Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

April 2009

Europe

Finland

Finland's January 2009 supplemental budget gradually eliminates employer contributions to the universal pension program (KELA) and increases employee and employer contributions to the earnings-related pension program (TyEL). To stimulate employment, employer contributions to KELA were lowered 0.8 percentage points April 1 and will be eliminated entirely January 1, 2010. The government expects the lower labor costs to help create as many as 10,000 new jobs. Previously, employer contributions, which were based on company size, averaged 1.54 percent of monthly payroll. While abolishing the employer KELA contributions is projected to reduce annual revenues by €833 million (US$1.1 billion), a combination of higher environmental and energy taxes on industry and commerce is expected to make up for this budget shortfall.

In addition, combined employer/employee contributions to TyEL are scheduled to rise 0.4 percentage points annually, a total of 1.6 percentage points, between 2011 and 2014. On average, employers currently contribute 16.8 percent of monthly payroll while employees contribute 4.3 percent of their gross monthly earnings to the TyEL program.

Separately, the Finnish government is planning to introduce a guaranteed minimum pension beginning March 1, 2011 that will be linked to Finland's Consumer Price Index. Under the proposal, a guaranteed pension supplement will be paid to any pensioner whose overall monthly pension income (combined KELA and TyEL benefits) is less than €685 (US$930). The government expects to spend €111 million (US$150 million) to help approximately 120,000 pensioners under the new program, which will raise the lowest pensions about €100 (US$135) per month.

The public retirement system in Finland includes the KELA and TyEL programs. KELA is based on residency for those aged 65 or older and varies from €5.93 (US$7.80) to €558.46 (US$734.59) a month, according to marital status and the value of other pension income received. KELA is financed primarily by local and central government contributions and partially (until 2010) by employer contributions. Under TyEL, a pension accrues between the ages of 18 and 68 and is based on average lifetime earnings. While a full benefit is payable at age 63, those that work until age 68 receive higher benefits.

Sources: *Social Security Programs Throughout the World: Europe, 2008*; "Agreement Reported on Removing Employers' National Pension Contribution," *Helsingin Sanomat*, January 22, 2009; "Government Unveils Stimulus Package," *Helsingin Sanomat*, January 30, 2009; Hewitt Associates, *Monthly Legislative Update*, February 2009; "Finland: Economist: Government Resuscitation Not Enough," Esmerk Finnish News, February 3, 2009; "Employers' Social Insurance Contribution to be Scrapped, Finland Government Says," *Pension & Benefits Daily*, February 3, 2009; Finland Prime Minister's Office, press releases, January 30, 2009 and March 2, 2009.

The Netherlands

The Dutch government February 20 announced a temporary extension of the recovery period permitted for underfunded pension funds to bring their coverage ratios—the ratio of assets to pension liabilities—up to the 105 percent minimum ratio required by law. According to the government, the extension, from 3 to 5 years, will provide necessary relief to pension funds that have experienced significant losses as a result of the financial crisis. Recent data from the Dutch pension regulator De Nederlandsche Bank (DNB) show that around half of the approximately 650 pension funds in the Netherlands had coverage ratios below 105 percent at the end of 2008, with an average across all pension funds of only 95 percent. In comparison, the average at the end of 2007 was 144 percent.

Under current regulations, underfunded pension funds must submit recovery plans to DNB outlining their strategies for reaching the 105 percent minimum coverage ratio within the mandated recovery period. Measures that funds are allowed to adopt include reducing pension benefits, increasing pension premiums, and selling assets. Increasing benefits, including through indexation, is prohibited during the 5-year recovery process. Funds that are unlikely to reach 105 percent within 5 years may be forced, at the request of DNB, to take more drastic measures, such as an immediate reduction in pension benefits.

In addition, pension funds with coverage ratios below 125 percent—the so-called 'full' coverage ratio required under current regulations—must state in their recovery plans how they plan to attain full coverage within 15 years. This requirement, which has been in effect since the current regulations were first implemented in 2007, is meant to ensure that pension funds have adequate reserves.

Sources: De Nederlandsche Bank, Jaarverslag 2008; "Pensioenfondsen Krijgen Langere Hersteltermijn," Ministerie van Sociale Zaken en Werkgelegenheid, 20 februari 2009; "Dutch Government Extends Recovery Period," *Global Pensions*, February 23, 2009; "Langere Hersteltermijn," *IPNederland*, 23 februari 2009; *IBIS Compliance Alert, the Netherlands*, February 27, 2009.

The Americas

Ecuador

Ecuador's National Assembly March 10 passed a number of amendments to its Social Security Law effective April 1. Specifically, the key changes:

- Introduce annual adjustments of benefits (old-age, survivors, disability, work injury, and social assistance) according to the increase in inflation over the prior 12 months. Previously, benefits were adjusted annually based on the availability of budget resources.
- Set up a monthly minimum pension equal to the national minimum wage (currently US$218 a month) for workers with 40 years of contributions. For workers with fewer years of contributions, the benefit is a percentage of the full monthly minimum pension, ranging from 50 percent of this minimum for workers with up to 10 years to 90 percent for those with between 36 and 39 years. Previously, there was no minimum benefit.
- Establish an income test for workers who collect a pension and remain in the labor force. Those who earn less than US$770 per month (based on the value of a market basket for a family of four) receive a full pension. For any earnings above US$770 per month, the pension is reduced by 40 percent, the government's share of the pension cost. Once the worker completely retires, the full pension is restored.
- Allow workers to transfer their home mortgages from a domestic financial institution to the Social Security Institute (IESS). To qualify, the house must be lien-free and the worker must have made at least 3 years of social security contributions and have worked for the same company for the previous 12 months. The IESS can offer lower interest rates and longer loan periods.

Sources: *Social Security Programs Throughout the World: The Americas, 2007*; Asamblea Nacional Comisión Legislativa y de Fiscalización, 9 de marzo de 2009; "Aprobadas Reformas de Seguridad Social," *El Universo*, 10 de marzo de 2009; "Reformas a la Ley de Seguridad Social son Positivas: González," Confirmado.net, 12 de marzo de 2009; "Las Reformas al IESS Se Aplicarán en Abril," *El Comercio*, 29 de marzo de 2009.

Reports and Studies

Organisation for Economic Co-operation and Development (OECD)

A recent OECD report, *Private Pensions Outlook 2008*, examines the development of private pension systems and reviews their performance in the context of the ongoing crisis in financial markets. According to the report, private pension funds in OECD countries lost US$5.4 trillion dollars in 2008, with a negative rate of return of 23 percent. Countries where these funds had more than two thirds of their assets in equities—including Ireland, the United States, the United Kingdom, and Australia—experienced the biggest losses.

The report finds that public pension systems in most OECD countries do not have large enough reserve funds to cover the increasing financial impact of aging populations. Between 2001 and 2007, public pension reserve funds had grown rapidly because the funds had reallocated their assets from relatively conservative to riskier investments. However, in 2008 this increased exposure to equities resulted in significant financial losses for these funds.

In addition, the report finds that individuals in many OECD countries may not have enough income in retirement to maintain the same standard of living as when they were employed. In a number of OECD countries, combined public and private pensions for an average worker replace less than 60 percent of pre-retirement income. Of even greater concern are low-income workers, who may not have access to private pensions and receive low benefits from their country's public system.

Other report findings include:

- Defined benefit plans represented more than 60 percent of pension assets in 19 OECD countries in 2007, although the number of defined contribution (DC) plans continues to grow.
- Management fees, high in some countries because they have many small funds, can reduce pension benefits significantly. For example, if the fees in Hungary were as low as in Sweden, Hungarian pension benefits would increase approximately 30 percent.

To address current deficiencies in pension provision, the report recommends that OECD countries:

- Improve the regulation of pension plans by strengthening the supervision of risk and investment performance and increasing the expertise of pension fund boards.
- Reduce older workers' exposure to risk in DC plans, especially where private pensions represent a major portion of overall retirement income.
- Evaluate default investment strategies and improve the design of pension pay-out options for DC plans.
- Expand private pension systems, especially in countries where public pension benefits are expected to be reduced.
- Increase public pension reserve funds to support public pay-as-you-go pension systems as population aging threatens the long-term solvency of these systems.
- Provide effective financial education programs.

Private Pensions Outlook 2008 is the first in a series of publications to be produced every 2 years. An executive summary is available at http://www.oecd.org/document/60/0,3343,en_2649_34853_41770428_1_1_1_1,00.html.

Sources: *Private Pensions Outlook*, OECD, 2008.

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