International Update

Recent Developments in Foreign
Public and Private Pensions

November 2017

Europe

Switzerland Modifies Second-Pillar Pension Provisions for High-Income Employees

On October 1, the Swiss Federal Council introduced new provisions regulating second-pillar "1e" pensions for employees with annual salaries above 126,900 francs (US$126,595), or 4.5 times the maximum annual social security pension. The provisions require companies that sponsor 1e plans to offer a greater selection of investments while limiting the investment risk for plan participants. The revised plan design eliminates mandatory interest guarantees, thus reducing overall pension liabilities for plan sponsors. Given the new rules, pension experts expect 1e plans to become more attractive to the 15 percent to 20 percent of the working population eligible to participate.

First introduced in 2006, 1e plans (named for the section of the pension law governing them) are pension plans that employers can offer higher-paid employees for the extra-mandatory portion of their contributions made on annual income above 126,900 francs. (Employees can also sign up for a 1e plan outside their employer with a separate pension institution.) Previously, pension funds affiliated with sponsors invested their assets collectively, thus applying a uniform strategy for all members. Under the revised 1e plan design, employees can choose their own investment strategies, allowing them to diversify their portfolio to match their personal preferences and risk appetite. Plans may offer a maximum of 10 investment strategies, which must include at least one low-risk option. Plans must provide members with background material on each investment option, including details on their risks and costs, and obtain written confirmation from the members acknowledging receipt of the information.

At present, approximately 100 companies offer 1e plans. Many companies have avoided offering them because of the mandatory interest guarantees on retirement account balances. (In Switzerland, most pension plans are cash balance plans and thus considered to be defined benefit plans for international accounting purposes.) Previously, if an account balance at the time of payout (when a member leaves a fund) was below the guaranteed amount (principal plus guaranteed interest), the plan was required to fund the shortfall. Removal of the interest rate guarantee under the new rules changes this outcome in two ways. First, it shifts the investment risk from the sponsor (employer) to the employee. Second, it allows companies to remove pension liabilities from their balance sheets because they can now account for 1e plans as defined contribution plans under international accounting standards (provided the benefits are paid as lump sums instead of pensions).

In Switzerland's multi-pillar retirement system, mandatory occupational pensions (including 1e plans) complement the first-pillar universal state pension; the combination of the first two pillars aims to provide a benefit of at least 60 percent of final salary. The third pillar consists of voluntary, tax-exempt savings vehicles managed by banks and insurance institutions.

Sources: "1e Pension Plans: About to Become Much More Attractive," *Disclose*, Issue 2, 2016; "Implementation Considerations for '1e' Plans in Switzerland," Willis Towers Watson, August 15, 2016; "Sector Slams Government Proposals for Regulation on Switzerland's 1e Plans," IPE.com, November 2016; "The Way Is Clear," *Aon Hewitt News*, Issue 4, 2017; "Swiss DC Pension Changes Target High Earners, Encourage Homeownership," Mercer, September 7, 2017; "Switzerland: Changes to Employer-Provided Top-Up Retirement Savings Plans Include Elimination of Minimum Benefit Guarantee," Willis Towers Watson, September 19, 2017; "Switzerland," IBIS eVisor News, October 24, 2017.

Ukraine Passes Public Pension System Reforms

On October 8, the Ukrainian president signed into law a pension reform bill that increases the minimum contribution period for partial old-age pensions, changes the pension formula, recalculates current pensioners' benefits, introduces automatic indexation, increases minimum old-age pensions, and makes other changes to the country's public pay-as-you-go (PAYG) pension system. The reforms are intended to make the pension system more financially sustainable and to improve benefit adequacy for many low-income pensioners. According to recent government estimates, the pension system's deficit will reach 141.3 billion hryvnias (US$5.25 billion) by the end of the year. The International Monetary Fund (IMF) made pension reform a key requirement for Ukraine to receive a US$8.4 billion loan payment, which was part of a larger US$17.5 billion loan package approved in February 2015 to help the country recover from a 2-year recession.

Under the new law, the minimum contribution period for a partial old-age pension will increase from 15 years to 25 years in January 2018, and by 1 year each subsequent year until it reaches 35 years in 2028. Individuals with less than the minimum years of contributions will be able to purchase up to 5 years of pensionable service for 16,896 hryvnias (US$628) per year. In addition to meeting the contribution requirement, individuals must reach the normal retirement age of 60 (men) or 58 (women, gradually increasing to age 60 in 2021) to be eligible for a pension. (The IMF had recommended an increase in the normal retirement age to 63 for men and women by 2027, but this was not included in the new law.)

Other key changes made by the law include:

- *Adjusting the pension formula:* Starting in 2019, old-age pensions will be 1 percent (down from the current 1.35 percent) of the average national wage over the previous 3 years multiplied by the number of full years of covered employment and the insured's wage factor (based on the insured's earnings and contribution history). Transitional rules apply to pensions claimed from October 2017 through December 2018.
- *Recalculating benefit amounts for current pensioners:* On October 1, current pensions were recalculated using the new formula and the average national wage from 2014 to 2016 (3,764.40 hryvnias [US$140]). The last time pensions in payment were adjusted was in 2012 (using the average national wage for 2007), even though the average national wage has more than tripled since 2007.
- *Introducing automatic indexation of pensions:* Starting in 2021, pensions will be adjusted annually by 50 percent of the growth in the consumer price index from the previous year and by 50 percent of the growth of average monthly wages for the past 3 years. (Currently, benefits are adjusted periodically according to changes in the average national wage and inflation.)
- *Increasing the minimum old-age pension:* On October 1, the minimum monthly pension increased from 1,312 hryvnias (US$49) to 1,452 hryvnias (US$54).

Ukraine's PAYG pension system covers all residents and stateless persons employed under labor or civil law agreements and self-employed persons. Employers contribute 22 percent of payroll and self-employed persons contribute 22 percent of the minimum wage to fund the system; insured persons do not contribute. An old-age social assistance pension is paid to low-income Ukrainian citizens who do not meet the contribution requirements for the old-age pension but are age 63 (men) or 61 (women).

Sources: *Social Security Programs Throughout the World: Europe, 2016*, U.S. Social Security Administration, September 2016; "Ukraine's Parliament Gives the Thumbs Up for Pension Reform," Unian, October 3, 2017; "President Approves Pension Reform," Ukrinform, October 9, 2017; "10 Things You Should Know about Ukraine's Pension Reform," Global Ukraine, October 10, 2017; "Pension Reform Law Comes Into Force," Ukrinform, October 11, 2017.

Asia and the Pacific

Thailand Changes Rules Governing Retirement Age and Severance Pay

Effective September 1, Thailand's government established age 60 as the default retirement age and began requiring all private-sector employers to pay severance to employees retiring at this age or later. Employers may set the retirement age below the default age of 60, but they still must pay severance when their employees retire. To receive the severance benefit, employees must notify their employers 30 days in advance of their intended retirement dates. Employers face fines of up to 100,000 baht (US$3,016) and imprisonment up to 6 months if they do not pay severance to eligible retiring employees.

Previously, Thai law did not specify a default retirement age nor require employers to pay severance at retirement. However, employees are generally entitled to severance pay when they can no longer work for pay (service termination) because of a business closure, a business relocation, or some other business-related change. In recent years, Thai courts have ruled that retirement is a form of service termination when employers establish retirement ages for their employees. In these cases, employers have been required to pay severance to retirees as they would to any other terminated employee. Current law limits severance pay to 300 days for employees with at least 10 years of service and lower amounts for employees with 120 days to 10 years of service. Thailand's legislature is currently considering amending the law to raise these severance pay limits, particularly for employees with 20 or more years of service.

In addition to severance benefits, Thailand maintains public-sector pension programs that cover workers in the formal sector (those who receive a wage and are eligible for severance pay from an employer) and certain individuals in the informal sector (those without an employer, such as self-employed persons and those operating small family businesses and microenterprises). Programs covering the formal sector (more than 14 million workers) include the Social Security Fund for private-sector employees and the Government Pension Fund for civil servants and state-enterprise employees; provident funds provide supplemental coverage to around 3 million private-sector workers. For informal-sector workers, there is an old-age allowance program providing financial assistance to low-income individuals aged 60 or older. In addition, the government introduced a voluntary retirement savings program in 2015, which features a government match for contributions for the 24 million workers younger than age 60 not covered by social security or a provident fund.

Sources: "Pension Systems and Old-Age Income Support in East and Southeast Asia," Asian Development Bank, 2011; "Thailand: New Voluntary Retirement Savings Program Is Introduced," *International Update*, U.S. Social Security Administration, October 2015; "Thailand," IBIS eVisor News, February 17, 2017; "Thailand Considers Statutory Retirement Age of 60, Related Severance Payment," Mercer, May 3, 2017; "Thailand 2017," IBIS eVisor Country Manual, June 30, 2017; "Thailand," IBIS eVisor Compliance Alerts, October 24, 2017; "A Look Inside Recent and Proposed Changes to Thai Labor Law (Revised)," Mercer, November 1, 2017.

The Americas

El Salvador Approves Changes to Mandatory Individual Account Program

On September 27, El Salvador's government approved changes to the country's mandatory individual account program that increased employee and employer contributions and established a new funding mechanism for minimum guaranteed benefits. (Minimum guaranteed benefits are paid if the individual account balance is insufficient to provide the minimum pension set by law.) Effective November 15, the employee and employer contribution rates applied to covered earnings rose from 6.25 percent to 7.25 percent and from 6.75 percent to 7.75 percent, respectively. Of the combined employee and employer contributions, 8 percent of covered earnings (down from 10.8 percent previously) is allocated to the individual account, 1.9 percent (down from 2.2 percent previously) to disability and survivor insurance and administrative fees, and 5 percent to the new Solidarity Guarantee Fund (*Cuenta de Garantía Solidaria* or CGS). Starting in 2019, the individual account allocation will gradually increase and the CGS allocation will gradually decrease until they reach 11.1 percent and 2 percent, respectively, by 2050. The CGS is intended to provide additional funds to finance minimum guaranteed benefits and certain contribution credits and special pensions. While the changes may result in lower pensions for some participants, the government expects them to improve the stability of benefits for current and future pensioners.

Other key details of the changes include:

- The entire employee contribution continues to be directed to the individual account. The shifting allocations of the total contribution reflects gradual changes in how the employer contribution is divided between the individual account and CGS. As before, the employer contribution also covers the entire cost of the program's disability and survivor insurance and administrative fees.
- Some pensioners and the government must also contribute to the CGS. Pensioners not receiving the minimum monthly pension (currently US$207.80) pay 3 percent to 10 percent of their pensions (according to benefit amount) to the CGS. Starting in 2018, the government will allocate 1.7 percent of its annual budget (rising to 2.5 percent in 2020) to the CGS.
- A new longevity benefit is paid to pensioners after 20 years of pension receipt. The amount of this benefit varies according to the payment option and amount of the original pension. (At retirement, a participant can choose to receive programmed withdrawals, purchase an annuity, or combine these two payment methods.) Funding for this new benefit comes from the CGS.

El Salvador's mandatory individual account program covers public- and private-sector employees not covered by one of the two legacy social insurance programs. (The government introduced the mandatory individual account program in 1998 to replace the social insurance programs.) To qualify for a pension under the mandatory individual account program, a participant must be at least age 60 (for men) or age 55 (for women) and have at least 25 years of contributions. (Retirement at any age is possible if a participant's account balance is sufficient to fund a monthly pension above certain minimums.) For a participant who meets the qualifying conditions but has an account balance that is insufficient to provide a minimum monthly pension (US$207.80 in 2017), the program subsidizes the individual account to guarantee that the participant receives the minimum monthly pension.

Sources: *Social Security Programs Throughout the World: The Americas, 2015*, U.S. Social Security Administration, March 2016; "Decreto N° 787: Reforma Ley del Sistema de Ahorro para Pensiones," September 2017; "Desde noviembre descontarán 15% al salario para pensiones," *El Mundo* (El Salvador), October 11, 2017; "ES: vigentes nuevas tasas de cotización para pensiones," El Economista, October 16, 2017; "A partir del 15 de noviembre te descontarán más en cotización AFP," elsalvador.com, November 2, 2017.

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Editor: John Jankowski

Writers/researchers: Ben Danforth, John Jankowski, and David Rajnes.

Social Security Administration
Office of Retirement and Disability Policy
Office of Research, Evaluation, and Statistics
500 E Street, SW, 8th Floor, Washington, DC 20254

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