Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

May 2014

The Americas

Chile

On April 29, President Bachelet introduced a new pension advisory commission to evaluate the country's current system of individual accounts, after more than 30 years of operation. The commission, made up of 25 national and international pension experts, will also assess the impact of the 2008 reform that made some fundamental changes to the rules regarding individual accounts, including providing benefits to previously uncovered groups. The commission is required to submit a preliminary report by October 2014 and a final report with proposals for necessary changes in January 2015. According to the president, a detailed analysis of the pension system is needed because of concerns surrounding the functioning of Administradoras de Fondos de Pensiones (AFPs)—pension fund management companies—and the adequacy of benefits (particularly for workers who have contributed to the system their entire working lives).

In addition to the issues outlined by the president, the commission will study the effect of demographic challenges facing the national retirement system, including a rapidly aging population. In 2010, according to the World Bank, 10 percent of the population was aged 60 or older, and that figure is projected to reach 16 percent by 2015 and 21 percent by 2030. The United Nations estimated in 2012 that life expectancy at age 60 was 25 years for women and 21 years for men compared with 22 and 19, respectively in 2005. As people are living longer, they will spend more time in retirement and will receive benefits for a longer period of time.

The commission will also analyze "contribution density" among current workers; that is, the proportion of months that a worker makes contributions compared with the maximum number of months the worker could have contributed. Low contribution density means lower benefits and lower replacement rates. Studies from the Superintendent of Pensions indicate that on average, workers contribute to an individual account during 52 percent of their working lives; men contribute during 56 percent and women contribute during 48 percent of their working lives.

Chile's system of individual accounts is made up of six privately managed AFPs, with a total of 91 trillion pesos (US$ 16.2 billion) in assets under management at the end of April. In addition to the monthly contribution of 10 percent of covered earnings, an account-holder must pay an administrative fee to their AFP that, beginning in August, will range from 0.47 percent to 1.54 percent of covered earnings.

Sources: *Population Ageing (Wall Chart)*, United Nations, 2006; "Chile," Population Projection Tables by Country and Group, World Bank, 2011; "Desafios para La Seguridad Social en Chile," Presentación por Ministra del Trabajo y de Previsión Social, el 12 de octubre de 2011; *Population Ageing and Development (Wall Chart)*, United Nations, 2012; Superintendencia de Pensiones noticias, el 27 de enero de 2014; "Valor y Rentabilidad de los Fondos de Pensiones," Superintendencia de Pensiones, abril de 2014; "David Bravo Presidirá Comisión Asesora sobre Pensiones," *Economía*, el 29 de abril de 2014; "Arenas Dice Que Comisión Sobre Pensiones es un Adelanto del Proyecto de AFP Estatal," elmostrador.com, el 29 de abril de 2014; "Economista David Bravo Presidirá Comisión Asesora sobre Sistema de Pensiones," *La Tercera*, el 29 de abril de 2014; Superintendencia de Pensiones comunicado, el 29 de abril de 2014.

Asia and the Pacific

Australia

On May 13, the government presented its 2014–2015 budget to Parliament, which affects many programs throughout the government, including pensions, health care, and family assistance. The government expects this budget to lower the deficit from 2.8 percent of gross domestic product (GDP) in financial year (FY) 2013–2014 to 0.4 percent in FY2016–2017, and reach a 1 percent of GDP surplus by FY2017–2018. According to the National Commission of Audit—an independent government agency that reviews government performance, functions, and roles—if no changes are made, pension expenditures are projected to increase from the current A$40 billion (US$37 billion) a year to over A$72 billion (US$67 billion) in FY2023–2024. About 40 percent of this increase can be attributed to the cost of indexing benefits, and the rest of the increase accounts for the growing number of beneficiaries. (The population aged 65 to 84 is expected to double by 2050.)

Proposals in the budget related to pensions and the aging workforce include the following:

- *Increase the retirement age to 70*. The retirement age is already scheduled to rise to 67 by 2023. Beginning in 2025, the age would rise by 6 months every 2 years and reach age 70 by 2035. Persons born before July 1, 1958, would be exempt from the rise to age 70. (Those born before July 1, 1952, are exempt from the rise to age 67.)
- *Change the indexation method*. Currently, twice a year, first-pillar pensions (Age Pension) are adjusted to changes in the consumer price index (CPI), the beneficiary living cost index; and the male total average weekly earnings. Beginning in September 2017, the Age Pension would be adjusted to the CPI only, twice a year.
- *Delay the increase in the superannuation guarantee contribution rate*. Currently, employers are required to contribute 9.25 percent of an employee's wages to his or her superannuation (retirement) account. That rate is now scheduled to rise to 9.50 percent in July 2014 and reach 12 percent by 2019. The proposal changes the schedule: the rate would remain at 9.50 percent until June 30, 2018, and then gradually increase to 12 percent by 2022.
- *Tighten the asset test.* Currently, the asset-test thresholds for the Age Pension are A$46,600 (US$43,230) for a single person and A$77,400 (US$71,803) for a couple and are indexed annually to changes in the CPI. Beginning in September 2017, the budget proposal lowers those thresholds to A$30,000 (US$27,830) and A$50,000 (US$46,385), respectively, and it maintains the same value (no adjustment) for 3 years.
- *Change incentives to keep older workers in the labor force.* Current tax incentives for workers aged 50 or older who remain in the labor force would be abolished on July 1, 2014, and replaced with wage subsidies paid to employers. Employers who hire workers aged 50 or older would receive up to A$10,000 (US$9,277), paid in installments every 6 months in which the older worker is employed, up to 24 months.

Australia's retirement income system consists of (1) the Age Pension—an asset- and income-tested benefit funded by general revenues; and (2) the Superannuation Guarantee (SG)—the employer-based retirement savings program, which consists of mandatory personal accounts that are funded primarily through employer contributions. (Employee contributions are voluntary.) The employee may choose between a private pension plan—either occupational or personal—and a retirement savings account. Total assets under management for the SG are A$1.3 trillion (US$1.21 trillion).

Sources: *Social Security Programs Throughout the World: Asia and the Pacific, 2012*, U.S. Social Security Administration, 2013; "Eligibility: Age Requirements," *Age Pension*, Australian Government, Department of Social Services, September 23, 2013; "Deeming Rules," Australian Government, Department of Human Services, November 2013; *Towards Responsible Government: The Report of the National Commission of Audit, Phase One*, Australian Government, National Commission of Audit, February 2014; "Introducing Your Super," *Employers Super*, Australian Tax Office, May 5, 2014; *Budget Measures 2014–15*, Budget Paper No. 2, Australian Government, May 13, 2014; "Budget Speech 2014–15," Treasurer of the Commonwealth of Australia, May 13, 2014.

Japan

Effective April 1, a new law changes the rules for Employee Pension Funds (EPFs) to address the increasing number of underperforming funds. The new law prohibits the establishment of any new EPFs; encourages currently underperforming EPFs to dissolve and/or convert to another type of pension plan by April 2019 (and allows the government thereafter to order EPFs that fail to satisfy adequate funding standards to dissolve); and imposes stricter funding rules for the remaining EPFs. Since 1966, employers have been allowed to contract employees out of the earnings-related tier of social security and set up an EPF, which can be a single- or multi-employer defined benefit (DB) plan, in hopes that private-sector asset management would yield higher returns. However, the deteriorating funding status of EPFs in recent years has increased the financial burdens on participating employers who are ultimately responsible for the cost of pensions. Many industry experts predict the new law could result in the elimination of all EPFs in the next 10 years (currently 210 out of the total 562 EPFs are considered to be underperforming).

Under the new law, EPFs with managed assets of less than 150 percent of the "minimum reserve," or the amount needed to pay benefits that replace the public earnings-related tier, must dissolve. EPFs that satisfy the 150 percent funding requirement may continue operation, but are required to pass an annual performance test to assure adequate funding levels. Employer sponsors of EPFs that are being wound up are obligated to return to the government an amount equal to the minimum reserve and make up any funding shortfall. To make it easier for plan sponsors to dissolve EPFs, employers are allowed to pay any shortfall in installments over a period as long as 30 years, provided they begin the wind-up process by April 2019. The interest charged to the employer for amortizing the shortfall is set at the rate of the 10-year government bond when the plan sponsor begins the wind-up process. At the same time, employees whose EPFs are being dissolved will be switched to the earnings-related public program, or Employees' Pension Insurance (EPI). The EPI will also assume the remaining losses of the EPFs that go bankrupt before completing the wind-up process.

EPFs not only provide a substitute benefit (equivalent to the earnings-related portion of the social security pension) but a supplemental benefit as well. Any assets that remain from a dissolved EPF after an employer returns the contracted-out portion owed must be transferred to another retirement plan on behalf of employees that includes (1) an existing or newly established employer-sponsored DB pension plan; (2) a new or existing employer-sponsored defined contribution plan; or (3) the government-sponsored Smaller Enterprise Retirement Allowance Mutual Aid plan, for small to midsize companies. (Asset transfer from an EPF to another type of retirement plan requires permission from employees.)

Japan's social security system includes the following two programs: (1) the National Pension (NP), a partially funded flat-rate program for self-employed persons, farmers, and nonworking spouses and students; and (2) EPI for full-time, private-sector employees. The EPI includes a flat-rate first tier (with contribution and benefit features identical to the NP program) and an earnings-related second tier. Voluntary private pension plans supplement the public pension system.

Sources: "Japan: Bill to Dissolve Employee Pension Funds Passes the Diet," Towers Watson, June 26, 2013; "Japan: Regulations Issued on the Dissolution for Employee Pension Funds," Towers Watson, April 8, 2014; "Japan: Compliance Alert," IBIS e-Visor, April 30, 2014.

Africa

South Africa

As part of the 2014 budget, new tax rules for retirement funds (including occupational and personal pension plans) went into effect on March 1 that increase the amount of lump-sum benefits that are tax exempt. The new rules are meant to help workers with low levels of retirement savings by reducing their tax burden. According to the government, further reforms to promote retirement savings in the country are anticipated in the next few years, based on the recommendations from a series of technical discussion papers released in 2012 and 2013.

Lump-sum benefits are taxed according to the following: (1) preretirement withdrawals, which occur primarily following separation from a job; and (2) retirement withdrawals, which occur at retirement, upon death of the plan member, or following a company closure. Under the new tax rules, the first 25,000 rand (US$2,367) of preretirement lump-sum withdrawals are now tax-exempt, up from 22,500 rand (US$2,130) previously. Withdrawals exceeding 25,000 rand will continue to be taxed at a rate ranging from 18 percent to 36 percent, depending on the size of the withdrawal; the highest rate applies to withdrawals exceeding 900,000 rand (US$85,206). For retirement lump-sum withdrawals, the first 500,000 rand (US$47,337) is now tax-exempt, up from 315,000 rand (US$29,822) previously. (As with preretirement lump sums, withdrawals above this threshold are taxed at a rate ranging from 18 percent to 36 percent.)

In addition, the 2014 budget notes that further reforms related to the taxation of retirement funds will be implemented in the coming years. This includes a plan to make employer and employee contributions to pension plans tax deductible (up to a certain limit) for the employee. (The legislation for this reform was passed in 2013, but it requires regulations that will be drawn up this year and are expected to go into effect in March 2015.)

The South African pension system consists of a noncontributory, means-tested old-age grant, financed by general revenues and supplemented by employer-sponsored and personal pension plans. The old-age grant provides up to 1,350 rand (US$128) a month—up from 1,265 rand (US$120) a month prior to the 2014 budget—to individuals meeting certain asset and income tests. Occupational pension plans are established on a voluntary basis by an employer or group of employers.

Sources: "South Africa," *International Update*, U.S. Social Security Administration, October 2009; *Social Security Programs Throughout the World: Africa, 2013,* U.S. Social Security Administration, August 2013; Budget Review 2014 and "Tax Pocket Guide," National Treasury, February 26, 2014; "South Africa," *IBIS Compliance Alerts*, March 31, 2014.

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