Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

March 2014

Europe

Norway

Effective January 1, new rules for occupational pension plans allow employers greater flexibility in designing and funding pension plans. Those rules include (1) an option for new tax-favored hybrid plans that combine features of defined benefit (DB) and defined contribution (DC) plan designs, and (2) higher maximum contribution limits for tax-favored DC plans. Until now, employers were required to provide either a DB or DC plan, and most employers chose to offer a less expensive DC plan. Under the amended law, companies may offer a benefit more comparable to a DB plan through a DC or hybrid plan. Industry sources expect the changes to encourage the recent trend away from employer-sponsored DB pension plans.

Tax-favored occupational pensions, introduced in 2001, have been mandatory since 2006, with employers deciding the type of pension plan for their employees. (The reform was intended to address demographic pressures and slow the growth of public pension expenditures.) Plan sponsors offering DC plans must contribute a minimum 2 percent of annual earnings up to 12 times the public pension base amount (known as "G"), set at 85,245 kroner (US$14,229) in 2013. (Pension contributions are tax-deductible for earnings above 12G.)

Under the new rules, a major change to DC plans increases the limit on contributions to 7 percent of employee earnings from 1G to 7.1G, and to 25.1 percent of earnings from 7.1G to 12G. (The previous limits were 5 percent of earnings from 1G to 6G and 8 percent of earnings from 6G to 12G.) DC plan sponsors have a 3-year transition period to adapt to the new rates. Also, although there were no changes mandated for DB plans, existing DB-plan members who are transferred by their employers to a hybrid or DC plan must immediately have their DB benefit converted to an individual annuity arrangement with an insurer.

The new rules also allow employers to offer a hybrid plan with guarantee features similar to a DB plan, which include the following:

- Limits on contributions to employee accounts are the same as those for DC plans.
- Life insurance companies in a collective trust generally manage the fund.
- Employers can choose the overall investment portfolio for all of their employees or determine an investment portfolio from which employees may select.
- Employers may guarantee a minimum rate of return that prevents the nominal loss of contributions in accounts; a higher guaranteed rate (established by the Financial Supervisory Authority) may apply when employees are allowed investment choice.
- Pension indexation costs must meet national insurance regulations and are the employer's responsibility; investment returns above the guaranteed rate may help finance such costs.
- Administrative expenses during the accumulation (preretirement) and decumulation (postretirement) investment phases for employees are the responsibility of the employer.

Other new requirements for occupational pension plans include establishing a flexible retirement age, from age 62 to 75, and providing a partial retirement pension, ranging from 20 to 80 percent of the full retirement benefit. Both of those measures are in accordance with the 2011 major reform of the public pension system, which introduced a guaranteed minimum benefit and an earnings-related benefit based on lifetime earnings and calculated according to life expectancy at retirement.

Sources: "Reforming Norway's Occupational Pensions," ipe.com, November 2007; *Norway Country Manual*, IBIS, 2013; "New Pension Act: Short Summary about Corporate Pension Scheme," Mercer, December 16, 2013; "Norway's Revised Pension Act Adds 'Hybrid Scheme'," Mercer, January 31, 2014; "Norway: New Law Liberalizes Pension Plan Options," Towers Watson *Global News Briefs*, February 12, 2014.

Poland

On February 1, a new pension reform law took effect that (1) makes second-pillar individual accounts voluntary for all new entrants to the workforce; (2) allows current participants to opt out of the second pillar and transfer their account balances to the public first-pillar notional defined contribution (NDC) program; and (3) transfers all government bond investments held by the second-pillar open pension funds (OFEs) to the first pillar, which is managed by Poland's social insurance institution (ZUS). (The law is currently under review by the Constitutional Tribunal, but there is no timeline for their judgment.) According to the government, the changes—which were first proposed in a June 2013 report from the Ministry of Labor and Social Policy and the Ministry of Finance—will ensure that workers have a stable source of income in retirement, while also reducing public debt in the country. The government estimates that the transfer of all government bond investments, which previously accounted for approximately 51.5 percent of all assets held by the OFEs, will reduce public debt by about 9.3 percent of gross domestic product in 2014.

Key changes under the new law include—

- *Making participation in the second pillar voluntary.* All new entrants to the workforce will have to opt in to the second pillar; those who fail to do so will participate in the first-pillar NDC program only. Previously, participation in the second pillar was mandatory for all economically active workers born after December 31, 1968.
- *Allowing current participants to opt out of the second pillar.* Current participants have from April 1 through July 31 to submit a written request to remain in the second pillar; those who fail to do so will automatically have their second-pillar account balances transferred to the first pillar. (Once the decision has been made to opt out of the second pillar, it cannot be reversed.) In addition, the law calls for opt-out periods to occur again in 2016 and every 4 years afterward.
- *Transferring all government bond investments from OFEs to ZUS and changing investment options for OFEs.* On February 3, the government transferred around 153 billion zloty (US$50.71 billion) in assets (those held in government bonds) from OFEs to ZUS. (The value of the redeemed bonds was credited to workers' first-pillar subaccounts.) In addition, OFEs are now prohibited from investing in Polish treasury bonds, although they may continue investing in other types of bonds (including those from other European Union countries).
- *Gradually transferring the remaining second-pillar assets to the first pillar as workers near retirement.* During the 10 years prior to reaching the normal retirement age, individual account balances will be gradually transferred to subaccounts managed by ZUS, with the assets treated in the same way as those in OFEs. As a result, ZUS is now responsible for paying both first-pillar NDC pensions and pensions from the individual accounts.

In 1999, Poland introduced a multipillar pension system consisting of the first-pillar NDC program, mandatory second-pillar individual accounts, and voluntary third-pillar retirement savings accounts. (A law implemented in May 2011 created new first-pillar subaccounts funded through contributions that had previously been diverted to the second pillar.) Workers participating in the second pillar contribute 6.84 percent to the NDC program and 2.92 percent to individual accounts; employers contribute an additional 9.76 percent to the NDC program only. (Employees who opt out of the second pillar contribute the full 9.76 percent to the NDC program.) The normal retirement age is 65 and 4 months for men (gradually rising to age 67 in 2020) and 60 and 4 months for women (gradually rising to age 67 in 2040).

Sources: *Social Security Programs Throughout the World: Europe 2012*, US Social Security Administration, August 2012; "Poland," *International Update*, US Social Security Administration, May 2011 and June 2013; "The Public Finance Sector Debt Management Strategy in the Years 2014–2017," *Ministry of Finance,* September 2013; "Reforma OFE: Pieniądze z Otwartych Funduszy Emerytalnych Trafiły do ZUS," *Money.pl*, February 3, 2014; "Udana Operacja Przekazania Aktywów z OFE do ZUS-u," *Money.pl*, February 4, 2014; "Poland," IBIS, February 27, 2014; "OECD Economic Surveys: Poland," Organisation for Economic Co-operation and Development, March 2014.

Portugal

A new law that was implemented on January 1 raises the full retirement age for a public pension, increases the special contributions levy on higher pensions, and abolishes the sustainability factor (introduced in 2008), which links initial benefits to average life expectancy at retirement. The new measures—which replace a series of measures passed in the 2014 budget that were declared unconstitutional by the constitutional court—aim at reducing Portugal's 2014 fiscal deficit target to under 4 percent of gross domestic product (GDP), as called for under the 2011 bailout agreement with the European Union, the International Monetary Fund, and the European Central Bank.

Changes under the new law include—

- Raising the retirement age from 65 to 66 as of January 2014. Workers may retire at age 65 with a full pension if they are "legally prevented" from working beyond that age. (Early retirement was suspended in May 2012 until the end of the bailout agreement, which is set to expire in June 2014. The only exception is for long-term unemployed individuals who may continue to retire at age 57.) The government plans to link future increases in the retirement age to life expectancy.
- Increasing the special contribution levy (introduced in 2011) for persons with high pension income. The government has lowered the threshold for total pension income that is subject to this levy, from 1,350 euros (US$1,860) to 1,000 euros (US$1,381) a month and introduced higher levy rates for higher income levels; the levy has ranged from 3.5 to 10.0 percent of total pension income, depending on the income level. Currently, the levy for pensions greater than 4,611 euros (US$6,370) a month is 15 percent for up to 7,125 euros (US$9,850) and 40 percent for pensions greater than 7,125 euros. According to the government, about 13 percent of pensioners are required to pay this levy.
- Eliminating the sustainability factor used to determine the initial pension (average life expectancy at retirement), beginning in 2015. Transitionally, the sustainability factor still applies in 2014. As a result, a 65-year-old individual who retires in 2014 has to work another year in order to receive a pension equal to one he or she would have received under the old rules.

Portugal's pay-as-you-go public pension system provides a retirement benefit to workers with at least 15 years of contributions. Since 2008, pensions are adjusted annually to a social support index, which is based on changes in the consumer price index plus growth in the country's GDP. Every 5 years, the index is reviewed to assess whether it is meeting its goal: maintaining the purchasing power of pensions and the financial sustainability of the social security system.

Sources: "Portugal," *International Update*, US Social Security Administration, February 2007 and May 2012; Decreto-Lei n. 167-E/2013, 31 de dezembro de 2014; "Contribuiçao Extraordinária de Solidariedade Afeta Apenas 12,5% dos Pensionistas," Governo de Portugal, 9 de eneiro de 2014; "Portugal Raises Retirement Age, Introduces Longevity Factor," Mercer, January 9, 2014; "Portugal Proposes Broadening Reach of 'Extraordinary Solidarity Contribution' Tax on Pensions," Mercer, January 13, 2014; "Pensão de Velhice," Segurança Social Direta, 20 de eneiro de 2014; "Portugal: Changes to Retirement Age and Sustainability Factor for 2014," IBIS, February 19, 2014; "Portuguese Parliament Oks Government's Pension Reform Plans," IPE.com, February 20, 2014.

The Americas

Costa Rica

Effective January 1, 2014, the ceiling on administrative fees that pension fund management companies (OPCs) may charge accountholders was lowered to 0.70 percent of the account balance. This measure is part of a 2010 ruling by the National Council for the Supervision of the Financial System, which—beginning in January 1, 2011—changed the method of calculating the administrative fees, from a mixed percentage of the accountholder's salary plus the fund's performance to a percentage of the account balance. The ceiling was set at 1.10 percent of the account balance for the 2011–2013 period, with a gradual decrease in the ceiling on fees every 3 years until reaching 0.35 percent in January 2020.

According to the Superintendent of Pensions, the change in the method of calculating fees and the decrease in the rate could increase an old-age pension by at least 21 percent (assuming the accountholder has made all required contributions over a 30-year period and received a 3 percent real rate of return). (Prior to the change, OPCs were permitted to charge fees of up to 4 percent of salary and 8 percent of the fund's performance.)

As of January 1, 2014, five of the six OPCs charge 0.70 percent of the account balance and the remaining one charges 0.68 percent. Total assets under management for the six OPCs was about $US5.5 billion at the end of November 2013; most of the assets are invested in government bonds.

An individual account is mandatory for new entrants to the labor force after 2005. Employees contribute 1 percent of salary and employers contribute 3.25 percent of payroll to the individual account. Employees may choose an OPC and transfer from one OPC to another at any time; those who do not choose an OPC are automatically enrolled in the Banco Popular OPC, part of the government-run bank—Banco Popular. The individual accounts supplement the first pillar pay-as-you-go public pension program. A full retirement benefit from either program is paid at age 65 with 25 years of contributions.

Sources: "Supen Busca Aumentar la Pensión un 21%," FIAP *Noticias*, el 18 de noviembre de 2010; "Estructura Comisiones ROP," Presentación AIOS, diciembre de 2010; SUPEN press release, December 20, 2013; "Supen Reduces OPC Commissions for 2014," IBIS, February 19, 2014; *Social Security Programs Throughout the World: The Americas, 2013,* US Social Security Administration, March 2014.

Reports and Studies

Social Security Administration

The Social Security Administration has released *Social Security Programs Throughout the World: Americas, 2013*—part of a four-volume series that provides a cross-national comparison of the social security systems in 36 countries in the Americas. 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 Europe, Asia and the Pacific, and Africa.

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