Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

January 2005

Europe

Austria

Austria has aligned the provisions of its pay-as-you-go pension systems for federal civil servants, farmers, the self-employed, and others with those for most workers in the private sector. In addition to reducing inequities between future pensioners, the government expects this action to enhance labor mobility by removing distortions generated by different contribution rates and benefit levels across the various systems. The parliament approved the reform legislation on November 24, following months of discussion between the government and the various constituencies. The new provisions modify some of the features of the pension reform legislation passed by the parliament in July 2003 and implemented in July 2004. (See also the August 2004 issue of *International Update*.)

The new provisions will apply fully to new entrants to the labor force who are under the age of 50 on or after January 1. A mix of the old and new provisions will apply to those with a work history under the old system. All workers will begin receiving an annual account statement beginning in 2007.

The full retirement age for men will remain at 65, but it will now be flexible with a "corridor" between the ages of 62 and 68. During this period workers may retire with an annual 4.2 percent reduction in their pension benefit for each year under age 65 or a 4.2 percent increase in the benefit for each year worked after age 65. Women will continue to be allowed to retire at age 55 until 2019, at which time the retirement age will be raised gradually to equal that for men by 2033. A current long-service pension provision for heavy laborers (*Hacklerregelung*) will be extended until 2015 to allow men with 45 years of coverage and women with 40 to remain eligible to retire without penalty at the ages of 60 and 55, respectively.

Workers in occupations defined as arduous or dangerous will be allowed to claim 3 months of early retirement for each year after a minimum of 15 years of employment with an annual deduction of 2.1 percent, or one-half the rate applied to other categories of workers who choose early retirement.

In general, the contribution rate will be set at the current level for private-sector employees, 22.8 percent of gross wages (12.55 percent from the employer and 10.25 percent from the employee), and 45 years of contributions will be required to receive a pension worth up to 80 percent of wages. Farmers and the self-employed, however, will contribute at a rate of 15 percent and 17.5 percent, respectively. The government will establish a supplemental pension program to compensate for potentially lower future retirement benefits to federal civil servants whose contribution rates are being reduced.

Sources: European Industrial Relations Observatory On-line (eironline; http://www.eiro.eurofound.eu.int), September 2004; APA News Service, October 12 and December 2, 2004; International Benefits Information Service (IBIS), October and December 2004; http://www.IPE.com (Web extension of *Investment & Pensions Europe*), November 24, 2004; and *Pensions International*, January 2005.

Malta

The Prime Minister issued a white paper on November 24 that recommends major eligibility and benefit reforms to the current social security system, including increasing the retirement age and creating a three-pillar framework. Details of the pension reform will be debated by the parliament as it considers the 2005 budget.

Today, Maltese workers are covered by a social security system under which the employee, the employer, and the government each contribute 10 percent of an employee's basic salary; the self-employed contribute at a rate of 15 percent, which is matched by the government. In both cases, contributions are capped at an annual maximum of about Lm 6,750 (US$20,419). The benefit formula is based on the average of the best 3 of the last 10 consecutive calendar-year wages in the case of employees and on the average net income of the last 10 years for the self-employed. The current retirement age is 61 for men and 60 for women, and a full pension is earned after 30 years of contributions with a partial prorated pension available to workers with at least 9

years of contributions. The social security benefit is reduced if a worker is eligible to receive an occupational pension.

According to a World Bank study in 2004, excluding the 10 percent government contribution, pension expenditures already exceed revenues by about 2 percent of gross domestic product (GDP)—a shortfall that will reach 3.5 percent of GDP by 2015 and 4.7 percent by 2030. Low fertility rates will cause the population to decrease by more than 14 percent by 2050, and the proportion of those aged 60 and older will increase steadily from the current 18 percent of the population to more than 31 percent in 2050. The country's labor force participation rate of 54 percent is well below the European Union's target of 70 percent for 2005.

The white paper recommends phasing in the following changes to the current social security system:

- Increase the contribution period for qualifying for a full pension from 30 years to 40 years, on the basis of the age of the individual as of January 1, 2007. There would be no change for those aged 46 years and older, but the contribution period would increase to 35 years for those aged 40 to 45 and to 40 years for those at or below the age of 39.
- Calculate pension benefits on the average of the entire 40-year contribution history for workers aged 44 or younger as of January 1, 2007. There would no change for those aged 55 and older, but the basis for calculation would be the average of the best 5 years for those aged 50 to 54 and the average of the best 10 years for those aged 45 to 49.
- Create a new minimum pension, which would be automatically indexed to inflation, to guarantee a better standard of living for those with short careers or very low earnings.
- Gradually increase the retirement age to 65 for men and women on the basis of the age of the individual as of January 1, 2007. For those aged 55 and older, there would be no change. However, for those aged 52 to 54, the retirement age would increase to age 62; for those aged 49 to 51, the age would increase to 63; and for those aged 48 years and younger, age 65 would be fully phased in.
- Allow early retirement for individuals between the ages of 61 and 65, with a proportional reduction in benefits.
- Encourage work beyond the new statutory retirement age by allowing full pension benefit payments without limiting outside earned income.

The introduction of a second pillar pension (SPPS), which would be implemented in January 2006, was also recommended. Initially voluntary, it would become compulsory by 2010. Workers would be able to select a pension fund with assets that would be strictly segregated from those of the employer. Annual contributions, initially set at 2 percent each for the employee and employer—to be increased to 5 percent each by 2020—would be tax deductible for the employer, tax free to the employee, and taxed at a fixed percentage at maturity. Pension accumulations would be portable, and there would be an option to convert a portion of the fund into a lump sum but with the bulk reserved to purchase an annuity. A worker would not be able to liquidate the fund before retirement.

The white paper also proposed that a voluntary third pillar pension (TPPS) be introduced in January 2006. Both the second and third pillars would be regulated by the Malta Financial Services Authority (MFSA).

Sources: World Bank, *The Maltese Pensions System: An Analysis of the Current System and Options for Reform* (Washington, DC: World Bank, March 2004); KPMG Malta, "Pension Reform: The Reform of the Pensions Institutional Framework—White Paper" (Valletta: KPMG Malta, November 2004); Ganado and Associates, *Insurance & Private Pension Law—Update*, Issue No. 2 (Valletta, Malta: Ganado and Associates, November 2004); Government of Malta, Pensions Working Group, *Pensions: Adequate & Sustainable* (Valletta: November 5, 2004; http://www.pensions.gov.mt); and PricewaterhouseCoopers, "Malta: Overview Budget 2005," *Newsalert: Tax and Legal Service*, November 24, 2004 (Valletta, Malta: PricewaterhouseCoopers International); Social Security Administration, *Social Security Programs Throughout the World: Europe, 2004* (Washington, DC: SSA, September 2004).

United Kingdom

Steadily rising pension liabilities are spurring the government to propose additional measures to address retirement security in the United Kingdom. The latest reforms would increase the age of eligibility and reconfigure pension benefits for the civil service, increase public pension benefits for those who postpone retirement beyond the official retirement age, and limit mandatory retirement for older workers.

The government has proposed cutting 15 percent to 20 percent from public-sector pension costs by increasing the age of pension eligibility for civil servants from age 60 to 65. In addition, civil service pension benefits will be switched from final-salary to career-average plans. The career-average plan will also allow older workers to work part-time toward the end of their careers without diminishing their pension benefit. If implemented, the changes will go into effect for new civil servants on April 6, 2006, and for current civil servants on April 1, 2013.

Beginning in April, any worker who delays retirement for 5 years beyond the official retirement age (65 for men and 60 for women) will receive an additional incentive—a 50 percent increase in their basic state pension to approximately £540 (US$1,035) per month. Currently, workers who postpone retirement for 5 years receive a 35 percent benefit increase, but since few people have taken advantage of the bonus in the past, it is uncertain whether the new benefit increase will have much of an effect.

In mid-December, the government announced that employers will retain the right to force employees to retire at age 65 but that employees will have the right to appeal. Employers will be required to retain an employee who appeals, unless they can provide a legitimate business reason to reject the appeal. The government's decision was not widely applauded, and many groups in the United Kingdom are threatening legal action to abolish mandatory retirement ages. The government has promised to review its decision in 2011.

Sources: Ian Cowie, "Johnson Pledges Pension Boost," *Telegraph*, December 8, 2004; Michael White, "Whitehall Braced for Big Pension Cuts in Reform Plans," *Guardian Unlimited*, December 8, 2004; Danielle Rossingh, " UK Ban on Forced Retirement," http://www.IPE.com (Web extension of *Investment & Pensions Europe*), December 14, 2004; David Turner, "Business Wins Battle on Retirement Age," *Financial Times*, December 15, 2004; James Daley, "Government U-turn on Plan to End Age Discrimination in Workplace," *Independent*, December 15, 2004; Nicholas Timmins, "Public Sector Workers Next in Line for Pension Reform," *Financial Times*, December 17, 2004.

Chile

A new study has concluded that workers who have retired early receive benefits up to 50 percent lower than they would receive if they had waited until full retirement age. The Chilean Pension Fund Administrator's Association (AFP Association) found that for each year of early retirement (before age 65 for men and age 60 for women), a pension decreases 7 percent to 10 percent. Women are particularly affected because they generally have lower earnings and live longer than men—a life expectancy of 87 years compared with 82 for men.

Currently, workers may retire early if their individual accounts have accrued enough funds to provide a pension that equals at least 52 percent of their average annual wage over the previous 10 years and is at least equal to 110 percent of the current minimum monthly old-age pension, currently 75,211 pesos (US$132) for those up to age 70 and 82,237 pesos (US$144) for those aged 70 and older. The government has attempted to reduce early retirement by implementing a law last August to gradually increase these percentages to 70 and 150, respectively, by 2010. (See also the March 2004 issue of *International Update*.) A worker with 10 years of contributions whose individual account would provide a retirement benefit equal to at least 70 percent of the worker's average earnings in the last 10 years and 150 percent of the current minimum pension (raised in August from 120 percent) can withdraw the excess balance of the funds for any use.

As of September 2004, 63 percent of all old-age retirees had chosen early retirement. Women on average retired 7 years early at age 53 and men 9 years early at age 56. Between June 2000 and June 2004, workers had withdrawn US$471 million from their individual accounts, an amount equal to 12 percent of all pensions paid during that time frame. The AFP Association estimates that if these workers had waited until full retirement age to withdraw their funds, their average monthly benefit would have been 323,000 pesos instead of 160,000 pesos (US$576 and US$285, respectively).

Chile is currently paying more than half a million pensions, including 351,000 for retirement, 38,000 for disability, and 132,000 for survivors. The retirement benefits of today's retired workers are composed of, in part, contributions to individual accounts as well as a recognition bond, which represents the value of accrued benefits under the old public pension system. The number of pensioners under the new system will soon equal that under the old system.

Sources: Asociación de AFP (Asociación Gremial de Administradoras de Fondos de Pensiones), Serie de Estudios Nos. 40 and 46, February and December 2004, available at http://www.afp-ag.cl; *El Mercurio*, December 14, 2004; Superintendencia de Administradoras de Fondos de Pensiones (SAFP), *Preguntas frecuentes sobre el sistema previsional chileno y el seguro de cesantia*, available at http://www.safp.cl/preg_frecuentes/index.html.

Asia

Kazakhstan

Kazakh pension fund managers are now permitted to invest in large domestic infrastructure projects and use foreign asset management companies. This change follows a regulation in July 2004 that expanded the allowable investments to include investment-grade foreign government securities and assets of foreign mutual funds. The Financial Regulatory Agency also increased the allowable domestic investments in mortgage securities from 15 percent to 20 percent, the investments in commercial banks from 10 percent to 15 percent, and the duration of bank deposits from 3 months to 1 year.

The country's system of individual accounts, established in 1998, has had a shortage of acceptable financial instruments to invest its US$2.5 billion in assets, about 8.5 percent of GDP. During the past year and a half, pension funds have lost money, with the value of the tenge relative to the US dollar rapidly rising and yields on domestic and international securities falling. An International Monetary Fund report in August 2004 indicated that "[t]he investment strategies of pension funds are currently focused on high returns through high-yield, short-term investments. This is in part due to lack of long-term financial assets to match their liabilities…." Investments as of July 2004 included 53 percent in government securities, 24 percent in corporate bonds, 10 percent in international holdings, and 7 percent in bank deposits.

Kazakhstan is the only country in the region to phase out its public pay-as-you-go system and replace it with mandatory individual accounts. The new system covering 6.4 million workers has 16 pension funds: 15 are privately managed, and one is run by the government. Four of the funds, including the state-managed fund, hold 75 percent of all pension fund assets. Under the system, workers must contribute 10 percent of their earnings to an individual account; employers, however, do not contribute. Men may retire at age 63 and women at age 55, provided that workers have at least 35 years of contributions.

Kazakhstan has a total population of 15 million: 64 percent are between the ages of 15 and 59, 25 percent are children, and 10 percent are pensioners.

Sources: Social Security Administration, *Social Security Programs Throughout the World: Asia and the Pacific, 2002* (Washington, DC: SSA, March 2003); ITAR-TASS World Service, February 25, 2004; International Monetary Fund, "Republic of Kazakhstan: Financial System Stability Assessment," IMF Country Report No. 04/268 (Washington, DC: IMF, August 2004); Reuters News, October 28 and December 21, 2004; Interfax, *Banking and Finance Weekly*, November 18, 2004.

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