Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

July 2013

Europe

Poland

On June 26, the Ministry of Labor and Social Policy and the Ministry of Finance jointly released a report that provides a wide-ranging review of the second pillar of Poland's pension system. The report analyzes the effectiveness of the second pillar in ensuring adequate retirement income for pensioners as well as its influence on public finance, capital markets, and economic growth in the country since 1999. In addition, it presents a number of possible reform options to increase economic growth and reduce the costs and risks of the second pillar. The report is now subject to 2 months of public consultation before being drafted into legislation.

In 1999, Poland introduced a multi-pillar pension system consisting of a first-pillar mandatory notional defined contribution (NDC) program, managed by the Social Insurance Institution (ZUS); mandatory second-pillar individual accounts, privately managed by open pension funds (OFEs); and voluntary third-pillar retirement savings accounts. In addition, a law implemented in May 2011 created new first-pillar subaccounts funded through contributions that had previously been diverted to the second pillar.

A few of the key areas analyzed in the report include the following:

- *Pension fund management fees:* The report finds that management fees charged by OFEs have been extremely high and unconnected to investment performance. For example, OFEs charged members around 2 billion zloty (US$602 million) during the financial crisis year of 2008 when assets under management fell by 20 billion zloty (US$6.02 billion).
- *Pension funds and public finance:* The report estimates that Poland's public debt would have been 38 percent of gross domestic product (GDP), rather than the current 56 percent, had the second pillar not been implemented in 1999. The report notes that this would have led to a higher credit rating for Poland and consequently lower debt-servicing costs.
- *Pension funds and the Warsaw Stock Exchange:* The report notes that OFEs have played an important role in the development of the capital market, accounting for 18 percent of stock exchange capitalization at present. However, this role is expected to lessen as the privatization of state-owned companies winds down.

The report concludes by suggesting three possible reforms to the second-pillar program, including—

- Transferring all government bond investments from OFEs to ZUS and limiting future OFE investments to investments in what the government terms the "real" economy, including stocks and corporate bonds. (The value of the redeemed bonds would be credited to workers' subaccounts managed by ZUS.) The report estimates that such a bond transfer would reduce public debt by approximately 11 percent of GDP.
- Making participation in the second pillar voluntary. Current participants would have 3 months to inform ZUS in writing of their intention to remain in the second pillar; those who fail to do so would have their second-pillar account balances transferred to their first-pillar subaccounts. In addition, new entrants to the labor force would have to "opt-in" to the second pillar.
- Making participation in the second pillar voluntary, but increasing the contribution rate for those who choose to participate. Participants would have 3 months to choose to participate in the second pillar, and the contribution rate for those who opt-in would increase by 2 percent of earnings. As a result, the total employer/employee contribution rate for old-age pensions would increase from the current 19.52 percent of earnings to 21.52 percent; of these contributions, 4 percent would be directed to individual accounts (up from 2.3 percent at present) and the rest would be directed to ZUS.

The report specifically ruled out other reforms, such as a partial or total liquidation of the second-pillar program and maintaining the status quo.

Sources: "Poland," *International Update*, US Social Security Administration, May 2011; *Social Security Programs Throughout the World: Europe, 2012*, US Social Security Administration, September 2012; "Polish Private Pension Funds: Outlook for 2013 After Strong 2012," Ministry of Treasury, March 1, 2013; "Przegląd Funkcjonowania Systemu Emerytalnego," Ministry of Labor and Social Policy and Ministry of Finance, June 2013; Ministry of Labor and Social Policy, press release, June 26, 2013; "Government Presents Three Options for Future of OFEs," *Warsaw Business Journal*, June 26, 2013; "Polish Government Unveils Plans for Second-Pillar Pensions Reform," *IPE.com*, June 27, 2013.

Switzerland

On June 21, the Swiss Federal Council announced a package of pension reform proposals (known as Retirement 2020) to address the mounting fiscal pressure on the public pension system from population aging. According to government estimates, the financing gap in the public pension system will grow from 1.2 billion francs (US$1.3 billion) in 2020 to 8.6 billion francs (US$9.1 billion) in 2030. Since 1990, average life expectancy in Switzerland has increased 3 years, and one-third of the population is projected to be above retirement age by 2050. Official sources indicate that consultations on the legislative package will conclude by the end of this year, and a draft bill will be introduced into parliament next year. If parliament passes the proposed reform, a nationwide referendum (required because reforms include an amendment to the constitution) must take place before planned implementation of the law in 2020.

The government's proposal outlines a comprehensive reform of both the first-pillar pay-as-you-go public pension and second-pillar mandatory occupational pensions that includes—

- *Retirement ages*. The retirement age for women (currently age 64) for both first and second pillars would gradually rise 1 year (at the rate of 2 months per year) to match that for men (age 65). Early retirement for men and women (age 58 under current law) would be delayed by 4 years to age 62, but could still be possible under certain conditions for workers with low average annual incomes, provided they made social security contributions from ages 18 to 21. Although 65 would remain the official retirement age (workers can already defer receiving a pension until age 70), greater flexibility would be provided for exiting the labor force from ages 62 to 70; for example, workers would have the option at age 62 and older of working part time while drawing a partial pension.
- *Benefit calculation for second-pillar pensions*. The conversion rate—the proportion of worker lifetime contributions paid as an annual annuity—would gradually decline from the current 6.8 percent to 6.0 percent over a 4-year period (by 0.2 percent each year). To prevent pensions from falling below current levels (official estimates indicate that the lower conversion rate would reduce second-pillar pensions by 12 percent), the government recommends various compensatory measures, including subsidies for older workers and strategies to encourage second-pillar savings at younger ages.
- *Funding the first-pillar pension*. To close most of the expected financing shortfall of the first-pillar pension, a gradual increase in the value-added tax (VAT) from 8 percent to 10 percent in two stages is proposed: 1 percent in 2020 and an additional 1 percent closer to 2030, based on actuarial projections and financing needs.
- *Guaranteed interest rate for occupational plans*. The method of calculating the minimum interest rate of accounts in the second pillar, currently set in advance for the next year based on assumptions for future returns, would be switched to a year-end calculation that reflects observed rates of return for that year.

Sources: "Switzerland," *International Update*, US Social Security Administration, January 2012; "2013 Update on Swiss Pension Legislation," Towers Watson *Hot Topics*, March 12, 2013; "Bern Proposes Later Retirement Age for Women," *The Local*, June 21, 2013; Swiss Federal Social Insurance Office, press release, June 21, 2013; "Government Announces Pension Plans," swissinfo.ch, June 21, 2013; "Switzerland Plans VAT Hike to Fund Pensions," tax-news.com, June 24, 2013; "Swiss Federal Council Adopts Pension Reform Proposals," Mercer *Select News*, June 27, 2013.

The Americas

Paraguay

On June 5, after 10 years of discussion, a new law was enacted that will allow self-employed workers, employers, female heads of household, and domestic workers to voluntarily participate in the country's pay-as-you-go (PAYG) public pension system. The

new law is scheduled to enter into force on August 5. According to the Social Security Institute (IPS), which administers the PAYG system, about 40 percent of the economically active population (3.5 million workers) will be eligible to enroll in IPS for old-age, survivors, and disability insurance (OASDI). Currently, less than 20 percent of the economically active population is covered by IPS, including more than one-third of employees. According to an IPS official, even though participation is mandatory for private-sector employees with an employment contract (either written or verbal), the penalties for noncompliance cost the employers much less than the actual contributions.

The contribution rate for voluntary participation will be 13 percent of gross earnings, including 0.5 percent for administering OASDI benefits. Currently private-sector workers are covered for OASDI, sickness and maternity, and work injury benefits—with employee contributions of 9 percent of gross earnings plus employer contributions of 14 percent of gross earnings. The minimum monthly earnings used to calculate all contributions—the legal monthly minimum salary, currently 1,658,232 guaraníes (US$365)—will be the same for both mandatory and voluntary participation.

The following qualifying conditions for old-age pensions will also be the same for both mandatory and voluntary participants in the public pension system:

- A full retirement benefit, payable at age 60 with 25 years of contributions;
- An early pension, payable at age 55 with 30 years of contributions; and,
- A reduced proportional benefit, payable at age 65 with 15 years of contributions.

However, the benefits are expected to be lower for the voluntary groups. The benefit formula will be based on average contributions during the past 120 months, compared with the past 36 months for private-sector workers.

Sources: *Manual del Asegurado,* Edición 2011, Instituto de Previsión Social, octubre de 2011; "Informalidad Laboral en Paraguay Deja Sin Cobertura A Cerca Del 80% de los Trabajadores," *América Economía*, el 30 de abril de 2013; Ley Número 4933, el 5 de junio de 2013;"Promulgan Ley que Permite Jubilacion por IPS a Trabajadores Independientes," *ABC Paraguay*, el 16 de junio de 2013.

Asia and the Pacific

Australia

On July 1, changes to the mandatory occupational pension (superannuation) system went into effect that (1) gradually increase the employer's mandatory contribution to an employee's superannuation fund, called Superannuation Guarantee (SG); and (2) abolish the age limit for making contributions to a superannuation account. These changes are meant to increase the level of retirement savings in the country as eligibility rules are tightened (beginning July 2014) for the Age Pension, the income- and asset-tested benefit funded by general revenues. According to government projections, by 2047, the percentage of Age Pension beneficiaries that receives a full benefit will fall from the current 75 percent to 50 percent. In addition, because life expectancy at birth is increasing (currently 79.7 years for men and 84.2 years for women, projected to rise to 85 years and 88 years, respectively, by 2056), people are more likely to spend more time in retirement and will require additional savings.

The SG contribution rate will increase gradually from 9 percent of basic wages to 12 percent—by 0.25 percent annually from now to 2015, and by 0.50 percent annually from 2016 to 2019. According to government estimates, this measure will benefit some 8.4 million employees and will add some A$500 billion (US$457 billion) in superannuation savings by 2035. The government also abolished the age limit for SG to encourage older workers to remain in the labor force and to give them more time to increase their retirement savings. Previously, employers could stop contributing on behalf of employees aged 70.

These two measures are part of the government's tax reform that, beginning July 1, increased superannuation taxes for high earners and raised the threshold for tax-free contributions by older workers (aged 60 or older this year, aged 50 or older next year). Provisions of another major government initiative called *Stronger Super*—an overhaul of the superannuation system (including lower fees, simpler products, streamlined processes, and strengthened governance)—are being implemented in stages.

Employee contributions to a superannuation fund are voluntary whereas employer contributions are mandatory. To encourage employees to contribute, the

government provides a matching contribution (called co-contribution) of up to A$500 (US$457) for workers who earn from A$33,516 (US$30,609) to A$48,516 (US$44,309) a year. The government also provides a tax rebate of up to A$500 for lower earners. (No worker contribution is required.) As of March 31, 2013, total superannuation assets under management were A$1.58 trillion (US$1.44 billion).

Sources: "Population Projections, Australia, 2006 to 2101," Australian Bureau of Statistics, September 4, 2008; *Intergenerational Report 2010: Australia to 2050: Future Challenges*, Commonwealth of Australia, January 2010; "Australia," *International Update,* US Social Security Administration, January 2011; *Retirement Outcome Projections Under 12% SGC*, Enterprise Metrics, July 2012; "Gender Indicators, Australia, Jan 2013," Australian Bureau of Statistics, January 30, 2013; "Statistics, Quarterly Superannuation Performance," Australian Prudential Regulation Authority, March 2013 (issued May 23, 2013); "Make the Most of the New Dawn in Superannuation," *The Australian*, June 30, 2013.

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