Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

February 2013

Europe

Estonia

On January 1, a new monthly pension supplement went into effect under Estonia's first-pillar, public pay-as-you-go (PAYG) program for pensioners who have provided care to a child aged 3 or younger. The supplemental benefit is paid to only one caregiver (including a parent, a guardian, or a foster parent) at a time, provided he or she raised the child for at least 8 years and is currently receiving an old-age, disability, or survivor's pension. The value of the benefit varies according to the child's date of birth, as follows:

- For each child born from December 31, 1980, through December 31, 2012, a supplemental benefit equal to 2 years of pensionable service (decreasing to 1 year of pensionable service in January 2015) is paid.
- For each child born after December 31, 2012, a supplemental benefit equal to 3 years of pensionable service is paid.

(Further details, including the definition of "pensionable service," are not yet available.)

In addition, current workers who care for a child aged 3 or younger may now receive a supplementary contribution from the government—equal to 4 percent of average earnings for each month that they pay a social insurance tax—deposited to their second-pillar individual accounts. Only one parent is eligible to receive the contributions at a time. (It is not yet clear if guardians and/or foster parents are also eligible.)

Estonia's pension system consists of a first-pillar PAYG public pension program that covers all permanent residents of Estonia and a second pillar of mandatory individual accounts that covers all persons born after December 31, 1982. Employers contribute 16 percent of gross payroll to the PAYG program and 4 percent to employees' individual accounts; employees contribute 2 percent of earnings to individual accounts only. Other pension supplements paid by the government under the PAYG program include those to veterans of the Estonian War of Independence and their widow(er)s, veterans of World War II or military personnel, and persons assessed with at least a 40 percent loss of earning capacity as a result of a nuclear test or accident.

Sources: *Social Security Programs Throughout the World: Europe 2012*, US Social Security Administration; "Estonia's Parental Pension Benefits Law Takes Effect," *Mercer*, January 7, 2013; "Pension Supplements," Estonian Social Insurance Board, February 11, 2013.

United Kingdom

On January 18, the Department for Work and Pensions published a draft bill introducing a flat-rate single-tier pension (STP) to replace the existing multi-tier public pension system. The STP would be implemented in April 2017 at the earliest and cover new entrants to the labor force and workers below the state pension age (SPA) when the new system is implemented. (Current pensioners and those reaching the SPA prior to the introduction of the STP would not be affected, but would continue to receive their pensions under existing rules.) According to the government, the reform would particularly benefit women, low earners, and the self-employed who find it difficult to earn a full state pension under existing rules. The government expects to introduce the bill to Parliament in May and to achieve royal assent by spring 2014.

If adopted, the STP would provide a single, flat-rate state weekly pension of £144 (US$228) above the current basic state pension of £107 (US$169). Set slightly higher than the means-tested benefit of £142.70 (US$225.95), the STP would be expected to reduce the proportion of those eligible for means testing by more than half. The STP would increase at least in line with average growth in earnings. A full STP pension would require 35 years of contributions (5 years longer than the requirement for the current benefit). The government stated that the 5-year increase was necessary given the planned increase in the SPA and longer working lives anticipated in the future. Those with less than 35 years, but with at least 7–10 years of contributions, would receive a reduced benefit.

In addition to introducing the STP, the bill would make future changes to the retirement age that would—

- Accelerate the increase in the SPA from 66 to 67 by 8 years and phase in that increase over 2 years beginning in 2026, implementing a policy announced in November 2011. Currently, the SPA for women is rising to 65 by 2018; thereafter, it will increase to age 66 for both men and women from 2018 through 2020 and then to age 67 by 2028.
- Introduce a framework for future changes to the SPA, subject to a 5-year review and, if necessary, adjust it to reflect changes in life expectancy.

Sources: *Draft Pensions Bill*, Department for Work and Pensions, January 2013; *The Single-Tier Pension: A Simple Foundation for Saving*, Department for Work and Pensions, January 2013; "Single-Tier Pension Spells End for Contracting Out," Towers Watson *UK—Pensions Digest*, January 2013; "People Must Work Longer for Pension," professionalpensions.com, January 14, 2013; "UK Plans Single-Tier State Pension," *Mercer Select News*, January 15, 2013; "Radical Overhaul of State Pensions," *The Press and Journal*, January 21, 2013.

The Americas

Peru

From February 1, 2013, through December 31, 2014, all new entrants to the labor force are assigned to Habitat, the pension fund management company (AFP) that won a tender held by the pension fund regulator in December 2012. Habitat, a Chilean AFP, competed with the four existing Peruvian AFPs and offered the lowest administrative fees among the five companies. As a result, Habitat is expected to enroll close to 700,000 workers in the next 2 years; those workers must remain with Habitat for 2 years from the date of their enrollment (and Habitat may not raise the fee during that time period), unless they switch to an AFP that offers a lower fee or a higher rate of return.

At the same time, Peru's four existing AFPs must lower their administrative fees for the next 2 years to the level of their bids in the tender. (The fees offered had to be lower than the lowest one charged by all AFPs in the past 12 months.) This competition, part of the country's July 2012 pension reform law, will be held every 2 years and is open to any existing AFP or qualified company (domestic or foreign) that plans to enter the market.

The type of administrative fee that AFPs may charge account holders is gradually changing (over 10 years) from a percentage of income to a percentage of the individual account balance. Existing AFP members have until March 31, 2013, to choose the type of fee they want: one based on the member's income and another based on a combination of the member's income and account balance (which in 10 years will only be based on the account balance). Those who do not make a choice will automatically be switched to the combination fee. The portion of the fee based on the account balance will only apply to new contributions to the member's account. Those existing AFP members who choose a fee based on income have until September 30, 2013, to change their minds. New account holders are charged the combination (also called mixed) fee. The table below shows the results of the December 2012 competition and the current fee structure charged by all of the AFPs.

New administrative fees, by AFP (in percent)

AFP	Type of fee		
		Mixed	
	Income only [a]	Income [a]	Account balance
Profuturo	1.84	1.49	1.20
Horizonte	1.85	1.65	1.40
Integra	1.74	1.55	1.20
Prima	1.60	1.51	1.90
Average [b]	1.76	1.55	1.43
Habitat	c	0.47	1.25

SOURCE: "Comisiones Antes De La Reforma y Nuevas Comisiones," SBS, enero de 2013.

a. As a percentage of monthly earnings up to a maximum of 8036.28 nuevos soles (US$3,055.47).

b. Of the four Peruvian AFPs.

c. Habitat announced that it will offer a fee on only earnings, but to date it has not announced the rate.

At the end of 2012, the four existing Peruvian AFPs managed some 97 billion nuevos soles (US$ 37 billion), which represents about 19 percent of the country's gross domestic product.

Sources: "Peru Awards New Pension Fund Accounts to Chile's Habitat," Dow Jones Global News Select, December 20, 2012; "Comisiones Antes De La Reforma y Nuevas Comisiones," SBS, enero de 2013; "Conoce los Principales Cambios en el SPP," SBS, enero de 2013; "Evolución del Sistema de Pensiones Al Cuarto Trimestre de 2012," SBS, enero de 2013; "Nuevo Esquema de Cobro de Comisiones," SBS, enero de 2013; "AFP Habitat Ofrecerá Comisión por Sueldo," *Correo*, el 14 de enero de 2013.

Reports and Studies

World Bank

On January 24, the World Bank released *Matching Contributions for Pensions,* which examines measures used internationally that provide for government "matching" of employee contributions (either to public or private pension programs or through preferential tax treatment of retirement savings). According to the authors, these measures are increasingly used to encourage individuals to build up their retirement income. The book contains analytical chapters on programs in middle-income countries (Chile, Colombia, Mexico, and Peru) as well as lower-income countries (China, India, Thailand, and Tunisia), and describes existing matching contribution models in higher-income economies (Germany, New Zealand, Japan, the United Kingdom, and the United States).

According to the World Bank, less than half of the working population in the majority of countries worldwide is currently covered by statutory pension programs. In lower-income countries, the number of working-age adults participating in a statutory program is often less than 1 in 10. In many middle-income countries, coverage rates have either stagnated or actually declined as an increasing number of jobs are in the informal sector of the economy. In higher-income countries, fiscal constraints exacerbated by falling fertility rates have motivated many governments to seek alternatives, such as government matching measures to help increase retirement savings outside of the mandatory earnings-related public pension systems.

Although government matching programs have a long history in higher-income countries, the authors question whether the experience of those countries could be replicated in less-developed countries that have weak institutional infrastructures (record keeping, financial literacy, and regulatory machinery) and larger proportions of informal-sector workers with generally lower earnings and savings capacity. According to the book, policymakers in developing countries must determine whether it is more fiscally efficient to introduce tax-financed universal old-age benefits or to encourage more workers (through measures such as government matching) to contribute to defined contribution retirement savings vehicles.

The book concludes that although matching contributions have been extensively researched at the national level in higher-income countries (such as the Netherlands, the United Kingdom, and the United States), relatively little cross-national comparative research has been carried out for middle- and lower-income countries. The authors recommend the collection of more empirical evidence to determine to what extent such measures reduce informality in the labor market and actually create new savings for retirement.

Source: *Matching Contributions for Pensions*: *A Review of International Experience*, World Bank, January 2013.

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