International Update

Recent Developments in Foreign Public and Private Pensions

December 2022

Europe

Estonia Adopts Measures to Help Older Residents

Estonia's government has recently adopted several measures targeted at the country's older residents, which include providing a one-time bonus and permanent benefit increases to old-age pensioners, establishing a higher basic tax exemption for the aged, and paying outstanding old-age benefits owed by Russia to Estonian residents. These measures are intended to help Estonia's older residents cope with financial disruptions caused by Russia's invasion of Ukraine and historically high inflation. In the last 2 years, Estonia's annual inflation rate has increased from -1.1 percent to 21.3 percent, the second highest rate among the 19 euro-area countries. This rapid increase in inflation has contributed to a jump in the share of Estonia's residents aged 65 or older who are at risk of poverty, with the share rising from 40.6 percent in 2020 to 52.4 percent in 2021. (Estonia considers individuals at risk of poverty if they have equivalized disposable incomes less than 60 percent of the national median. In 2021, the risk-of-poverty threshold was €763 [US$798] a month.)

The measures adopted to help Estonia's older residents include:

- *Providing a one-time bonus:* In November, the government distributed a one-time bonus of €50 (US$52) to old-age and disability pensioners and child benefit recipients.
- *Implementing permanent benefit increases:* Effective January 1, the basic flat-rate component of the social insurance old-age pension (currently €255.76 [US$267.37] a month) and the social assistance national pension (currently €275.34 [US$287.84] a month) will increase by €20 (US$21) a month. (The social insurance old-age pension has a basic flat-rate component and two earnings-related components.) These extraordinary increases are separate from the cost-of-living adjustment made to old-age pensions every April based on changes in inflation and social security revenues.
- *Establishing a higher basic tax exemption for the aged:* On January 1, the government will introduce a separate basic tax exemption for individuals who have reached the normal retirement age of 64 years and 6 months (gradually rising to 65 by 2026). Under this exemption, qualifying individuals will pay no income taxes on their monthly incomes up to Estonia's average monthly old-age pension (projected to be €704 [US$736] in 2023). Currently, retirement-age and working-age individuals receive the same basic tax exemption, which starts at €500 (US$523) a month and decreases with higher incomes.
- *Paying outstanding old-age benefits owed by Russia:* On November 25, the government paid the old-age benefits owed by Russia to around 4,000 Estonian residents for July, August, and September. Although Estonia and Russia have a bilateral agreement allowing residents of each country to receive old-age benefits from the other, financial sanctions imposed against Russia after its invasion of Ukraine have hindered Russian pension payments to Estonian residents. (Estonia has not encountered any similar problems making pension payments to Russian residents.)

Estonia's old-age pension system consists of the social insurance program, an individual account program, and the social assistance national pension program. The social insurance program covers employed and self-employed residents of Estonia and is financed by employers and self-employed persons (with a contribution rate of at least 16 percent of gross monthly payroll/earnings). Workers covered by the social insurance program and born after 1982 are automatically enrolled in the individual account program, though they can suspend or terminate their participation at any time. (Workers not covered by this auto-enrollment provision can voluntarily join the program.) To fund the individual account program, employees contribute 2 percent of gross monthly earnings and employers contribute 4 percent of gross monthly payroll. Individuals qualify for social insurance and

individual account old-age pensions at the normal retirement age if they have at least 15 years of service. (Early or deferred retirement is possible.) Retirement-age individuals who do not qualify for a social insurance pension may qualify for a national pension if they have resided in Estonia for at least 5 years.

Sources: *Social Security Programs Throughout the World: Europe, 2018*, U.S. Social Security Administration, September 2018; "Pensioni indekseerimine ja ümberarvutamine," Sotsiaalkindlustusamet, April 1, 2022; "Average Monthly Pension to Increase by More Than €100 Next Year," ERR, August 23, 2022; "Basic Exemption for People of Retirement Age to Rise to €704 on January 1," ERR, November 1, 2022; "Ühekordne hinnatõusu leevendamise toetus aitab eakaid, lastega peresid ja töövõimetuspensionäre," Sotsiaalkindlustusame, November 8, 2022; "Estonian Government Makes One-Off Russian Pensions Payment," ERR, November 30, 2022; "Basic Exemption at Pensionable Age," Estonian Tax and Customs Board, December 9, 2022; "At-Risk-of-Poverty Rate Is Highest Among the Elderly, While Among Families With Children It Is Highest for Single Parents," Statistics Estonia, December 9, 2022.

Portugal to Lower Retirement Age

On January 1, Portugal's normal retirement age will decrease from 66 years and 7 months to 66 years and 4 months following a decrease in the country's average life expectancy during the COVID-19 pandemic. Since 2015, the normal retirement age for Portugal's pension system has been adjusted annually based on changes in average life expectancy at age 65. According to Statistics Portugal, the country's average life expectancy at age 65 for the 2019–2021 period decreased by 0.34 years (or approximately 4 months), from 19.69 years to 19.35 years. This was the first decrease since the normal retirement age was linked to average life expectancy at 65.

Based on current estimates of average life expectancy for the 2020–2022 period, the normal retirement age would remain at 66 years and 4 months in 2024. According to Statistics Portugal, the average life expectancy at age 65 for this 3-year period decreased by 0.05 years (or less than 1 month) compared to the 2019–2021 period. However, this provisional estimate does not incorporate the full results of Portugal's 2021 census. Statistics Portugal will publish estimates based on the complete results of the 2021 census in 2023.

Portugal's old-age pension system consists of a contributory program for employed and self-employed persons and a noncontributory program for residents not entitled to contributory benefits. To qualify for a contributory old-age pension at the normal retirement age, an individual must have at least 15 years of contributions. (A full pension is paid with at least 40 years of contributions.) However, the contributory pension can be claimed as early as age 60 with at least 40 years of contributions. In most cases, early pensions are reduced by 0.5 percent for each month they are claimed before the normal retirement age and by an additional percentage based on a sustainability factor. (The sustainability factor is the ratio between the average life expectancy at age 65 in 2000 and in the year before an early pension is claimed. In 2022, the reduction based on this factor is 14.06 percent.) A Portuguese resident who does not qualify for a contributory pension at the normal retirement age can receive a noncontributory old-age pension if they have gross monthly income below a certain limit.

Sources: *Social Security Programs Throughout the World: Europe, 2018*, U.S. Social Security Administration, September 2018; "The Provisional Value of Life Expectancy at Age 65 Was Estimated at 19.35 Years - 2019–2021," Statistics Portugal, November 29, 2021; "Retirement Age Will Decrease in 2023 Due to Pandemic Effects," Supercasa, November 30, 2021; "The Provisional Value of Life Expectancy at Age 65 Was Estimated at 19.30 years - 2020–2022," Statistics Portugal, November 29, 2022; "Retirement Age to Remain the Same," *The Portugal News*, November 29, 2022.

International

Organisation for Economic Co-operation and Development Releases OECD Pensions Outlook 2022

On December 1, the Organisation for Economic Co-operation and Development (OECD) released *OECD Pensions Outlook 2022*, the sixth edition of its biennial report on major policy issues facing public and private pension systems in the 38 OECD member countries. This year's report highlights the growing importance of asset-backed pension arrangements—pension arrangements in which retirement savings are invested to accumulate assets that fund benefits—in OECD countries and provides recommendations on introducing, developing, and strengthening such arrangements. The report also discusses creating fees structures to protect retirement assets and better reflect servicing costs, improving mortality assumptions, and creating non-guaranteed lifetime retirement income arrangements.

The report finds that recent economic shocks have not significantly affected pension outcomes, although longer-term developments may undermine the capacity of pension programs to deliver in the future. To mitigate this risk, OECD countries have implemented

reforms in the last 2 decades that include introducing new asset-based pension arrangements (such as new defined contribution programs), transforming unfunded defined benefit programs into asset-backed arrangements, expanding existing asset-backed pension arrangements through the introduction of mandatory coverage or automatic enrollment, and creating asset-backed pension arrangements for workers lacking other pension coverage (such as self-employed persons). As a result of these reforms and other developments, the total assets earmarked for old-age pensions in OECD countries reached just over 100 percent of the countries' combined gross domestic product at the end of 2021.

The report's other key conclusions on the development and operation of asset-backed pension arrangements include:

- *Establishing good governance:* The experiences of OECD countries show that introducing asset-backed pension arrangements comes with risks, especially when capital markets are incomplete or lack depth. Governments can manage these risks by giving regulators the necessary authority and capacity to supervise asset-backed pension arrangements. This includes establishing a robust legal framework to ensure that pension plan providers act in the best interest of plan participants. Governments can also strengthen asset-backed arrangements by adopting measures that foster competition and build trust. For example, developing a system around pension providers that are independent (e.g., Australian industry funds) or not-for-profit (e.g., Dutch pension funds) can generate higher trust in the system.
- *Encouraging employer involvement:* Employers play an important role in administering and financing asset-backed pension arrangements—the share of employer contributions to these arrangements is greater than 50 percent in most OECD countries and exceeds 70 percent in 10 OECD countries. However, some employers (especially smaller ones) may be unwilling to establish pension plans due to the expense, complexity, and administrative burden involved. To encourage broad employer involvement in asset-backed pension arrangements, governments can adopt measures that consider labor market patterns and mobility, reduce barriers to establishing pension plans, allow tailored pension plans, and streamline the financial regulatory environment.
- *Optimizing fee structures:* To finance asset-backed pension arrangements, providers can levy fees on contributions, assets, or investment returns. Although these fee structures can be designed to have identical effects on accumulated assets and net returns, pension providers usually prefer to charge fees based on assets or returns. Governments can use these performance-based fees to align the interests of providers and savers and produce more optimal outcomes for both groups.
- *Reevaluating mortality assumptions:* Mortality assumptions have an essential role in determining the amount of assets a pension plan must accumulate to provide lifetime retirement benefits for its members. To improve the accuracy of these assumptions, governments and regulators can establish guidelines and rules that encourage pension providers to use mortality models that more closely match their participant populations, better account for future improvements in life expectancy, and better reflect other economic and social trends.
- *Creating non-guaranteed lifetime retirement income arrangements:* Non-guaranteed lifetime retirement arrangements provide benefits for life by pooling the longevity risk of their participants, but they do not require any financial guarantees from the sponsors. These arrangements may be attractive because they have the potential to generate higher returns for participants—with the understanding that benefits are not guaranteed and may be adjusted to align with available assets—while limiting the financial liabilities of sponsors. However, the experiences of OECD countries show that there are many obstacles to implementing these arrangements in the real world.

Sources: *OECD Pensions Outlook 2022*, Organisation for Economic Co-operation and Development, December 2022.

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