction and core principles of the reforms.

In both white papers the government stated that all of the reform proposals were consistent with the government's underlying principles of promoting responsibility, affordability, fairness, simplicity, and sustainability.

Sources: Department of Work and Pensions, press release, October 30, 2006; *Security in Retirement: Towards a New Pensions System, Summary of Responses to the Consultation*, Department of Work and Pensions, October 30, 2006; *Report on Pension Reform: Government Response to the Fourth Report of the Work and Pensions Select Committee*, Department of Work and Pensions, October 30, 2006; *Guardian Unlimited*, October 30, 2006.

The Americas

Argentina

In early November, La Nación, an affiliate of the National Bank of Argentina and the country's state-run pension fund management company, lowered its fees to increase its share of account holders. The government's pension regulator approved La Nación's request to reduce its fees from 2.35 percent to 2.10 percent of a worker's monthly earnings. The average monthly fee for the 11 pension fund management companies (AFJPs) is 2.58 percent, with rates ranging from 2.05 percent to 2.90 percent. The fees include both the AFJPs' administrative commissions (on average, 1.145 percent) and the cost of survivors and disability insurance (on average, 1.426 percent).

Since 1994, workers covered by the public pay-as-you-go system for a basic universal old-age benefit have had a choice between receiving an additional benefit from the public system and contributing to an individual retirement account managed by an AFJP. Currently, about 2 million workers are covered by the public system only, and about 11 million workers are covered by the public system and have individual accounts.

Workers who enter the labor force and do not make a choice between an additional public benefit and an individual account are assigned to an AFJP whose fees fall at or below a certain threshold, currently 2.10 percent of monthly earnings. After reducing its fees, *La Nación* is entitled to one-quarter of the "undecided" new workers. In 2005, 83 percent of new account holders were "undecided" compared with almost 50 percent since the inception of the program in 1994.

In the past 12 months, about 20 percent of all transfers switched from another AFJP to *La Nación*. A worker may change companies after making four monthly contributions to an AFJP; two transfers are permitted each year. At the end of September, *La Nación* had more than 1 million members, about 9 percent of all AFJP account holders. Its assets under management were close to 14.5 billion pesos (US$4.7 billion), or 14.4 percent of all AFJPs. *La Nación's* gross nominal rate of return has averaged 17.1 percent since 1994 compared with an average of 15.1 percent for all of the other AFJPs.

Argentina's public pension system is financed by worker contributions of 11 percent of earnings, employer contributions of either 10.71 percent or 12.71 percent (depending on the type of enterprise), and government contributions from general revenue, investment income, and certain earmarked taxes. Workers who elect the individual account option contribute 7 percent of their monthly earnings to an individual account and the AFJP deducts its commissions and the cost of survivors and disability insurance from the contribution; employers do not contribute.

During the economic downturn in late 2001, the government increased take-home pay by lowering workers' contribution rates for both the public system and the individual accounts from 11 percent to 5 percent. By early 2002, the government had raised the public pension contribution rate back to 11 percent of earnings and the individual account rate to 7 percent. Although the government has postponed several contribution rate increases for the individual account system, the rates are scheduled to increase to 9 percent on January 1, 2007, and to 11 percent in July 2007. The workers' contribution rate to the public system will remain unchanged.

Sources: *Social Security Programs Throughout the World: The Americas, 2005; Noticias Financieras*, 21 de Julio de 2006; Fund Pro Latin America, July 13 and October 4, 2006; SAFJP *Boletín Estadístico Mensual*, Octubre 2006; *Business News Americas*, November 2, 2006.

Canada

Beginning December 12, Ontario employers will no longer be able to mandate that all workers retire at age 65. The Ending Mandatory Retirement Statute Law Amendment Act, 2005, which passed Ontario's legislative assembly a year ago by a wide margin, amended the Ontario Human Rights Code (OHRC) and abolished the employer option of mandating retirement at age 65 for workers. The new law now applies age discrimination protection to workers aged 65 or older.

The law provides for a 1-year transition period to enable employers to:

- Familiarize themselves with the act and its possible effects on the workplace;
- Consider necessary changes to existing workplace retirement policies; and
- Discuss with their unions required changes to collective bargaining agreements.

The "bona fide occupational requirement" of the OHRC allows mandatory retirement for labor categories that require certain physical abilities. Employers will not be required to reinstate workers who turned age 65 before the law is implemented or who retire during the transition period. Similar laws repealing mandatory retirement have been adopted in the provinces of Manitoba and Québec and have been proposed in Saskatchewan.

Nationwide, Canadians with at least 10 years of residency after the age of 18 are eligible for a universal pension. Withdrawal from the workforce is not necessary to access this pension benefit. Two earnings-related retirement pensions are also available: the Canada Pension Plan (see also the April 2004 *International Update*) and the Québec Pension Plan for residents of that province. Early pensions at a reduced amount may be taken at age 60 if employment is fully or substantially ceased.

Sources: *HRM Guide*, June 2005; "FAQ: Mandatory Retirement," Ministry of Labour, December 12, 2005; "Countdown to End of Mandatory Retirement in Ontario," Ministry of Labour, September 2006; Watson Wyatt, September 2006; *The Hamilton Spectator* (Canada), October 14, 2006; Cassels Brock, October 27, 2006; Social Security Worldwide, October 27, 2006; CTV.ca, November 7, 2006.

Asia and the Pacific

Vietnam

Vietnam will offer its first occupational pension plan in early 2007. The Vietnam Fund Management Company (VFM) has announced that it will offer employers defined contribution plans soon after the applicable regulations become effective in January 2007. Although the contribution rate for the new pensions has not been determined, the VFM estimates that it will collect between 50 billion dong (US$3.1 million) and 100 billion dong (US$6.2 million) from employers and employees within the first year of operation.

International financial experts agree that before the passage of the Securities Law on June 23, 2006, insufficient government regulations and accounting standards made defined contribution pension funds risky. The new law strengthened the framework for the country's existing stock market by establishing accounting standards for publicly traded companies as well as providing greater oversight of stock brokerage companies and the stock exchange. The intention of the new regulations, which will be overseen and enforced by the State Securities Commission, was to bring Vietnam within the international standards required for membership in the World Trade Organization.

Vietnam established its public pay-as-you-go system, the Old-Age Pension, in 2002. Participation is mandatory for all public- and private-sector workers, except for the self-employed. Employees contribute 5 percent of gross monthly wages and employers contribute 10 percent. Full pension benefits are paid after 20 years of contributions at age 60 for men or at ages 55 (women) and 50 (men) with at least 30 years of contributions.

Public pension benefits replace 45 percent of average lifetime earnings. Men receive an additional 2 percent of lifetime earnings for each year of contributions paid after 15 years and women receive an additional 3 percent. The maximum benefit replaces 75 percent of a worker's average earnings for the last 5 years of employment. Workers who contribute to the public pension system for more than 30 years also receive a lump-sum benefit equal to 50 percent of their average monthly earnings over the last 5 years. Retirement is required to receive benefits.

Workers who do not qualify for an Old-Age Pension receive a noncontributory Old-Age Grant from the government at normal retirement age. It provides a lump-sum benefit equal to 50 percent of a worker's average monthly earnings in the last 5 years of employment, multiplied by the number of years of employment.

Sources: Vietnam News, February 2, 2006; Thai Press Reports, May 30, 2006; Yahoo! Asia News, June 23, 2006; Vietnam Economy, September 25, 2006; Vietnam News, October 24, 2006; *Social Security Programs Throughout the World: Asia and the Pacific, 2006* (forthcoming, March 2007).

Reports and Studies

European Commission

On October 12, the European Commission (EC) urged European Union (EU) member countries to balance their budgets to address the impact of aging populations on public finances. *The Long-Term Sustainability of Public Finances in the EU* report recommends measures to lower public debts, raise employment rates, and improve productivity while emphasizing the need for pension, health care, and long-term care reforms. This document, the EC's first report devoted exclusively to the long-term fiscal sustainability of EU member countries, builds on EC projections released in February 2006. (See also the March 2006 issue of *International Update*.)

The report highlights the fiscal challenges arising from fertility rates that are well below the natural replacement rate of 2.1 (1.48 in 2004); retiring post-World War II baby boomers; and continuing increases in life expectancy (more than 1 year per decade to 2050). These factors are projected to result in annual age-related expenditures for the EU region increasing by about 4 percent of gross domestic product (GDP) by 2050, with some member countries likely to experience increases of 7 percent or more.

In addition to its EU regional analysis, the report assesses EU member countries by the level of risk to their long-term fiscal sustainability.

- *High-risk countries* (Cyprus, Czech Republic, Greece, Hungary, Portugal, and Slovenia) are projected to experience increases in age-related expenditures of 5 percent of GDP or more by 2050. These countries currently have large budget deficits.
- *Medium-risk countries*, where the long-term budgetary impact from aging is more limited (2 percent to 5 percent of GDP), are divided into three categories: countries with relatively strong fiscal positions but with significant age-related costs requiring reform (Ireland, Luxembourg, and Spain); countries whose age-related costs have been reduced through pension reform but that still need to improve their public finances (France, Germany, Italy, Malta, Slovakia, and the United Kingdom); and Belgium, which has characteristics common to the other categories among the medium-risk countries.

- *Low-risk countries* (Austria, Denmark, Estonia, Finland, Latvia, Lithuania, Netherlands, Poland, and Sweden) have made the most progress in addressing population aging. These countries have either strengthened their budgets (Denmark, Finland, and Netherlands), implemented comprehensive pension reforms (Austria, Estonia, Latvia, Lithuania, Poland, and Sweden), or applied both measures (Estonia, Latvia, Lithuania, and Sweden). The long-term budgetary impact from aging is more moderate in these countries (increase of 2 percent of GDP or less), and their pension expenditures as a share of GDP are expected to decrease between 2020 and 2050. However, spending on health care and long-term care expenditures is expected to exceed the positive impact from reduced pension expenditures.

According to the report, without reform, average public debt in the EU region will grow from today's 63 percent of GDP to more than 200 percent of GDP by 2050. The report recommends that EU members address the budgetary impact of population aging by:

- Achieving fiscal sustainability and lowering public debt before the full impact of aging takes hold;
- Increasing employment rates (especially among women and older workers) and enhancing labor productivity; and
- Reforming pension, health-care and long-term care systems while securing the core program goals of adequacy and access.

The full text of the report and related materials are available at http://ec.europa.eu/economy_finance/publications/european_economy/2006/ee0406sustainability_en.htm.

Sources: *The Impact of Ageing on Public Expenditure*, European Commission, February 15, 2006; *The Long-Term Sustainability of Public Finances in the European Union* and *Communication from the Commission to the Council and the European Parliament*, European Commission, October 12, 2006.

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Editor: Denise Lamaute.

Writers/researchers: Barbara E. Kritzer, Jennifer McNabb, David Rajnes, and Craig Romm.

Social Security Administration
Office of Policy
Office of Research, Evaluation, and Statistics
500 E Street, SW, 8th Floor
Washington, DC 20254

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