Social Security

# International Update:

Recent Developments in Foreign Public and Private Pensions

April 2011

## Europe

### *United Kingdom*

On April 4, the Department for Work and Pensions issued the Green Paper, *A State Pension for the 21st Century*, outlining proposals to change the state pension system. The government emphasizes that pension reform should reduce system complexity and provide future pensioners with a better foundation for saving. Release of the Green Paper follows the March release of the 2011 budget in which the government presented similar ideas for pension reform.

The current state pension system includes the basic state pension (BSP), a near universal flat-rate benefit, and the state second pension (S2P), which is based progressively on earnings bands for lower-income and higher-income earners. Means-tested benefits complement the BSP. As a result of the Pensions Act 2007, the S2P will become a flat-rate benefit in the early 2030s. Employers are allowed to "contract out" of the S2P by setting up separate occupational pension plans for their employees. (The practice of contracting out into a defined contribution plan is scheduled for elimination in April 2012.)

The Green Paper requests feedback from interested parties (employers, the public, and the pension industry) on three topics regarding the state pension system. The first issue considers two options to simplify the state pension system for future pensioners. One option would accelerate the shift to a two-tier, flat-rate structure by 2020 rather than by the early 2030s. That option would continue to permit contracting out of the S2P into occupational defined benefit (DB) plans for around 2 million employees. By contrast, a second reform would combine the BSP and S2P into a single flat-rate pension set above the level of existing means-tested pension benefits, eliminating both means-tested pension benefits and the contracting-out option.

A second topic involves examining the prospects for changing current means-tested programs in line with other pension reform proposals to meet the future needs of certain pension groups (women, low earners, and the self-employed). The government aims to reduce the uncertainty and disincentives to saving in the state pension system and help pensioners avoid poverty. Currently, about 50 percent of pensioners qualify for noncontributory means-tested benefits.

The final topic for consultation considers future changes in the state pension age (SPA). The government is considering a more automatic mechanism for changing the SPA that could include either a formula automatically adjusting the SPA to reflect revisions in projected longevity or an independent review of projected changes in life expectancy, scheduled at predetermined intervals. The SPA is currently age 65 for men and age 60 for women (increasing to age 65 by 2020). The SPA will then gradually increase for both men and women until it reaches age 68 in 2048.

**Sources:** *The Pensions Primer*, Pensions Policy Institute, March 16, 2011; "Budget 2011: State Pension Age Could Get Longevity Link," *Professional Pensions*, March 24, 2011; "Webb to Confirm Flat-Rate State Pension in Green Paper," *Professional Pensions*, April 4, 2011; "Flat-Rate State Pension: Stop Whining, Start Saving," *Citywire Money*, April 5, 2011.

## The Americas

### *Canada*

On March 17, Quebec's Minister of Finance announced the budget for 2011–2012, which includes adjustments to the Quebec Pension Plan (QPP)—the province's mandatory earnings-related pension program—and the introduction of new voluntary retirement savings plans (VRSPs). (The QPP is similar to the earnings-related Canada Pension Plan, which covers other provinces.) The measures will be incorporated into an omnibus bill, which is expected to be introduced to the provincial parliament in the coming weeks. According to the government, the measures address the fiscal pressures of a rapidly aging population; Quebec's population will age at one of the fastest rates in the world over the coming years, with the ratio of workers to retirees expected to reach 3:1 by 2020, down from 8:1 in 1980.

To ensure the long-term stability of the QPP, the budget proposes increasing the contribution rate (funded equally by employers and employees) by 0.15 percent per year over a period of 6 years, from 9.9 percent currently to 10.8 percent in 2017. (Under current provisions, benefits are projected to exceed contributions starting in 2013, at which time the QPP's reserve fund will be drawn on until becoming exhausted in 2039.) In addition, to encourage later retirement, the budget calls for an increase in the accrual rate of pension benefits (from the current 0.5 percent per month to 0.7 percent) for workers who delay retirement past the full retirement age of 65. Workers who retire before age 65 would have their benefits reduced at a higher rate of 0.6 percent per month, up from 0.5 percent.

In addition, the budget aims to increase saving through the introduction of VRSPs, particularly among workers who are not currently covered under an employer-sponsored pension plan. Under the proposal, employers who currently do not provide their own private plans to their employees must offer a VRSP. Employees would be automatically enrolled in the new plans, but may opt out if they wish. Contributions would be collected by employers, but managed by private financial institutions. (Employer contributions on behalf of their employees would also be voluntary.) Currently, less than half of all workers in Quebec are covered by an employer-sponsored pension plan.

**Sources:** "A Stronger Retirement System: Meeting the Expectations of Quebecers of Every Generation" and "Budget at a Glance: Budget 2011–2012," Finances Quebec, March 2011.

## Africa

### *Malawi*

On March 1, the Parliament of Malawi adopted a bill establishing a system of mandatory individual accounts for most workers in the country. The president is expected to sign the bill into law. While many of the specific details (including coverage, investment rules, and withdrawal rules) are not yet available, the government has released the following key provisions of the bill.

- Employees with earnings above a minimum salary threshold (to be established in future regulations) will contribute 5 percent of salary to a new national pension fund. Employers will be required to contribute 10 percent of salary for all employees who have worked for them for at least 12 months.
- Workers will be able to retire at age 50 or older with at least 20 years of service. Retirement can be deferred until age 70 (the so-called "maximum retirement age").
- Workers who are unemployed for more than 6 months will be able to withdraw a portion of their individual account balances prior to reaching the minimum retirement age.

Previously, there was no public pension system for private-sector workers in Malawi. However, the government encouraged state-run and private-sector companies through favorable tax policy to provide voluntary occupational retirement plans to their employees. (In 2008, around 150,000 workers were covered by 450 private pension funds.) Public-sector workers are covered under the pay-as-you-go Government Public Pension Scheme (GPPS). (Active government employees totaling 125,000 and beneficiaries totaling 30,000 were covered under GPPS in 2008.)

**Sources:** "Malawi," *International Update*, October 2005, US Social Security Administration; "Financial Sector Assessment: Malawi," *World Bank* and *International Monetary Fund*, July 2008; "MCTU Happy with New Pension Law as Government is Defeated," *Malawi Voice*, March 1, 2011; "Malawi Modifies Pension Bill," *The Nation*, March 1, 2011; "House Passes Pension Bill," *BNL Times*, March 2, 2011; "Malawi: New Pension Scheme Introduced," *US Library of Congress*, March 9, 2011.

## Reports and Studies

### *Organisation of Economic Cooperation and Development (OECD)*

On March 17, the OECD released *Pensions at a Glance 2011*, the latest in the biennial series that examines pension systems in member countries. The theme of the latest volume (which covers 34 member countries and 8 nonmember G-20 countries) is the link between pensions, retirement, and life expectancy. The report finds that most of these countries will be unable to cover future pension costs because life expectancy is rising faster than the legislated increases in retirement ages. Public pension benefits represent about 60 percent of retirement income, on average, and private pensions and retirement savings represent the remaining 40 percent.

According to the report, the retirement ages for both men and women will need to be even higher to match future gains in life expectancy. Based on recent changes, the average retirement age for both men and women among member countries will be nearly age 65 by 2050. However, the report argues that these changes are not enough given projected increases in life expectancy at age 65 (an additional 3.1 years for men and 3.6 years for women by 2050). The report also examines how many countries have added a link between pensions and life expectancy to their pension benefit formulas in order to address the rapid aging of the population.

Another finding is that linking benefits to life expectancy results in lower pension benefits and increases the need for additional social assistance benefits to protect lower earners. The cost of these additional benefits for lower earners, in relation to the country's overall budget, will most likely offset savings that resulted from the pension reforms. The following are among the report's other conclusions: (1) linking retirement age (and not benefits) to longevity is preferable to preserve a certain level of benefits for lower earners; (2) encouraging people to save more for retirement, through private pensions and personal savings, to compensate for reduced public pensions is crucial.

Another part of the report focuses on older workers. In many member countries, despite recent pension reform incentives for workers to remain in the labor force after the normal pension age, barriers remain against hiring older workers. With an aging labor force and fewer younger employees, employers will have to hire older workers as the labor force ages. The report recommends that policies must be set in place to make it easier to train and hire older workers.

*Pensions at a Glance 2011* also provides 38 comparative indicators and detailed country profiles on the public and private pension systems of the countries studied.

**Sources:** "Pensions at a Glance 2011: Retirement-Income Systems in OECD and G20 Countries," Organisation for Economic Co-operation and Development, 2011.

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