Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

December 2011

Europe

Italy

On November 12, the Italian parliament passed a series of austerity measures that include an increase in the retirement age, privatization of state-owned enterprises and properties, and steps to improve labor market efficiency. Those measures are expected to boost economic growth and cut the country's debt, which is at 1.9 trillion euros (US$2.5 trillion). Italy has the world's fourth largest debt, which accounts for 120 percent of gross domestic product (GDP). Passage of the austerity package, required by the European Central Bank and the European Commission, preceded within hours of the transition to a new government.

The legislation further increases the retirement ages for both men and women in the public and private sectors. A 54 billion euro (US$73 billion) austerity plan that passed in September had raised the retirement age for women working in the private sector from age 60 to 65 (matching the retirement age for men), from 2014 through 2026. The new policy gradually increases the retirement age (for both men and women) from age 65 to 67 by 2026 (timetable unspecified).

Doubts over the country's ability to implement the September measures motivated renewed demands for additional austerity measures. (Current spending on public pensions for private-sector workers and public employees in Italy account for approximately 14 percent of GDP—more than any other member country in the Organisation of Economic Co-operation and Development.)

Sources: "Italy," *International Update*, October 2011, US Social Security Administration; "Berlusconi Snatches Pension Reform Deal ahead of Summit," EurActiv.com, October 26, 2011; "Monti Tipped to Lead Italy after Berlusconi Quits," CNN.com, November 12, 2011; "Italy's Latest Austerity Measures Include Pension Age Increase, Labor Law Changes," *Select News*, November 14, 2011.

Romania

On October 31, the Romanian parliament adopted a law creating a guarantee fund for second- and third-pillar private pensions. The aim of the guarantee fund is to protect the retirement savings of participants of private pension funds should a pension fund become insolvent. Many of the specific details of that new guarantee fund will be established through regulations in the coming months, and it is expected to begin operations in the first half of 2012.

The guarantee fund will be financed through contributions from private pension fund administrators and providers, including an initial, one-time contribution and subsequent annual contributions—the level of which is to be determined by January 31 each year. The contributions must be paid by April 30, 2012. The guarantee fund will be administered by a board consisting of a chairman appointed by the Romanian Private Pension Supervisory Commission (CSSPP), a member appointed by the Ministry of Public Finance, and a member appointed by the Romanian Pension Funds' Association (APAPR).

The Romanian pension system consists of a first-pillar, public pay-as-you-go (PAYG) program; second-pillar individual accounts, which are mandatory for all new entrants to the labor force and those who were younger than age 36 on January 1, 2008; and third-pillar voluntary individual accounts. Employees contribute a total of 10.5 percent of gross earnings, of which 3 percent is directed to second-pillar individual accounts for those who participate, and the rest is directed to the PAYG program. Employers contribute 20.8 percent to 30.8 percent of gross earnings (depending on the industry) to the PAYG program only. The CSSPP regulates the 9 pension funds operating in the second pillar and the 13 pension funds in the third pillar. According to data from the APAPR, at the end of July there were approximately 5.3 million participants in the second pillar and 244,000 participants in the third pillar. Net assets under management amounted to 5.5 billion new lei (US$1.7 billion) in the second pillar and 394 million new lei (US$122 million) in the third pillar.

Sources: *Social Security Programs Throughout the World: Europe, 2010*, US Social Security Administration; "Statistici," Romanian Pension Funds' Association, July 2011; "International Headlines," *Mercer*, October 5, 2011; Private Pension System Supervisory Commission, press release, November 1, 2011; "Private Pensions Guarantee Fund Budget/Romanian Pvt Pension Guarantee Fund to Have Initial Budget of EUR500,000," Mediafax News Brief Service, November 10, 2011.

United Kingdom

On November 3, the Pensions Act 2011 became law upon receiving Royal Assent. The new law accelerates the existing timetable for increasing the state pension age (SPA), amends the legislative framework requiring employers to automatically enroll employees into a qualifying pension plan and contribute to the plan, and affects the indexation and revaluation of private-sector occupational pensions.

One major provision in the Pensions Act 2011 affects the SPA, which for women will increase on schedule from the current age 60 to 65 (the same retirement age as that for men) by November 2018. However, beginning in March 2019, the new law gradually increases the SPA further for men and women until reaching age 66 in October 2020. The Pensions Act 2007 had scheduled the increase to age 66 to take effect between 2024 and 2026, but the timetable for increasing the SPA was accelerated because of higher official projections for average life expectancy in future decades.

The new law also amends provisions for automatic enrollment. Under the Pensions Act 2008, beginning in October 2012, large employers (with 120,000 or more workers) must enroll their employees into a company pension plan or into the state-run National Employment Savings Trust and contribute on their behalf, although employees may eventually choose to opt out. The government has indicated that medium-sized businesses scheduled to enroll employees through June 2013 will do so on schedule, but that small businesses (less than 50 employees) will receive additional time to prepare for the implementation of automatic enrollment until May 2015. The new law aims to inject a degree of flexibility for those employers by—

- Phasing in the level of contributions to help employers and employees adjust over time. Contribution rates (payable on qualifying employee earnings) will gradually increase from 1 percent each from the employer and employee in October 2012 to 2 percent each in October 2016, when a 1 percent contribution-related tax credit (reducing taxable income) will be introduced. Finally, in October 2017, the employer will pay 3 percent and the employee will pay 4 percent.
- Introducing a 3-month grace period, during which the employer can defer enrolling an employee in a pension plan (primarily to help employers with a high turnover of seasonal or temporary staff).
- Permitting alternative arrangements (to be specified in regulations) under which an employer can self-certify that its pension plan satisfies the requirements to be a qualifying scheme for automatic enrollment purposes.

In addition, the new law allows more flexibility in adjusting defined benefit occupational pensions for inflation by permitting plans to increase pensions by the Retail Price Index (RPI); the Consumer Price Index (CPI); or a combination of the two, depending on the rules applicable to the plan. After deciding in July 2010 to use the increase in CPI rather than the (generally higher) increase in RPI to measure inflation for increasing social security benefits and public-sector pensions, the government subsequently announced in July 2011 that the CPI would also be used for occupational pensions. (The government considers the CPI a more appropriate measure of inflation than RPI, as it is calculated according to a common European Union methodology for measuring price levels and is the index used by the Bank of England to measure inflation.) However, many pension plans were unable to switch to the CPI, as their plan rules specified using the RPI for indexing pension benefits.

Sources: *Pensions Act 2011: Explanatory Notes*, November 2011; "Pensions Act 2011 Receives Royal Assent," *Pensions World*, November 2011; "Pension Bill Given Royal Assent," PlanSponsorEurope.com, November 3, 2011; "Pensions Act 2011," shoosmith.co.uk, November 8, 2011; "Pensions Act 2011: Summary of Impacts," Department for Work and Pensions, November 21, 2011; "AE Delay: The DWP Statement in Full," *Professional Pensions*, November 28, 2011.

The Americas

Mexico

Beginning in December, some new rules are being implemented that allow individual retirement account holders more fund choices and promote more competition among the management companies. Those changes are part of the 2007 law that created the separate system of individual accounts for public-sector workers and closed the pay-as-you-go system for new public-sector employees.

Pensionissste, the public institution that has managed the individual retirement accounts of public employees for 3 years, is now permitted to compete for members of the privately managed pension fund companies (AFOREs). (Until now, only private-sector workers could enroll in an AFORE.) At the same time, public employees are permitted to switch to any of the AFOREs; new public employees who do not make a choice are automatically assigned to Pensionissste. Starting next year, public employees will be permitted to transfer to an AFORE or back to Pensionissste once a year (private-sector employees can already transfer among the AFOREs).

The government expects Pensionissste to be a catalyst for competition in the pension industry because of its low administrative fee. By law, that fee may not be higher than the average of all the AFOREs. It currently charges members 1 percent of earnings, compared with the AFORE system average of 1.52 percent.

At the end of October, Pensionissste managed about 2 percent of all the system's individual account holders, the third lowest market share among all of the pension administrators (Pensionissste and the 14 AFOREs); the company with the largest market share had 16 percent of account holders. At the same time, about 63 percent of Pensionissste's assets under management were in government debt and 6 percent in international instruments, compared with the AFORE system average of 58 percent and 13 percent, respectively. CONSAR, the pension system's regulator, oversees both the publicly and privately managed companies.

Since 2007, public-sector employee mandatory contributions to an individual account have increased gradually from 3.5 percent of monthly salary to 5.6 percent and will reach 6.125 percent in 2012; the government agency continues to provide 5.175 percent on behalf of the employee. The federal government also contributes a small subsidy to public- and private-sector worker accounts for each day that a worker contributes to an account.

Sources: "Preguntas Más Frecuentes Sobre La Reforma del ISSSTE," Coordinación General de Comunicación Social ISSSTE, 2007; "Sistema de Cuenta Individual," PensionISSSTE, 2007. "Mexico," *International Update*, May 2007, US Social Security Administration; "Información para Trabajadores ISSSTE, Subcuentas y Aportaciones," CONSAR, el 17 de enero de 2011; "Panorama General del SAR," CONSAR, noviembre 2011; "PensionISSSTE es un Catalizador del Mercado," *El Economista*, el 6 de noviembre de 2011.

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