Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

April 2007

Europe

Romania

Romania's Minister of Economy announced in March 2007 that contributions for mandatory occupational individual account pensions will begin in January 2008. Generally, workers with individual labor contracts or those who earn over a certain threshold are required to participate in Romania's first-pillar public defined benefit pay-as-you-go (PAYG) system. Now, workers aged 18–35, who are required to participate in the first-pillar PAYG system, must also participate in the new second-pillar occupational pension system, which is a defined contribution system. Workers aged 36–45 may voluntarily participate in the new second-pillar plan. Workers older than age 45 will participate in the first pillar only.

Employees and employers currently contribute a total of 30 percent of the employee's gross earnings (employees contribute 9.5 percent and employers contribute 20.5 percent) to Romania's PAYG system. The rate increases to 40 percent for more arduous jobs. The worker's initial occupational pension contribution rate of 2 percent will increase annually by 0.5 percent until 2010 when it reaches 6 percent. Thus, the employee's PAYG contribution will be reduced to 7.5 percent (eventually down to 3.5 percent) of gross wages.

To receive full retirement benefits under the PAYG pension system, men must be aged 63 (rising to 65 by December 2014) with 31 years of contributions. Women must be aged 57 and 9 months (rising to 65 by December 2014) with 25 years and 9 months of contributions. Early pensions are allowed up to 5 years before the full retirement age but only when contributions have been made for at least 10 years beyond the required contribution period.

The Private Pension Supervisory Commission announced in February 2007 that one occupational pension plan received a second-pillar license and up to nine more funds will probably obtain licenses. Providers of second-pillar pension plans must have a minimum of 50,000 participants to obtain a license. The Romanian government estimates that 2.5 million people will participate in one of these second-pillar plans beginning in January 2008, and assets are expected to reach €800 million (US$1.06 billion) by 2010.

In addition to the first-pillar public and second-pillar occupational pension systems, workers may now voluntarily contribute to a variety of third-pillar individual pension plans. The third-pillar plans are defined contribution systems. Participation in voluntary plans is expected to reach 500,000, with approximately €300 million (US$399 million) in assets by 2010.

Romania began reforming its pension system in 2000 when it began to seek membership in the European Union (EU). Its pension reform measures included establishing mandatory occupational and voluntary pension plans, increasing the retirement age, increasing the number of years of service required to obtain a pension, and extending coverage to include more workers. (See also the August 2005 and July 2004 issues of *International Update*.) Romania joined the EU on January 1, 2007.

Sources: *Social Security Programs Throughout the World: Europe, 2006*; *Mercer*, February 7 and 22, and March 7, 2007; *Rompres*, February 27, 2007; personal communication, financial reform program manager, U.S. Agency for International Development, February 27, 2007.

The Americas

Argentina

A new law effective March 8, 2007, permits Argentine workers to switch from the individual retirement account system to the pay-as-you-go defined benefit pension system. The old law allowed transfers only from the PAYG system to the individual account system. In a January survey conducted by *La Nación*, one of the country's leading newspapers, 54 percent of eligible workers surveyed indicated that they would choose the PAYG retirement system over the individual account system, 36 percent would stay in the individual account system, and the remaining workers had no opinion. The new law also strengthens the PAYG system.

Provisions of the law regarding switching between the individual account and the PAYG pension systems include the following:

- Workers with an individual retirement account have 180 days to change to the PAYG pension system beginning April 12, 2007. The change will be effective January 1, 2008. Once every 5 years after that, the President may allow another 180-day period for workers (men younger than age 55 and women younger than age 50) to switch to the PAYG system. Workers within 10 years of retirement will not be permitted to switch to the PAYG system unless they have less than 20,000 pesos (US$6,458) in their individual account.
- New labor force entrants (beginning April 1, 2007) who do not choose a system within 90 days of starting work will be assigned to the PAYG system.
- Workers may continue to switch from the PAYG to the individual account system at any time.
- A worker's individual account balance is transferred to the PAYG pension system when the worker switches to the PAYG system. At retirement, that worker will receive one benefit that represents accrued rights for the years contributed to each system.

Under the old rules, the "undecided" new workers were assigned to one of the pension fund management companies (AFJPs) in the individual account system whose administrative fees were below a certain threshold. (See also the November 2006 issue of *International Update*.) Since 1994, an average of 50 percent of new workers failed to choose an AFJP each year. More recently, the percentage of undecided workers has increased from 15.3 percent of new workers from 1994–1995 to 83 percent of new workers from 2005–2006.

Provisions of the new law that help strengthen the PAYG system include the following:

- Raising the contribution wage ceiling from 4,800 pesos (US$1,550) a month to 6,000 pesos (US$1,937) a month, effective January 1, 2008. About 200,000 people will be affected by this change.
- Increasing the number of months of contributions required to qualify for a benefit for workers who earn more than 6,000 pesos a month (US$1,937) from 330 to 420 months for the individual account system and from 528 to 660 months for the PAYG pension system.

Since 1994, workers covered by the PAYG system for a basic universal old-age benefit have had a choice of either receiving an additional earnings-related benefit (PAP) from the PAYG system or contributing to an individual retirement account managed by an AFJP. The new law increases the retiree's PAP benefit from 0.85 percent to 1.5 percent of the worker's average earnings in the 10 years before retirement for each year the worker contributed to the PAYG system after 1994, up to a maximum of 35 years.

Effective January 1, 2008, the new law equalizes employee contribution rates for both the PAYG and private pension systems at 11 percent of earnings. During Argentina's economic downturn in late 2001, the government increased workers' take-home pay by lowering their contribution rates from 11 percent to 5 percent for both retirement systems. 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. Additional increases in the contribution rate for the individual account system were not implemented until now.

The new law also requires AFJPs to adhere to the following:

- Limit the fees charged to account holders to 1 percent of a worker's earnings. The current average AFJP administrative fee is about 1.2 percent of earnings.
- Invest from 5 percent to 20 percent of their assets under management in domestic infrastructure projects.
- Charge everyone the same premium for survivors and disability insurance. As of February 2007, the monthly survivors and disability insurance costs among all AFJPs ranged from 0.9 percent to 1.8 percent of a worker's earnings.

Currently, 11.3 million workers have individual retirement accounts and 2.6 million workers are covered by the PAYG pension system. A worker may change pension fund management companies after making four monthly contributions to an AFJP; two transfers are permitted each year. Eleven AFJPs manage a total of US$30 billion in assets. The average real rate of return since 1994 is 10 percent.

Sources: *Social Security Programs Throughout the World: The Americas, 2005*; SAFJP, *Boletín Estadístico Mensual*, febrero de 2007; Reuters Noticias Latinoamericanas, el 24 de enero, el 7 de mayo de 2007; *Clarín*, el 28 y el 30 de enero, el 25 y el 28 de febrero, el 8 de marzo de 2007; *Boletín Oficial de la República Argentina*, el 8 de marzo de 2007.

Asia and the Pacific

Taiwan

On March 2, 2007, Taiwan's parliament passed a law establishing a supervisory commission to manage the Labor Pension Fund (LPF) assets. The commission, subject to parliamentary oversight, will select fund managers to invest in a variety of asset classes including domestic and foreign equities, fixed income, and balanced products. Currently, the LPF deposits these assets in low-yielding bank accounts. The government has indicated that the commission should begin operations within 6 months.

Since July 1, 2005, private-sector employees have been covered by the portable individual defined contribution retirement accounts system created under the 2004 Labor Pension Act (LPA). LPA replaces Taiwan's employer-based defined benefit retirement system for all individuals who enter the labor force or change employers after July 1, 2005. (See also the July 2004 and April 2005 issues of *International Update*.) Employees covered by the old defined benefit system may join the new LPA system by 2010 and retain their right to severance and retirement benefits accrued under the old system, provided that they remain with the same employer. Currently, 4.3 million out of 5.6 million employees, representing 77 percent of private-sector workers in 363,590 Taiwanese companies, participate in the new LPA system.

Under the LPA system, employers generally contribute 6 percent of an employee's monthly earnings into the employee's account. The employee's maximum monthly earnings for contribution purposes equal NT$150,000 (US$4,534). Employees may voluntarily make tax-deductible contributions of up to 6 percent of their monthly salary with full vesting in their own and in their employers' contributions from the date of employment. At retirement (age 60 or older), employees with less than 15 years of service under the new retirement system receive a lump-sum benefit; employees with more than 15 years of service can elect to receive either a lump-sum benefit or a monthly pension.

The average return on LPF investments must not fall below the 2-year time deposit savings rate set by the central bank, which has averaged 2 percent in recent years. The government must make up any shortfall below this guaranteed rate of return and has paid about NT$407 million (US$12 million) into the LPF so far. The government anticipates that using outside fund managers to manage the LPF investments could boost the average return on nearly NT$142 billion (US$4.3 billion) in LPF assets to as high as 4 percent annually.

The government estimates that annual contributions under the new retirement system, currently about NT$96 billion (US$2.9 billion), could grow to between NT$150 billion (US$4.5 billion) and NT$200 billion (US$6 billion) with the potentially higher rates of return that are likely with outside asset managers. Also, it expects employees to make voluntary contributions. On that basis, officials project a potential LPF asset accumulation of NT$3 trillion (US$91 billion) in 15 years.

Under the old defined benefit system, employers are required to contribute from 2 percent to 15 percent of payroll—based on years of service, salaries, turnover rates, and retirement rates—to a government-administered pension reserve fund established by the company. The old employer-based defined benefit system pays a lump-sum benefit at retirement to employees aged 55 or older with at least 15 years of service (or at any age with at least 25 years of service). Under the old defined benefit retirement system, employees lose their right to a lump-sum benefit if they change jobs or otherwise fail to complete at least 15 years of service. However, many workers are unable to collect these retirement benefits because most small- and medium-sized firms in Taiwan have a life cycle shorter than 15 years.

Sources: *AIG Group Management Division Far East Newsletter—Country Updates (Taiwan)*, February 2005; Hewitt, March 3, 2005; taiwanheadlines.gov.tw, March 2, 2007; *China Post*, March 3, 2007; *Taipei Times*, March 3 and 5, 2007; *Taiwan Business News*, March 4, 2007; Economist Intelligence Unit, March 5, 2007; *Financial Times*, March 5 and 19, 2007; *Taiwan Journal*, March 9, 2007.

Africa

South Africa

On February 23, 2007, the National Treasury released a paper on the government's agenda for comprehensive reform of South Africa's pension system by 2010. The reform agenda includes the creation of a public pay-as-you-go social security system as part of a multipillar system. Currently, the only retirement benefits provided to private-sector workers by the government are social assistance grants for retired South Africans with limited income. The government views the introduction of a first-pillar contributory retirement plan as an essential element to improve the quality of life for retirees in South Africa.

Although the government will draft many of the specific pension reform provisions in coming months, its agenda sets forth a series of reform goals to guide the process. These goals include the following:

- A mandatory national social security system (first pillar) providing basic old-age, survivor, death, and disability benefits
- Mandatory private occupational or individual retirement funds (second pillar) for individuals with earnings above a yet to be determined earnings threshold
- Supplementary voluntary savings plans (third pillar)

- A mandatory unemployment program
- Social assistance grants funded from general government revenue

Since 2004, South Africa has provided means-tested social assistance grants, funded from general revenue, to private-sector workers. These grants pay a maximum monthly retirement benefit of 870 rand (US$120) to women aged 60 or older and men aged 65 or older and will probably continue after reform.

The government plans to provide a retirement benefit under its proposed mandatory national social security system fixed at 40 percent of final salary for each covered individual. The system will be funded with a combined employer and employee payroll tax of 14 percent to 18 percent of salary. The government is considering wage subsidies to minimize the impact of the new payroll tax on both low-wage earners and their employers. It also plans to eliminate the existing unemployment insurance fund, rolling that system into its new mandatory national social security system. Other reform goals to be elaborated on and implemented over the next 3 years include the following:

- Administrative reforms to enable the South African Revenue Service (SARS) to maintain individual contributor records and to ensure efficient and reliable benefits administration
- Greater governance, supervision, and regulatory oversight of the retirement fund industry
- Improved tax collection and enforcement

South Africa currently has 13,500 private pension funds. In recent years, these funds have come under increasing regulatory scrutiny because of rising administrative costs and questions about investment strategies. The government plans to increase regulatory oversight of these plans and then bring them into the new system as providers of the mandatory second-pillar pension funds.

Finally, the government established an Inter-Ministerial Committee (IMC) to lead the social security and retirement reform process within the government. This committee will be chaired by the Minister of Finance and include the Ministers of Social Development, Labor, Health, and other cabinet ministers. During 2007, the proposals outlined in the government's pension reform agenda will form the basis for consultation with the business sector, trade unions, and other stakeholders. Details on associated reforms of the retirement fund industry are also expected throughout 2007.

Sources: *Social Security Programs Throughout the World: Africa, 2005*; *Business Day*, February 19, 2007; *Sunday Times*, February 20, 2007; Republic of South Africa National Treasury, February 23, 2007; *Moneyweb*, February 26, 2007.

Reports and Studies

Social Security Administration

The Social Security Administration has released *Social Security Programs Throughout the World: Asia and the Pacific, 2006*, part of a four-volume series that provides a cross-national comparison of the social security systems in 48 countries in Asia and the Pacific. This publication summarizes the five main social insurance programs in those countries: old-age, disability, and survivors; sickness and maternity; work injury; unemployment; and family allowances. The other regional volumes in the series focus on the social security systems of countries in Europe, Africa, and the Americas. The report is available online at http://www.socialsecurity.gov/policy/docs/progdesc/ssptw/2006-2007/asia/index.html.

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