Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

July 2016

Europe

Ukraine Amends Tax Code to Exempt Low-Income Pensioners from Personal Income Taxation

On July 1, a new law went into effect that increases the personal income tax exemption threshold for state pensions. Under the new law, pensioners receiving a monthly state pension of up to 10 times the "minimum subsistence level for people with a disability" are now exempt from personal income taxation. (As of May 1, 2016, the minimum subsistence level for people with a disability is 1,130 hryvnias [US$45.55].) Pensions exceeding this threshold are subject to an 18 percent tax on the portion above the threshold. Previously, pensions exceeding three times the monthly minimum wage were subject to a 15 percent or 20 percent income tax (depending on the pension amount) on the portion above the threshold. (As of May 1, 2016, the monthly minimum wage is 1,450 hryvnias [US$58.45].) According to the government, the new law aims to protect the most vulnerable pensioners from falling into poverty.

Ukraine's pay-as-you-go social insurance system, which includes old-age, survivors, and disability pensions, covers all residents and stateless persons employed under labor or civil law agreements, including those who work abroad, and self-employed persons. Employees contribute from 2 percent to 4.5 percent of their earnings (depending on income), self-employed persons contribute 33.2 percent of the monthly minimum wage, and employers contribute 33.2 percent of payroll. Men who have at least 35 years of coverage can receive the full old-age pension at age 60; women who have at least 30 years of coverage can receive it at age 55 and 6 months as of 2014, gradually rising to age 60 by 2025. The government pays a partial pension to workers who meet the age requirement for the full pension, but who have less than a full coverage period. The old-age pension may be deferred (for an increased pension) from one to 10 years after the normal retirement age. In addition, the government pays a means-tested social pension to low-income citizens who are not working and who are ineligible for an old-age pension.

Sources: *Social Security Programs Throughout the World: Europe, 2014*, U.S. Social Security Administration, September 2014; "Ukraine: Changes to Ukrainian Income Tax Provisions," *Ernst and Young HR and Tax Alert*, March 2015; "Changes in the Ukrainian Pension System (Since 2015)," Ukrainian Law Blog, March 6, 2015; "Taxation and Investment in Ukraine 2016," Deloitte, 2016; "Ukraine: Authorities Clarify New Minimum Wage Levels," Bloomberg BNA, February 16, 2016; "Poroshenko Enacts Amendments to Legislation Exempting Pensions from Taxation," *Interfax-Ukraine*, June 6, 2016; "President Signed Legislative Amendments on Tax Exemption of Pensions," Official Website of the President of Ukraine, June 10, 2016.

Asia and the Pacific

Israel Implements Changes to Second-Pillar Mandatory Retirement Savings

In the first half of 2016, Israel implemented a number of changes to occupational retirement plans to help strengthen retirement savings. One major change involves increasing the minimum mandatory contribution rates for defined contribution (DC) occupational pension plans for both employers and employees. Other changes include harmonized employer contribution rates across different types of retirement plans, reduced tax relief for higher earners, and increased employer responsibility for retirement plan administrative costs. According to a 2016 report by the Organisation for Economic Co-operation and Development, changes to Israel's occupational plans in recent years have enabled the coverage rate of mandatory pension savings to grow to approximately 70 percent of the working-age population aged 15 to 64—a relatively high level for mandatory pension plans internationally.

Since the mid-1990s, Israel's voluntary defined benefit (DB) pension plans for private-sector employees and civil servants (negotiated by collective bargaining) have gradually been replaced by the less generous DC pension plans. In 2008, the DC pension plans became mandatory for all employees not covered by collective bargaining agreements. Employers are now required to provide DC plans for new entrants to the labor force,

including both full-time and part-time (after 6 months) employees. Employees choose a provider and retirement plan, which may be a DC pension plan, provident fund, or life insurance policy (managed by a broker). Under all of these retirement savings options, employees must withdraw a minimum portion of their savings as an annuity at retirement. The main difference among the options stems from the risks covered by the plans. For example, provident funds do not provide death and disability benefits, which are required of DC pension plans and offered by insurance policies. (Different regulations apply to the older DB plans, which also cover death and disability.)

The recent increase in minimum contribution rates amounts to 1 percent overall (equally shared by employer and employee) and is occurring in two steps. (Contribution rates apply to monthly average earnings [currently 9,464 new shekels (US$2,462)].) On July 1, the minimum contribution rate increased from 6.0 percent to 6.25 percent for employers and from 5.5 percent to 5.75 percent for employees. On January 1, 2017, these minimum rates will increase to 6.5 percent for employers and to 6.0 percent for employees.

Other occupational retirement plan changes that took effect earlier this year include:

- On January 1, the earnings threshold—below which employees are exempt from paying taxes on employer contributions—was reduced from 4.0 times to 2.5 times national average earnings, with the result being that higher-paid employees now have a progressively higher tax liability than do lower-paid employees.
- Since February 5, employees remain free to choose the plan and provider for their retirement savings, but the government prohibits employers from contributing at different rates to employee-selected plans or providers. Instead, employers must "align" their contribution rates to ensure that the highest aggregate rate is chosen among all contribution rates currently paid to employee-selected providers or plans. As a result, employer costs are likely to increase, but the employer's total contribution rate (for old-age, disability, and life insurance) is capped at 7.5 percent of earnings.
- Effective June 1, employers must directly pay a share (exact percentage unavailable) of retirement plan administrative costs; previously, this financing came entirely from employer and employee contributions.

In addition to mandatory occupational retirement plans, Israel's retirement system includes a first-pillar universal social insurance program combined with a supplementary means-tested income support program and a third pillar of voluntary personal savings.

Sources: "Israel: Review of the Private Pensions System," Organisation for Economic Co-operation and Development, October 2011; "OECD Economic Surveys: Israel," Organisation for Economic Co-operation and Development, January 2016; *Israel Country Manual*, IBIS eVisor, March 28, 2016; "Israel: Mandatory Contributions to Occupational Retirement Plans to Increase, and Other Changes," *Global News Briefs*, Towers Watson, April 19, 2016.

International

New Organisation for Economic Co-operation and Development Report Examines Differences in Life Expectancy and the Retirement Policy Implications

On June 9, the Organisation for Economic Co-operation and Development (OECD) released *OECD Business and Finance Outlook 2016*, the latest edition of its annual report on major global trends affecting business, finance, and investment. This year's report focuses on the idea of "fragmentation" and contains chapters addressing a diverse set of eight topics, ranging from investing in clean energy to the structuring of stock markets. In one chapter, the report examines how life expectancy differences among older people have produced fragmented or inefficient retirement markets and how these differences could be addressed through policy changes.

The OECD analysis of demographic and retirement data for 23 member countries finds significant life expectancy differences across socioeconomic groups and that the differences have grown over time. Using measures of education, income, and occupation to distinguish between higher and lower socioeconomic groups, the analysis finds that life expectancy at age 65 is consistently higher for higher socioeconomic groups. The life expectancy differences between the highest and lowest socioeconomic groups (as defined by levels of educational attainment) range from one year (Sweden) to seven years (Czech Republic) for men and from six months (Greece) to four years (Australia) for women. In all but one of the countries analyzed, the socioeconomic-based life expectancy differences are larger for men than for women. Those differences have generally widened across time because higher

socioeconomic groups typically experience greater gains in mortality improvement than lower socioeconomic groups.

Given the empirical findings of real and growing disparities in life expectancy across socioeconomic groups, the report provides several key points and policy recommendations, including:

- Pension funds and annuity providers that mostly serve higher socioeconomic groups are likely underestimating longevity risk among their clients because they usually base mortality assumptions on population averages rather than more targeted averages.
- Governments should help produce more detailed and frequently updated data on mortality to allow for better assessment of longevity risk across different segments of society, particularly socioeconomic groups.
- Policymakers should encourage the development of new types of pensions and annuities that can better meet the varied needs of different socioeconomic groups.
- Policymakers should be aware that adjustments to retirement ages and other retirement-policy parameters based on improvements in average life expectancy are likely to be disadvantageous to lower socioeconomic groups given their lower life expectancies. A better approach would be to make adjustments with the aim of keeping the ratio of years in retirement to years of contributions equal across socioeconomic groups and constant across time.

Source: *OECD Business and Finance Outlook 2016*, Organisation for Economic Co-operation and Development, June 2016.

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