Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

September 2011

Europe

Estonia

On August 1, new regulations went into effect for Estonia's second-pillar of mandatory individual accounts that increase workers' flexibility to switch pension funds, impose stricter investment limits for conservative funds (the least risky of the three categories of pension funds), and promote greater program transparency. These new regulations are the result of the Ministry of Finance analyses of the impact of the financial crisis on the second pillar, which focused on the most critical issues of investments, disclosure, and risk management.

In Estonia, the five pension fund management companies offer three types of funds with varying degrees of risk: (1) conservative funds, with no equity exposure; (2) balanced funds, with up to 25 percent invested in equities; and (3) aggressive funds, with up to 50 percent in equities. Under the new regulations, workers can switch pension funds three times a year (in January, May, and October), up from only once per year previously. Although contributions are paid to only one fund at any given time, previously paid contributions can either be left in the old fund or transferred to the new fund. As a result, workers could have accounts in several different funds over their full working careers.

Other key elements of the new regulatory framework include the following:

- *Stricter investment restrictions for the conservative fund*. Investment options are more limited than under the previous regulations, and investments in bonds must conform to certain credit rating requirements.
- *Increased disclosure requirements*. Pension fund management companies are now required to produce and submit monthly investment performance reports to pension fund members. Previously, performance reports were issued only twice per year.

The Estonian pension system consists of a first-pillar, public pay-as-you-go program; second-pillar individual accounts, which are mandatory for new entrants to the labor force and workers born after December 31, 1982; and third-pillar voluntary individual accounts. By the end of last year, 662,700 Estonians held mandatory individual accounts, and 53,400 held voluntary individual accounts. Assets under management were approximately 16.8 billion kroons (US$1.4 billion) in the second pillar and an additional 1.4 billion kroons (US$119 million) in the third pillar.

Sources: *Social Security Programs Throughout the World: Europe, 2010*, US Social Security Administration, August 2010; "Estonia," *International Update*, US Social Security Administration, May 2010; "Estonian Financial Market as at 31.12.2010," Estonian Ministry of Finance; "Q&A with Government Adviser Kertu Fedotov on Estonian Pension Reform," *IPE.com*, August 5, 2011; "International Headlines," *Mercer*, August 10, 2011.

The Americas

Peru

On July 13, Peru's Congress raised the pension fund limit on investment abroad from 30 percent to 50 percent of assets. The increase in the limit will be implemented gradually as soon as the rules are published in the country's official gazette. The government expects this measure to broaden fund investment options and diversify risk. Over the past 5 years, the limit has been raised a number of times from 10.5 percent of assets in 2006.

Currently there are four pension fund management companies (AFPs), with total assets under management of 81.3 billion nuevos soles (US$29.5 billion). Close to 30 percent of those assets is invested abroad, 15 percent is invested in Peruvian government bonds, and the remaining investments include domestic stocks and bonds. Since 2005, each AFP must offer three types of funds with varying degrees of risk: Fund 1, preservation of capital; Fund 2, balanced; and Fund 3, growth.

In Peru, public- and private-sector workers have a choice between the individual account system (SPP) and the public pension system (SNP). Those workers who do not make a choice are enrolled in the SPP by default. SNP members may switch to the SPP at any time, but most SPP members are not permitted to switch to the SNP. (Some older workers have been allowed to switch back to the public system.) Contribution rates are different for each system. For the SNP, workers pay 13 percent of gross earnings for old-age, survivors, and disability insurance; SPP members contribute 10 percent of gross earnings to an individual account managed by the AFP of their choice, plus an average of 1.95 percent of total gross earnings for administrative fees, and 1.22 percent of earnings—up to a maximum of 7,586 nuevos soles (US$ 2,756 per month)—in premiums for survivors and disability insurance, as of June 2011. Employers do not contribute to either pension system on behalf of their workers.

Sources: *Social Security Programs Throughout the World: The Americas, 2009*, US Social Security Administration, March 2010; "Peru," *International Update,* US Social Security Administration, October 2010; "Comisiones por la Gestión de Aporte Obligatorios y Primas de Seguro por AFP," Superintendencia de Banca y Seguros del Peru, junio de 2011; "Foreign Investment Limit Hiked to 50%," *Investment Strategy*, July 14, 2011; *Boletín Semanal del Sistema Privado de Pensiones: Año 2011*, Número 33, Semana del 15 al 19 de agosto de 2011.

Asia and the Pacific

Japan

Japan's legislature passed the Pension Security Enhancement Act in August. The new law, which becomes effective January 1, 2012, represents the most significant change to the country's voluntary defined contribution (DC) pension plans since their introduction in 2001. DC plans have grown steadily, with approximately 5 trillion yen (US$65 billion) in assets for more than 15,000 employer sponsors and 4 million participating employees.

Provisions of the act will—

- Allow employees to contribute to an employer-sponsored DC plan for the first time. At present, only employers may contribute to a DC plan on behalf of employees. Under the new rules, employee contributions cannot exceed employer contributions. The limit on combined employer and employee contributions (both receiving preferential tax treatment) to a DC plan will remain the same: 51,000 yen (US$659) per month if the employer sponsors only one occupational DC plan for employees, or 25,000 yen (US$323) if the employer also sponsors a defined benefit (DB) plan.
- Extend coverage to workers aged 65 or younger. Currently workers aged 60 or younger may participate in a DC plan.

There are two types of DC plans in Japan: employer-sponsored plans for employees and individual plans available to the self-employed and to workers of employers who do not sponsor a pension plan. Contributions receive favorable tax treatment. In the case of employer-sponsored plans, contributions are recorded as an expense by the company and are not counted as income for the participant; for individual plans, the entire contribution is tax deductible for the participant up to the contribution limit, currently 612,000 yen (US$7,910) annually.

Voluntary private pension plans in Japan (including DC and employer-sponsored DB plans) supplement the country's two-tiered public pension system, which comprises a flat-rate plan for all residents under the national pension program and an earnings-related plan under the employees' pension insurance program.

Sources: "Proposal for Fundamentally Reforming Japan's Defined Contribution Pensions," *Nomura Journal of Capital Markets*, Autumn 2009; "New Defined Contribution Limits in Japan," mercer.com, October 5, 2009; "Japan: Employee DC Plan Contributions to be Permitted Beginning January 1, 2012," *Global News Briefs*, August 2011; email from Towers Watson staff, August 30, 2011.

Reports and Studies

Organisation for Economic Co-operation and Development (OECD)

Pension fund assets returned to pre-crisis levels by the end of 2010 in most OECD and selected non-OECD countries, according to the OECD's latest edition of *Pension Markets in Focus*. While the OECD assessment found that pension fund asset levels in most countries had strong growth during 2010, the report cautioned that the uncertainty of future economic growth and likelihood of regulatory changes—the adoption of new international accounting practices, as well as potential new funding and solvency rules in the European Union—could pose challenges.

Pension funds in OECD countries experienced a positive (weighted average) net real return on investment of 3.5 percent in 2010. The best performing funds were in the Netherlands (18.6 percent), New Zealand (10.3 percent), and Chile (10.0 percent), while pension funds in Portugal and Greece experienced negative returns (-2.4 percent and -7.4 percent, respectively). Although pension fund assets in most OECD countries grew above the level managed at the end of 2007, some countries (Belgium, Ireland, Japan, Portugal, Spain, and the United States) had not recovered completely from the 2008 losses by the end of 2010. Overall, pension funds in OECD countries recovered US$3.0 trillion of the US$3.4 trillion lost in 2008. By comparison, pension fund performance in selected non-OECD countries during 2010 was better on average than across the OECD region, with a higher weighted average of investment returns of 9.9 percent in real terms—more than twice the OECD average—and total assets above the level at the end of 2007 in all non-OECD countries observed.

Public pension reserve funds in OECD countries regained the ground lost during the 2008 financial crisis. By the end of 2010, the total amount of assets within OECD countries was equivalent to US$4.8 trillion, compared with US$4.6 trillion in 2009. Although most OECD reserve funds performed positively on average in 2010 (5.0 percent), investment returns were lower than in 2009 (7.3 percent).

Pension Markets in Focus is an annual OECD publication that reviews trends in the financial performance of private-sector pension funds and public pension reserve funds, including investment returns and asset allocation.

Source: *Pension Markets in Focus*, Organisation for Economic Co-operation and Development, July 2011.

Social Security Administration

The Social Security Administration has released *Social Security Programs Throughout the World: Africa, 2011*—part of a four-volume series that provides a cross-national comparison of the social security systems in 44 countries in Africa. It summarizes the five main social insurance programs in those countries: (1) old-age, disability, and survivors; (2) sickness and maternity; (3) work injury; (4) unemployment; and (5) family allowances. The other regional volumes in the series focus on the social security systems of countries in the Americas, Asia and the Pacific, and Europe.

International Update is a monthly publication of the Social Security Administration's (SSA's) Office of Retirement and Disability Policy. It reports on the latest developments in public and private pensions worldwide. The news summaries presented do not necessarily reflect the views of SSA.

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SSA Publication No. 13-11712