Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

March 2007

Europe

Iceland

On January 11, 2007, the Ministry of Finance announced the passage of two amendments to Iceland's 1997 Pensions Act, which governs Iceland's mandatory private pensions. The first amendment increases the mandatory minimum employer wage contribution rate by 2 percentage points, leaving the employee rate unchanged. The second amendment provides guidelines for changing pension benefits to maintain pension fund solvency.

Under the contribution amendment, employers must now contribute 8 percent of an employee's taxable wages to the employee's private pension account, up from 6 percent. Employees will continue to contribute a minimum of 4 percent of their taxable wages to their pension account. The contributions are divided between a defined benefit fund and a defined contribution fund. The contributions allocated to the defined benefit fund must be sufficient to guarantee that all participants in the plan can be paid a minimum benefit on the basis of their final salary. Each of Iceland's 52 authorized private pension funds determines the percentage of total contributions that must be contributed to the defined benefit fund to meet the funds' defined benefit obligations and deposits the remainder into the employees' defined contribution accounts.

Iceland's mandatory pension system, managed by the private sector, covers public- and private-sector employees as well as the self-employed. Employees covered by a collective bargaining agreement participate in a pension plan specified by the agreement. Employees not covered by a collective bargaining agreement may choose an available plan. If the employees not covered by a collective bargaining agreement do not choose a plan, they are assigned to the state-run General Pension and Insurance Fund.

The solvency amendment provides guidelines on when pension funds should amend their bylaws to reduce pension benefits when faced with solvency issues. Now, all pension funds must reduce benefits if they experience an actuarial shortfall of 10 percent in any one year or actuarial shortfalls of 5 percent or more each year in a five-year period. Before the amendment, pension funds with assets in banks or with government solvency guarantees were considered exempt from these benefit reduction solvency rules.

Iceland also has a universal pension funded by a payroll tax of 11.58 percent of wages shared equally between employer and employee. The universal pension benefit is payable at age 67 to all residents who lived in Iceland for a minimum of three years between the ages of 16 and 66. The government pays the maximum benefit to workers with 40 years of residency and prorates benefits for workers with less than 40 years of residency. The universal benefit is incrementally reduced as a retiree's annual income exceeds IKr1,894,254 (US$28,540), with the benefit phased out at IKr2,809,713 (US$42,334).

Sources: *Complementary and Private Pensions Throughout the World, 2003*; Global Pensions, July 2004; *Social Security Programs Throughout the World: Europe, 2006*; Ministry of Finance in Iceland, November 30, 2006, January 11, 2007, and February 2007; KPMG, January 17, 2007.

Liechtenstein

As of January 1, 2007, most of Liechtenstein's mandatory occupational pension funds will be protected by the Swiss Guarantee Fund (LOB). LOB was created under Switzerland's Federal Law on Occupational Benefits to make benefit payments in the event of Swiss pension insolvency. Because of its size and location, Liechtenstein has a history of entering into customs and monetary agreements with Switzerland, including adopting the Swiss franc as its official currency in 1924.

The pension fund guarantee agreement between Liechtenstein and Switzerland's LOB was reached in December 2006. The move came when the government of Liechtenstein had to fund an occupational pension plan after a company owner misappropriated funds from his firm's corporate pension. The government of Liechtenstein sought LOB's pension fund guarantee assistance because it is not in a position to cover large corporate pension fund losses in the future. Total assets for 35 of Liechtenstein's 41 occupational pension funds covered by LOB now equal 3 billion francs (US$2.4 billion).

The LOB agreement to guarantee Liechtenstein's pension funds applies to all occupational pensions for workers who are mandated to participate in the public old-age and occupational pension plans. The remaining six occupational pension funds not covered by LOB comply with the European Union's occupational pension fund directive and as such will remain guaranteed by the government of Liechtenstein.

Liechtenstein's retirement system includes a public pay-as-you-go old-age and survivors pension, mandatory occupational pensions, and voluntary private pensions. All workers in Liechtenstein, regardless of residency, are covered by the public pension. Participants in the public system contribute 3.8 percent of earnings and may begin receiving benefits at the age of 64 for men and 63 for women (rising to 64 by 2009) with at least one year of contributions. Additionally, workers over the age of 23 must contribute to an occupational pension fund if they have three months or more of employment, contribute to the public system, and have annual earnings greater than 19,350 francs (US$15,679). Workers and employers each contribute at least 6 percent of earnings between 19,350 francs (US$15,679) and 77,400 francs (US$62,718)—minus a tax allowance of 12,900 francs (US$13,453). Employers and employees share the pension fund's administrative costs.

Sources: *Social Security Programs Throughout the World: Europe, 2006*; Investment and Pensions Europe, January 12 and 18, 2007; personal communication, assistant to Liechtenstein's ambassador to the United States, January 31, 2007; Portal of the Principality of Liechtenstein, February 9, 2007; LOB Guarantee Fund, February 21, 2007.

Poland

In 2007, workers in certain labor categories in Poland's mandatory privately managed defined contribution system can retire early under prereform early retirement rules. After protests by miners in 2005 concerning their inability to retire early under Poland's 1998 pension reform law, parliament voted to allow miners to retire under the rules of the old defined benefit public pension system beginning in 2007. This law also extends the early retirement option based on the old defined benefit system rules to other labor categories, such as teachers, up to the end of 2007. Nearly 10,000 workers are eligible to retire early under this policy.

Before Poland's 1998 pension reform, workers were covered by a public pay-as-you-go pension system. Pension reform changed the defined benefit pension system by requiring younger workers to participate in a mandatory government-managed notional defined contribution (NDC) system and a fully funded, privately managed defined contribution system, commonly referred to collectively as open pension funds (OPFs). Workers born before January 1949 were required to remain in the old defined benefit system. Workers born between January 1949 and December 1968 were required to participate in the NDC system but were given the choice to participate in the OPF system. Workers born after December 1968 were required to participate in the new system—the two-tiered NDC and OPF system. Accrued rights from the old defined benefit system were transferred as the initial capital in the NDC accounts.

Today, Poland's retirement age is 65 for men and 60 for women. However, the early retirement age for workers in the old defined benefit system is as low as 55 in some cases, and in other cases (such as miners) there is the possibility for early retirement based on time spent working under special conditions. Pension experts believe workers eligible to retire early under the new law will do so. (See also the September 2004 and 2005 issues of *International Update*.)

The 1998 pension reform legislation established OPF accumulation rules, but it did not establish payout rules for OPF pension distributions that are to begin as early as 2009. The Social Insurance Office administers the old defined benefit and the new NDC systems. The Commission for Financial Supervision (KNF) supervises the OPF system.

In September 2006, KNF was established to replace the Polish Securities and Exchange Commission and the Insurance and Pensions Supervisory Commission. In 2008, KNF is slated to take over responsibilities of the Banking Supervisory Commission as well.

Sources: Anarkismo.net, July 27, 2005; *Social Security Programs Throughout the World: Europe, 2006*; Deutsche Presse-Agentur, September 29, 2006; *PAP Market Insider*, December 29, 2006, and February 19, 2007; *PNB*, December 29, 2006, and January 2, 10, and 17, 2007; *IPE*, January 30, 2007; Polish Ministry of Labor, February 23, 2007; personal communication, senior social security specialist, International Labor Organization, February 26 and March 1, 2007; personal communication, insurance supervision officer, Polish Commission for Financial Supervision, February 24 and 28, 2007, and March 1 and 2, 2007.

The Americas

Brazil

On February 12, President Luiz Inácio Lula da Silva announced the creation of the National Forum for

Social Security to evaluate and suggest changes to sustain the public pay-as-you-go (PAYG) social security system. The forum is made up of seven federal government officials, nine representatives from private-sector workers' and retirees' unions, and five representatives from national employers' confederations. Led by the Minister of Social Security, the forum will hold hearings at which social security specialists and representatives of research institutions will present their assessment of the public system and make recommendations for reform. The group has six months to come to a consensus on specific reform proposals.

Although President Lula did not provide the forum with a specific agenda, some government officials have said that establishing a minimum retirement age is a likely topic of discussion for the forum to consider. Under current law, private-sector workers can retire at any age with 35 years of contributions for men and 30 years for women. According to the Minister of Social Security, a new pact between the young and old generations is necessary to ensure the future sustainability of the public pension system as the population ages. Currently, 9 percent of the population is aged 60 or older. That figure is expected to rise to 25 percent by 2050, and the percentage of the population aged 80 or older is projected to increase from 14 percent to about 22 percent by 2050.

Brazil's pension deficit in 2006 was equal to about 2 percent of gross domestic product (GDP), more than half of the overall public-sector deficit of 3.34 percent of GDP. The country's social security benefits, including pensions, are linked to the minimum wage. According to the Organisation for Economic Co-operation and Development (OECD), the increase in the minimum wage in real terms is one of the main causes of the rising pension costs. Also, the number of beneficiaries is growing at a faster pace than the number of contributors as the population ages and many workers remain in the informal sector. To reduce Brazil's pension costs, the OECD recommends severing the link between the minimum pension and the minimum wage and indexing benefits to prices.

Brazil's PAYG public pension system covers private-sector workers. There are special pension systems for public-sector workers and military personnel. Workers eligible for the PAYG system contribute between 7.65 percent and 11 percent of earnings, according to the level of earnings, and employers contribute about 20 percent of payroll.

Sources: *Social Security Programs Throughout the World: The Americas, 2005*; United Nations, "Population Ageing," 2006; OECD Policy Brief, November 2006; Dow Jones International News, February 1 and 12, 2007; Reuters Focus, February 7 and 9, 2007; Diário Legislativo, February 12, 2007.

Asia and the Pacific

Fiji

On January 24, 2007, the interim government of Fiji reduced the retirement age for civil service employees from 60 to 55 years of age. This newly enacted mandatory retirement measure requires approximately 1,000 civil service employees aged 55 or older to retire immediately. However, the government may rehire some of the recently retired civil service employees as contractors in areas where there is a shortage of expertise. The private-sector retirement age is 55, but it is not mandatory.

The Fiji interim government, which took power following a coup in December 2006, made reducing the retirement age for civil servants a priority. The Interim Minister for Public Service and Public Sector Reforms stated that the decision to reduce the civil service retirement age was made for two reasons: to reduce the number of civil servants in Fiji and to address the unemployment rate (currently 5.8 percent).

Civil service employees hired before 1971 receive benefits from the Civil Service Act's pension system, and civil service employees hired after 1971 receive provident fund benefits.

Fiji's national provident fund is mandatory for public- and private-sector employees between the ages of 15 and 55, with an exemption provided for employees covered under approved private pension plans. Domestic employees, students, and the self-employed may participate on a voluntary basis.

For private-sector employees and those public-sector employees covered by the provident fund, the fund receives 8 percent of salary from employees and a minimum of 8 percent of employees' wages from employers. At age 55 or older, employees can receive an annuity or a lump-sum payment based on the balance in their account.

Before retirement, workers who have been provident fund members for at least two years and have an account balance of at least F$1,000 (US$601.58) can withdraw up to two-thirds of their account balance for housing costs. They can also withdraw up to one-third of their account balance for education and medical expenses. These early withdrawal provisions are available without penalty or repayment requirements.

Sources: *Social Security Programs Throughout the World: Asia and the Pacific, 2006*; Village News, January 24, 2007; Fiji Times Online, January 25, 2007; Radio New Zealand International, January 25, 2007; Fiji Times Online, January 25, 2007; Pacific Islands Report, February 2, 2007.

South Korea

On February 5, 2007, the Korean government proposed its "2 + 5 strategy" to increase the working-age population (aged 15–64) in anticipation of a projected labor shortage beginning around 2010. The plan aims to lengthen the time workers spend in the labor force by lowering the average entry age of first-time job seekers by two years (to 23) and delaying the average retirement age by five years (to 62). The government is concerned that low birthrates and population aging are slowing the growth of the working-age population, which could create a labor shortage and diminish the country's economic capacity. According to the government, Koreans work approximately seven to eight years less, on average, than workers in many other developed countries.

The government's "2 + 5 strategy" would expand the workforce by:

- Raising the retirement age and providing incentives to employees to encourage them to work longer. The government is considering a gradual increase in the normal retirement age of the public pension system from 60 to 65 by 2033, corresponding to the projected increase in life expectancy at birth from age 76 in 2000 to nearly 82 in 2030. The government also plans to propose higher pension benefits for workers who defer receiving their pension beyond the normal retirement age of 60.
- Encouraging companies to adopt a more flexible salary system, such as the "wage-peak system," to retain older workers. Under that system, companies may pay their employees who are older than 53 a lower wage and extend their employment at one-year intervals up to a maximum of six years until the employees reach age 60. Since January 2006, the government has subsidized this arrangement by compensating wage-peak workers who earn less than 46.8 million won (US$49,715) annually with 50 percent of their reduced earnings. To qualify, workers with at least a 10 percent reduction in earnings must be employed for at least 18 months by a company with a wage-peak system in place during that time. Public expenditures for wage-peak system compensation are expected to grow from 5.9 billion won (US$6.1 million) in 2006 to 7.9 billion won (US$8.4 million) in 2007.
- Restructuring the educational system to lower the age at which students enter the labor force by two years from the current average age of 25. The Education Ministry proposes reducing the elementary school enrollment age from age 6 to 5; beginning the school year in the fall rather than in the spring; and expanding engineering and business-oriented vocational high schools whose graduates enter the job market about four years earlier than college-bound students.
- Reducing the period of compulsory military service by six months to enable young people to enter the labor market earlier. The reduction in the military commitment would occur gradually in annual increments of 18 to 26 days beginning in 2008 and would continue until 2014.

Between 2000 and 2005, the number of people aged 65 or older rose 29.5 percent, to 4.4 million, nearly 13 times the rate of growth of the entire Korean population. A recent report by the state-run Korea Development Institute indicated that the nation's fertility rate is the world's lowest at 1.08 in 2005 and well below the 2.1 needed to maintain the current population.

Sources: "Ageing and Long-Term Care: National Policies in the Asia-Pacific," International Development Research Centre, 2002; *Labor Today* (Seoul), March 27, 2006; AFX Asia, February 5, 2007; Dynamic-Korea.com, February 5, 2007; KBS World News, February 5, 2007; Korea.net news, February 5, 2007; TMCnet.com, February 5, 2007; Yonhap News, February 5 and 10, 2007; *Korea Times* (Seoul), February 6, 2007; *The Korea Herald* (Seoul), February 6, 7, 9, and 12, 2007; Asia Pulse, February 11, 2007.

International Update is a monthly publication of the Social Security Administration's Office of Policy. It reports on the latest developments in public and private pensions worldwide. The news summaries presented do not necessarily reflect the views of the Social Security Administration.

Editor: Denise Lamaute.

Writers/researchers: Richard Chard, Barbara E. Kritzer, Jennifer McNabb, and David Rajnes.

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

SSA Publication No. 13-11712