Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

November 2011

Europe

Slovak Republic

On September 14, the Slovak parliament approved a law that makes participation in second-pillar individual accounts mandatory for new entrants to the workforce, introduces a new type of pension fund, and limits the guarantee currently available on all second-pillar contributions to only those contributions invested in the least-risky pension fund. The changes, which come into effect in April 2012, reverse many of the provisions contained in a March 2009 law passed by the previous government.

Under the new law, participation in the second pillar will be mandatory for all new entrants to the workforce, although they will be able to opt out within the first 2 years of employment. Persons choosing to opt out of the second pillar will have their contributions sent to the first-pillar, pay-as-you-go (PAYG) program. (Pension fund management companies (or DSSs) will not be allowed to charge any fees for persons who decide to opt out.) Since July 2009, participation in the second-pillar program has been voluntary for new entrants to the workforce, but once a worker has chosen to participate, he or she must continue to do so.

In addition, the law creates a new pension fund—the so-called "equity-linked index fund"—that will track the performance of selected equity indexes. (Detailed investment rules for this new pension fund are not yet available.) The new fund will supplement the three types of funds currently offered—conservative, mixed, and growth—which will be renamed as bond funds, balanced funds, and stock funds, respectively. (These funds differ in terms of risk level, depending on the percentage of equities allowed in the fund's investment portfolio.) Workers who do not choose a fund within the first 180 days of their employment will be automatically enrolled in the balanced fund.

Finally, the new law eliminates guarantees on investment performance for all pension funds except for the least-risky bond funds. Since July 2009, DSSs have been required to create separate guarantee accounts for each pension fund, containing that fund's earnings. If investment returns are positive following a 6-month monitoring period, DSSs can charge a fee of 5.6 percent of the appreciation of pension assets, with the remaining 94.4 percent distributed to the individual account holders. However, if investment returns are negative following the 6-month monitoring period, DSSs are responsible for making up the difference to ensure that workers' accounts do not fall below the principal amounts they have contributed. From April 2012 onwards, only investments made in the bond fund will have that protection.

Sources: "Slovak Republic," *International Update*, May 2009, US Social Security Administration; *Social Security Programs Throughout the World: Europe, 2010*, US Social Security Administration; "Second Pension Pillar—Version 21," *The Slovak Spectator*, September 26, 2011; "Slovakian Parliament Shakes Up Investment Rules for Pension Funds," IPE.com, September 27, 2011.

Sweden

In late September, Sweden's Ministry of Finance and the government Pension Group (representing major political parties) launched a wide-ranging review of the state pension buffer funds. According to the Ministry, changes in financial markets and lessons learned during the recent financial crisis justify reexamining the buffer fund framework introduced in 2001. Terms of reference for the review include an assessment of fund investment rules, governance, and overall structure, including the possible merger of some funds. The findings are scheduled for release in August 2012.

Under Sweden's public pension system, five buffer funds help smooth temporary fluctuations during periods when contributions are insufficient to cover pension disbursements. Creating several buffer funds was expected to diversify risk, increase competition to the system, ensure that funds would not be so large as to interfere with the operation of domestic financial markets, and reduce the risk from possible political influence on the governance of Swedish enterprises (whose shares would be held by funds). Contributions from the earnings-related social insurance program are transferred to the four largest funds, which finance pension expenditures and manage any surplus revenue.

(Another much smaller buffer fund invests primarily in unlisted companies in Sweden; unlike the other funds, there are no regular payments to or withdrawals from this fund.) At the end of 2010, buffer capital amounted to 895 billion kronor (US$132 billion).

According to the government, most arguments for operating several funds rather than one large fund may no longer exist, and a reduction in the number of funds is under consideration for cost reasons. An annual government evaluation conducted in 2010 expressed dissatisfaction with its long-term performance. In addition to considering a reduction in the number of buffer funds, the review will look at whether the funds should have less restrictive investment rules; currently, the four largest funds are prohibited from investing more than 5 percent of their money in unlisted assets, such as private equity and infrastructure, which have gained stronger acceptance in recent years.

Sweden's public pension system includes a means-tested minimum guarantee pension, pay-as-you-go notional accounts, and mandatory individual retirement accounts. Quasi-mandatory occupational-funded pension plans, based on collective agreements covering 90 percent of employees, supplement the public system. There are also voluntary private pension plans.

Sources: "Sweden," *International Update*, January 2010, US Social Security Administration; "Sweden—Current Pension System: First Assessment of Reform Outcomes and Output," European Social Observatory, May 2010; "Swedish Government Criticises Long-term Returns of AP Funds," IPE.com, May 28, 2010; *Annual Report 2010*, Second Swedish National Pension Fund/AP2, 2011; "Sweden Sets Out Review of €100bn State Funds," *Financial News*, June 23, 2011; "Swedish Government Considers Closing Two AP Funds in Major Review," IPE.com, June 23, 2011; "Swedish Government Appoints Industry Veteran to Review AP Buffer Funds," IPE.com, September 30, 2011.

Ukraine

On October 1, a new pension reform law went into effect that equalizes the retirement age for men and women and increases the number of contribution years required to receive a pension. The reforms, approved by Parliament on July 8 and signed into law by the president on September 12, aim to lower spending on the country's pay-as-you-go (PAYG) public pension system, which currently accounts for 18 percent of the country's gross domestic product. Reform of the pension system was one of the conditions imposed by the International Monetary Fund for the release of a US$1.5 billion loan installment, part of a larger US$15 billion loan package approved in July 2009.

Under the new law, the retirement age for women will gradually increase from age 55 to age 60 by 6 months per year starting in January 2012. In addition, the number of contribution years required for a full pension will gradually rise from 20 years to 30 years for women and from 25 years to 35 years for men. Similarly, the number of contribution years required for a partial pension—paid if a worker has reached the full retirement age but does not meet the contribution requirements for a full pension—will increase from 5 years to 15 years for both men and women. (The timetable for the gradual increase in contribution-year requirements is still unclear.)

Ukraine's social insurance system, which includes old-age, survivors, and disability pensions, covers all citizens and foreigners residing in the country. Workers contribute from 2 percent to 5 percent of earnings, depending on income, and employers contribute 33.2 percent of payroll. To encourage older workers to remain in the workforce, the old-age pension is increased for workers who defer receiving their pension beyond the normal retirement age. In 2003, a law was passed creating a multipillar system consisting of a modified PAYG program, second-pillar mandatory individual accounts, and third-pillar voluntary individual accounts. However, the introduction of that new system has been postponed indefinitely.

Sources: "Ukraine," *International Update*, December 2003, US Social Security Administration; *Social Security Programs Throughout the World: Europe, 2010*, US Social Security Administration; "Ukrainian Pension Reform Faces Uncertain Future," IPE.com, July 27, 2011; "President Approves Pension Reform," Ukrainian Radio, September 12, 2011; "Pension Age Reform Law Comes into Force in Ukraine," RIA Novosti, October 1, 2011.

The Americas

Trinidad and Tobago

On October 10, the Minister of Finance proposed some modifications to the National Insurance Scheme (NIS) in the Budget Statement 2012 to Parliament. According to the government, changes to the NIS are needed to expand the social safety net especially for the elderly, to control government expenditures on retirement benefits, and to address the fiscal challenge of an aging population. The International Labour Office projects that by 2055 the country's overall population will increase by 11 percent, the number of pension-age individuals will nearly triple, and persons of working age will decline by about 10 percent. That means a decrease in the ratio of contributors to pensioners from about 4:1 to about 1:1.

If adopted by Parliament, the changes to the NIS would be effective in 2012 and include the following:

- The guaranteed minimum pension would be increased from TT$2,000 (US$308) to TT$3,000 (US$462) per month.
- The ceiling on contributions would be raised from TT$8,300 (US$1,279) to TT$10,000 (US$1,541) per month to help fund the increase in the guaranteed minimum pension.
- The benefit formula would be simplified, with pensions based on 1 percent of salary for each year of contributions up to a maximum of TT$10,000 (US$1,541) per month. Currently the benefit is based on average weekly earnings in 16 wage classes that range from TT$160 (US$25) per week to TT$1,915 (US$295) per week.

In addition, the government proposed extending coverage to the country's 115,000 self-employed persons and granting employers who are delinquent in their NIS contributions a temporary waiver of penalties and interest charges.

Trinidad and Tobago's public, pay-as-you-go pension system provides old-age, survivors, and disability benefits to both public- and private-sector workers and social assistance benefits to needy individuals. To help ensure the financial solvency of the pension system, in January 2012, contribution rates for old-age, survivors, and disability benefits are scheduled to increase to 11.4 percent of earnings according to wage class (a gradual increase from 9.9 percent in 2007). Employees pay about one-third of the contributions and employers about two-thirds.

Sources: "The 7th Actuarial Review," National Insurance Board of Trinidad and Tobago, 2007; "Trinidad and Tobago," *International Update,* December 2007, US Social Security Administration; "From Steady Foundation to Economic Transformation," Government of Trinidad and Tobago, Budget Statement 2012, October 10, 2011; "International Headlines," *Mercer*, October 19, 2011.

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