Europe

Netherlands

On January 1, 2007, a law overhauling Dutch private pension funding requirements took effect. The legislation, known as the Pension Act, passed parliament on December 5, 2006, and replaces the Pension and Savings Funds Act of 1952. Proponents of the Pension Act argued that the 50-year-old Pension and Savings Funds Act, which had been amended numerous times, was out-of-date and difficult to understand.

One of the goals of the Pension Act is to create clear communication channels among employers, private pension plan providers, and participants. Specifically, the act:

- Establishes the concept of a “pension administrator” and removes the distinction between pension funds and insurers;
- Requires pension plans to state explicitly if and how pensions are indexed;
- Requires pension plans to abide by the good governance principles established in the December 2005 Stichting van de Arbeid labor foundation report, which details labor representatives’ response to the Netherlands’ mandatory annual National Reform Programme report;
- Requires that employers provide clear pension eligibility information to new employees within 3 months of hire; and
- Lowers the age at which workers can enroll in a pension fund from 25 to 21.

The new law establishes a framework for financial assessment of private pension funds. It requires that private pension funds be tested annually to ascertain if they meet the minimum solvency and contribution requirements. Within a given year, funding shortfalls must be less than 2.5 percent. At the end of the second quarter of 2006, Dutch pension fund assets were approximately €640 billion (US$813.2 billion).

The Netherlands’ social insurance system, which includes a universal old-age and survivors pension as well as disability benefits, covers all residents who meet earnings and contribution requirements. Workers contribute 17.9 percent of annual earnings between €13,160 (US$17,056) and €29,543 (US$38,290) for the old-age pension and 1.25 percent for the survivors pension. Employers contribute 5.4 percent of wages within the same annual earnings range for disability pensions. In some cases, the government provides a subsidy to retirees whose pensions fall below the minimum monthly pension amount of €784 (US$1,016) for single persons and €1,088 (US$1,410) for couples (whether married or not).


Portugal

A new social security law implemented in January requires major changes to Portugal’s pay-as-you-go public pension system to maintain the program’s solvency. The law incorporates the provisions of the agreement on social security reform between the government and its social partners signed in October 2006. (See the July 2006 issue of International Update.)

The reforms will be phased in and include:

- A “sustainability factor,” beginning in 2008, linking initial benefits to average life expectancy (ALE) when a worker retires. An increase in the country’s ALE is expected to result in a lower initial monthly benefit than that paid to workers who retired when the ALE was lower. Workers may work longer to increase their benefits.
- Benefits indexed annually, beginning in 2008, to the new measure of social support, known as indexante de apoios sociais (IAS), rather than to changes in the national minimum wage. The IAS will be adjusted to the changes in the consumer price index (CPI) plus growth in the country’s gross domestic product (GDP), in contrast to the national minimum wage that is adjusted according to changes in the CPI. Every 5 years the IAS will be reviewed to assess whether it is meeting its goal: maintaining the purchasing power of pensions

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and the financial sustainability of the social security system.

- A transitional benefit formula for workers who begin contributing to social security between 2001 and 2016. The transitional formula uses a combination of two formulas: the 10 best of the last 15 years of earnings and average adjusted lifetime earnings. Before 2001, benefits were based on the 10 best of the last 15 years of earnings. Beginning in 2017, all new pensions will be calculated on the basis of average adjusted lifetime earnings.

- A “national strategy for the promotion of active aging” that encourages older workers to remain in the labor force, prevents and combats the unemployment of older workers, and establishes a nationwide education program on employing older workers.

- A new supplementary government-run, voluntary individual retirement account system financed by employees covered by social security. A new government agency, the Management Institute of Social Security Individual Accounts, will be established to oversee and contract out some of the program functions.

By 2020, without reform, the social security deficit is projected to reach 3.5 percent of the country’s GDP. The government predicts that the percentage of the population aged 65 or older will rise from 17 percent in 2005 to 32 percent by 2050. Also, the fertility rate has decreased from 2.6 children per woman in 1976 to 1.5 today.


Spain

Effective January 1, 2007, Spain’s new income tax law reduces occupational pension tax incentives for both employers and employees. The changes to the tax rules for pension plans include:

- Reducing the maximum allowable combined employee/employer contribution: for employees aged 50 or younger, to €10,000 (US$12,961) or 30 percent of an employee’s earnings, whichever is lower; and for those over age 50, to €12,500 (US$16,201) or 50 percent of earnings, whichever is lower. Under the old rules, the employee (up to age 52) and the employer each had a contribution limit of €8,000 (US$10,364). From age 53 to age 65, the amount increased gradually to €24,250 (US$31,430).

- Eliminating, in 2011, the 10 percent tax rebate to employers on employee’s earnings of up to €27,000 (US$34,994).

- Encouraging employees to buy annuities by removing the 40 percent employee’s tax deduction on lump-sum retirement benefits.

- Allowing individuals to continue making contributions to their pension plan after they retire. Until December 31, 2006, retirees could contribute only to increase a pension for their survivors.

The new law introduced another type of pension plan called an occupational provident plan that provides a guaranteed interest rate and has no pension plan control committee. Also, banks will begin to offer individual systematic savings plans known as planes individuales de ahorro sistemático (PIAS) to supplement pension savings. Contributions to PIAS may not exceed €8,000 (US$10,364) per year and may be invested in stocks, life insurance, and mutual funds. PIAS will have no tax incentives.

Source: ABC, December 31, 2006; Watson Wyatt News, January 2007; El Pais, el 14 de enero de 2007; Cinco Dias, el 19 de enero de 2007; Ministerio de Economía y Hacienda, el 20 de enero de 2006.

The Americas

Canada

On December 13, 2006, the provincial government of Quebec overhauled its funding rules for private defined benefit pension plans. The new legislation, Bill 30, An Act to Amend the Supplemental Pension Plans Act, is intended to protect private pension benefits by improving plan funding, governance, and services offered by pension committees and pension plan providers. The bill completely revises the 1990 private defined benefit plan funding rules after lengthy discussions and public consultation.

The new pension funding measures included in Bill 30 apply to all private defined benefit plans except those associated with universities, municipalities, and childcare centers. The changes, which go into effect in 2010, include:

- Establishing a provision for adverse deviation that will require plan sponsors to make additional contributions whenever a defined benefit plan experiences a deficit (adverse deviation is the risk that the estimated value of pension obligations at plan termination are higher than previously estimated).
• Allowing plan sponsors to use a letter of credit up to 15 percent of the plan’s solvency liabilities to guarantee all or part of the required solvency contributions,
• Bringing solvency ratios to 90 percent by mandating accelerated funding, and
• Requiring an annual actuarial valuation report if a plan is not fully funded.

Although Bill 30 indemnifies individual pension committee members in certain situations and under certain conditions, it also imposes stricter guidelines for plan operation and governance. By the end of 2007, committees must adopt ethics bylaws and publish the duties and obligations of committee members.

Bill 30 will affect approximately 1.4 million people, or 26 percent of Quebec workers, who are members of at least one of the more than 1,700 defined benefit pension plans. Pension plan member protections incorporated in Bill 30 include a requirement that service providers notify the pension committee of any situation that might adversely affect the fund’s financial interests. Beginning in 2010, plans must ensure that active members, nonactive members, and beneficiaries are treated equitably whenever any fund surpluses are used.

Private pension plans supplement the Canadian public pension system. Generally, Canadian workers are covered by a noncontributory flat-rate universal old-age pension. The government of Quebec opted out of participating in the earnings-related Canada Pension Plan. Quebec’s workers are covered by a similar public earnings-based pension plan called the Quebec Pension Plan.


Asia and the Pacific

Bahrain

Bahrain reported that its public pension system faces bankruptcy in about 20 years. A 2005 actuarial study by the Financial Audit Bureau, an office within the Audit Directorate of the Ministry of Finance, concluded that Bahrain’s pension system would be unable to meet its obligations to government workers by 2026 and to military personnel by 2035 without immediate corrective measures. (See also the November 2005 issue of International Update.)

The 2005 deficit of 3.1 billion dinars (US$8.2 billion) includes shortfalls in both the Pension Fund Commission (PFC), which covers government employees and military personnel, and the General Organization for Social Insurance (GOSI), which covers private-sector workers. PFC has a deficit of 2.4 billion dinars (US$6.4 billion) and GOSI has a deficit of 740 million dinars (US$1.96 billion).

According to a September 2006 actuarial report, the imbalance between benefits and contributions began in 1986 when the government reduced the contribution rate from 21 percent to 15 percent for both pension funds. Also in 1986, the government increased the replacement rate from 75 percent to 88 percent. The report noted that an average employee receives a return of 12.1 percent on contributions.

Currently, government employees and military personnel contribute 7 percent of their wages to PFC and the government contributes 14 percent of wages, up from 5 percent and 12 percent, respectively, before 2005. The PFC provides a monthly pension at age 60 to public employees with 25 years of service. The fund covers approximately 78,000 government employees and currently pays benefits to 2,230 retirees. (Bahrain does not release information on military personnel.)

Private-sector employees contribute 5 percent of their wages to GOSI and employers contribute 7 percent, subject to a salary cap of 4,000 dinars (US$10,610) per year. GOSI currently pays benefits to 4,616 retirees.


Pakistan

On January 8, the Securities and Exchange Commission of Pakistan (SECP) formally launched its new Voluntary Pension System (VPS) by certifying four asset management companies to operate as pension fund managers. The government introduced the VPS to increase long-term savings and promote the growth of the country’s financial markets. The VPS was designed especially for self-employed individuals and workers without occupational pension plans.

The SECP, which regulates Pakistan’s corporate sector and capital markets (including insurance companies and private pensions), began developing the VPS framework in June 2003 with the formation of a study committee
consisting of representatives from the private sector, the Ministry of Finance, and the SECP itself. Draft regulations and guidelines for a tax-deferred VPS system were issued in January 2005. (See also the April 2005 issue of International Update.) Later that year, Finance Bill 2005 amended the income tax laws, which paved the way for the VPS to begin operation in 2007.

Under the VPS:

- Pakistani citizens over age 18 who have a valid national tax number and who are not covered by an occupational pension plan may open an individual pension savings account with a registered VPS pension fund manager. Participants may switch their account balance among VPS pension funds once a year.
- Participants may contribute up to 20 percent of their net taxable income in a year. Catch-up provisions allow participants over age 40 to make additional contributions to their VPS account. Employers may also contribute to their employee’s VPS account. In all cases, the total combined (employee and employer) annual contribution is limited to 50 percent of the worker’s net taxable income and must not exceed 500,000 rupees (US$8,251) in any one year. VPS contributions and investment income are exempt from taxes, but VPS benefits are generally taxed.
- Tax penalties apply to participant withdrawals before age 60. By age 75, participants must annuitize any remaining VPS account balance.
- Benefit payouts take one of two forms:
  1. A tax-free cash withdrawal of up to 25 percent of the account balance, with the remainder of the account balance used to purchase an annuity from a VPS-approved life insurance company, or
  2. A tax-free cash withdrawal of up to 25 percent of the account balance, a withdrawal of the remaining account balance in planned monthly installments until age 75, and, after age 75, the purchase of an annuity with the remaining VPS account balance from a VPS-approved life insurance company.
- Asset management companies and life insurance companies may apply to become a registered pension fund manager. Life insurance companies may also be authorized to offer VPS annuities. VPS rules cap front-end and investment management fees.
- Pension fund managers must offer VPS participants at least four preset investment portfolios (very conservative, conservative, balanced, and aggressive). Participants who fail to select one of the portfolio choices are assigned to a default portfolio. Currently, pension fund managers invest in equities, debt, and money market asset classes. Future asset classes may include real estate and international investments.

Pakistan is a relatively young country with few of its workers participating in the social security system or occupational retirement plans. According to the 2002 Pakistan Labour Survey, less than 2 million of Pakistan’s 43 million workers were covered by social security in that year. The private-sector pension industry estimates that perhaps as few as 1 million workers are covered by private-sector retirement plans. Pakistan’s 1 million military personnel and public employees are covered by a noncontributory defined benefit pension plan.