International Update

Recent Developments in Foreign Public and Private Pensions

January 2023

Asia and the Pacific

Australia Offers Incentives for Pensioners to Downsize Homes

On January 1, Australia's government implemented a law that provides financial incentives for recipients of the means-tested Age Pension to downsize to smaller homes by extending the period during which proceeds from the sale of a primary residence are not counted as financial assets and reducing the interest rate at which those proceeds are deemed to earn income. A statement from Ministers for the Department of Social Services said the new law is intended to increase the stock of larger homes available for younger families to purchase by incentivizing home-owning pensioners to downsize to smaller homes. According to a recent study of Australian census data, 55 percent of Australians aged 25 to 39 were homeowners in 2021 compared to 66 percent of the same age group in 1991.

Australia's Age Pension is subject to both asset and income tests. Under previous rules, proceeds from the sale of a primary residence were exempt from the asset test for 12 months, with a further 12-month extension possible in extenuating circumstances. In addition, most of the proceeds from the sale of a home were deemed to earn income at the rate of 2.25 percent annually. (This deemed income counts against the income test for the Age Pension.) Under the new rules, the asset test exemption for home-sale proceeds has been extended to 24 months (with a further 12-month exemption possible in extenuating circumstances), and the deeming rate used to calculate annual income from these proceeds has been reduced to 0.25 percent. Thus, pensioners who sell a primary residence will have more time before the sale proceeds count against the asset test and less income counted against the income test.

The main components of Australia's old-age pension system are the superannuation program and the Age Pension. The superannuation program is a mandatory defined contribution occupational pension program covering employed persons aged 18 to 69. Employees are not required to contribute, but the government offers tax incentives and matching funds to encourage voluntary contributions. Voluntary coverage is possible for self-employed persons. Employers are required to contribute an amount equal to 10.5 percent of employees' earnings (rising by 0.5 percentage points a year until reaching 12 percent in July 2025) to private superannuation funds. A homeowner and spouse aged 60 or older who sell a home after 10 or more years of ownership can make tax-free contributions up to A$300,000 (US$203,900) each to their superannuation accounts, which can be withdrawn tax-free at retirement. To receive a superannuation retirement benefit, a participant must have reached age 59 (rising to age 60 in July 2024) and be permanently retired (or participating in the Transition to Retirement program). Individuals aged 66 and 6 months or older (rising to age 67 in July 2023) who meet certain asset, income, and residency requirements may also qualify for the Age Pension, which is funded and administered by the Australian government.

Sources: *Social Security Programs Throughout the World: Asia and the Pacific, 2018*, U.S. Social Security Administration, March 2019; "Pensioners Incentivised to Downsize to Free Up Housing Stock for Young Families," Ministers for the Department of Social Services (Australia), September 7, 2022; "Owning a Home Has Decreased Over Successive Generations," Australian Bureau of Statistics, October 20, 2022. "Pensioners Receive Added Incentive to Downsize," Ministers for the Department of Social Services (Australia), November 25, 2022; "Pensioners Offered Further Incentives to Downsize Their Home," Startsat60.com, November 27, 2022.

China Launches Third-Pillar Pension Program

On November 25, China's government launched a third-pillar private pension program in 36 cities to complement the country's first-pillar state pension and second-pillar occupational pension programs. The government first announced the framework for the third-pillar program in April 2022 after implementing a pilot program in select cities in September 2021. The third-pillar program is intended to boost voluntary retirement savings among China's workers as the country faces growing economic challenges from rapid population aging. With its relatively low retirement age (60 for men, 55 for women white-collar workers, and 50 for women blue-collar workers) and declining fertility rate (1.16 children per woman in 2021), China is expected to see its working-age population shrink by around 35 million individuals from 2021 to 2025. As a result of these trends, the government projects the ratio of retirees to workers in China to rise from 17 percent in 2020 to 33 percent in 2035.

The latest details of the new third-pillar pension program include:

- *Eligible workers:* Individuals covered by the first-pillar state pension programs can choose to participate in the third-pillar program. At the end of 2021, the first-pillar programs covered 1.03 billion individuals.
- *Account setup:* A participant can have one personal pension account under the third-pillar program. The account must be opened using the Personal Pension Information Management Service Platform, which tracks contributions, investment earnings, payments, taxes, and other transactions.
- *Account contributions:* Participants can contribute up to 12,000 yuan (US$1,739.45) annually to their personal pension accounts. (There are no employer contributions.) The contribution ceiling may be adjusted in the future by the Ministry of Human Resources and Social Security and the Ministry of Finance based on socioeconomic factors.
- *Tax incentives:* To encourage participation, the government offers an annual tax deduction for contributions up to 12,000 yuan and a reduced tax rate on pension benefits (reduced from 7.5 percent to 3 percent). In addition, a participant's investment gains are not taxed.
- *Investment options:* Participants can invest their savings in products that meet certain standards, including having clear investment strategies and focusing on long-term performance. These products can include target date funds (with assets under management of at least 50 million yuan [US$7.25 million]), mutual funds, equity funds, bond funds, and insurance products. Pension industry sources forecast that third-pillar program investments could result in China's private pension market growing from the current US$300 billion to US$1.7 trillion by 2025.
- *Benefits access:* Participants can make withdrawals from their account once they have reached the normal retirement age, lost the ability to continue working, or left China. Funds can be withdrawn as a lump sum or in monthly installments.
- *Inheritance provisions:* If a participant dies before reaching the normal retirement age, their account balance will bequeath to their designated heirs.
- *Program administration:* The China Banking and Insurance Regulatory Commission oversees the commercial banks and wealth management companies that administer the personal pension accounts. Separately, the China Securities Regulatory Commission regulates the investment products that can be offered to participants.

Besides third-pillar pensions, China's pension system consists of: (1) separate first-pillar programs for urban employees, and rural residents and nonsalaried urban residents, which are administered at the provincial and local levels; and (2) second-pillar occupational pension programs that primarily cover employees of large state-run enterprises. The first-pillar programs for urban employees generally include a social insurance pension funded by an employer contribution of up to 20 percent of payroll, and a mandatory individual account funded by an employee contribution of 8 percent of gross covered earnings. The first-pillar programs for rural residents and nonsalaried urban residents generally include a noncontributory pension funded by the central and local governments, and an individual account funded by personal contributions. The second pillar consists of voluntary employer-sponsored occupational pensions.

Sources: "China Rolls Out Private Pension Plan," State Council of the People's Republic of China, April 21, 2022; "China Outlines Third-Pillar Pension Framework," *International Update*, U.S. Social Security Administration, May 2022; "China's First Ever Private Pension Scheme—What You Need to Know," *China Briefing*, September 29, 2022; "China Rolls Out Private Pension Scheme in 36 Cities," *The Business Times*, November 25, 2022;

"China Officially Launches New Private Pension Scheme—Who Can Take Part?" *China Briefing*, December 5, 2022; "What China's Demographic Decline Means for Its Retirement and Pension Systems," Stratfor, January 13, 2023.

The Americas

El Salvador Implements Pension Reforms

On December 30, El Salvador's government implemented reforms to the country's mandatory individual account program (Sistema de Ahorro para Pensiones, or SAP) that include modifying contribution rules, lowering account fees, applying a 30 percent benefit increase, establishing a maximum monthly pension, and creating a new pension agency. The government approved the reforms on December 20 to address long-standing concerns about old-age pension adequacy and sustainability. However, the reforms do little to expand pension coverage to workers in El Salvador's large informal sector. In October, the SAP had 833,181 registered contributors (or around 31 percent of the labor force) and over US$14.1 billion in assets.

The key provisions of the SAP reforms (effective December 30 unless otherwise noted) include:

- *Increasing the employer contribution rate:* The employer contribution rate increased from 7.75 percent to 8.75 percent of monthly payroll. The employee contribution rate remains at 7.25 percent of monthly earnings.
- *Expanding the contribution base:* Contributions are now calculated based on an employee's total gross monthly earnings—including paid leave, commissions, and other compensation—without a cap. Previously, there was a US$7,045.06 ceiling on the monthly earnings used to calculate contributions.
- *Lowering account fees:* The fees paid to the pension fund management companies (Administradoras de Fondos de Pensiones, or AFPs) that administer the SAP decreased from 1.9 percent to 1 percent of monthly earnings. (These fees are incorporated into the employer contribution rate and cover disability and survivor insurance and administrative costs.)
- *Applying a 30 percent benefit increase:* Effective January 1, old-age pensions increased by 30 percent, with minimum and maximum adjusted monthly benefits of US$400 and US$3,000, respectively. (Certain old-age pensioners, including those who made early withdrawals, received smaller benefit increases. The 30 percent increase also applied to old-age pensions paid under El Salvador's two legacy social insurance programs.)
- *Establishing a maximum monthly pension:* Starting on January 1, old-age pensions cannot exceed US$3,000 a month. Previously, only the pensions of certain participants who opted into the individual account program under transition rules were subject to a maximum of US$2,000 a month. The minimum monthly old-age pension remains at US$304.17.
- *Modifying solidarity contribution rules:* Old-age pensioners receiving monthly pensions greater than six times the minimum monthly pension (or US$1,825.02) must pay 7 percent of their pensions to the Solidarity Guarantee Fund (Cuenta de Garantía Solidaria, or CGS). (The CGS is used to finance the longevity pension provided to SAP pensioners who exhaust their savings and other guaranteed minimum benefits.) Previously, the solidarity contribution was levied on monthly pensions exceeding the minimum monthly pension, and the contribution rate ranged from 3 percent to 10 percent, depending on the pension amount.
- *Ending early withdrawals:* Participants can no longer withdraw up to 25 percent of their account balances before retirement.
- *Creating a new pension agency:* The government created the Salvadorian Pension Institute (Instituto Salvadoreño de Pensiones) to administer legacy social insurance benefits and oversee borrowing from the SAP to finance these benefits. (Since 2006, the government has borrowed over US$9.6 billion from the SAP.)

The SAP covers public- and private-sector employees not covered by the two legacy social insurance programs. (The government introduced the SAP in 1998 to replace the social insurance programs.) To qualify for an old-age pension under the SAP, a participant must have reached age 60 (men) or age 55 (women) and have at least 25 years of contributions. If a participant meets these qualifying conditions but has an account balance that is insufficient to finance the minimum monthly pension, the participant's pension is topped up to the monthly minimum pension using funds from the CGS. Individuals who do not qualify for a SAP or social insurance pension may receive a government-financed basic old-age pension if they have reached age 70 and reside in a municipality with a high level of extreme poverty.

Sources: *Social Security Programs Throughout the World: The Americas, 2019*, U.S. Social Security Administration, March 2020; Decreto N° 614: Ley Integral del Sistema de Pensiones, 2022; "Boletín mensual de rentabilidad de los fondos de pensiones," Superintendencia del Sistema Financiero, October 2022; "Gobierno de Bukele sí ha usado $1,322 millones de los ahorros de trabajadores para pagar pensiones," elsalvador.com, December 14, 2022; "Los 12 cambios más significativos de la reforma de pensiones en El Salvador," *Diario El Mundo*, December 20, 2022; "Cotizantes esperaron 26 años para tener una ley que brindara pensiones justas," Asamblea Legislativa de El Salvador, December 21, 2022; "Lineamientos sobre la aplicaciem de disposiciones establecidas en la Ley Integral del Sistema de Pensiones," Banco Central de Reserva de El Salvador, December 30, 2022.

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Editor: Ben Danforth

Writers/researchers: Ben Danforth, Patrick J. Purcell, and David Rajnes.

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

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