Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

May 2008

Europe

Germany

In May, Germany's parliament ratified a government plan to raise monthly public pension amounts above the level required by an indexation rule that was adopted in 2005 to reduce the financial strain on the social security system. Government economists estimate that the increases of 1.1 percent in 2008 and 2 percent in 2009 will cost around €12 billion (US$19 billion) from July 2008 through the end of 2012. Pensions for the more than 20 million retirees are adjusted annually to changes in wage growth and in the ratio of workers to retirees, and pension increases in 2008 had been scheduled to rise by 0.46 percent. However, the government announced that recent robust economic growth warrants the larger increase. A 19.9 percent contribution rate currently finances Germany's public pension system, with the contribution amount divided evenly between employers and employees. The rate applies to earnings in excess of €400 (US$626) per month. A government subsidy compensates for the cost of benefits not covered by contributions. Without the benefit increases, by 2011 the system's sustainability reserve was expected to trigger a projected automatic contribution-rate reduction to 19.1 percent. An upward adjustment of the pension payments, however, delays the contribution-rate reduction until 2012. Germany's central bank is criticizing the pension increase as detrimental to the current policy of budget austerity because it ignores the restrictions on pension increases under the 2005 indexation rule.

Sources: Mercer Worldwide, "International Headlines: Germany," September 12, 2007; *Morning Star Online*, "Germany Gives OAPs Unexpected Cash Boost," April 8, 2008; Deutsche Welle, "Former President: Germany Turning into Pensioner Democracy," April 11, 2008; Reuters, "German Parliament Approves Pensions Increase," May 8, 2008.

United Kingdom

A recent Department for Work and Pensions (DWP) proposal, if adopted, will increase the powers of The Pensions Regulator (TPR), which oversees employment-based pensions in the United Kingdom, to reduce member risks in defined benefit (DB) pension plans. On April 21, 2008, the DWP released a consultation document to permit TPR to restrict companies from purchasing unprofitable businesses with well-funded DB plans, which might jeopardize members' pension benefits. The expanded powers also guard against threats to plan members' retirement security resulting from the purchase of pension plans by noninsured buy-out business firms currently outside regulatory oversight. The proposal addresses the government's concern that such buy-out firms may abandon an acquired pension plan and off-load the plan onto the Pension Protection Fund, which partially guarantees the benefits of private-sector DB pension plans where the employer becomes insolvent or funds in a plan are insufficient. Under the expanded powers, TPR will be able to force firms involved in a transfer of pension plan members, assets, and liabilities to make additional contributions to the pension plan if that transaction appears to threaten the plan's ability to finance current and future benefits. The consultation period runs for 8 weeks. Increasing TPR's powers requires parliamentary approval, and if passed, the proposed changes will take effect retroactively to April 2008.

Sources: bna.com, "New Rights Proposed for U.K. Regulator to Protect Employee Pensions After Buyouts," April 17, 2008; *Financial Advisor*, "Government Plans for Increasing Pension Regulator Powers," April 24, 2008; mondaq.com, "Proposed Extension of Pensions Regulator's Powers," April 25, 2008.

The Americas

Colombia

A financial services reform bill submitted to Congress on April 11, 2008 includes changes to Colombia's system of individual retirement accounts. The bill would require each pension fund management company (AFP) to offer three types of pension funds with varying degrees of risk: high, medium, and low. Currently each AFP can offer only one fund. The maximum combined fees (for survivors and disability insurance and for administrative fees) that AFPs may charge their account holders would remain at 3 percent of earnings. The bill would also modify the rules for the minimum rate of return. Currently, each AFP must yield a minimum rate of return that is based on the average annual rate of return for all the AFPs in the system. The reform bill would also require a separate minimum rate of return for each type of pension fund. Congress is expected to pass the bill by the end of the year, and the new law would be implemented 14 months after it is enacted.

Sources: Ministerio de Hacienda y Crédito Público, "Comunicado de Prensa—028," el 11 de abril de 2008; "Proyecto de Ley Por el Cual Se Dictan Normas en Materia Financiera, de Seguros, del Mercado de Valores y Otras Disposiciones," el 11 de abril de 2008; "Update: Colombia Government Submits Financial Services Reform Bill," Dow Jones Newswire, April 11, 2008.

Mexico

The new system of individual accounts for Mexico's public-sector employees began operation on March 12, 2008. New hires beginning April 1, 2007 (a day after the law was passed) must join the new system. Other public employees under age 46 have until the end of July 2008 to join or remain in the existing pay-as-you-go (PAYG) program for public employees. Those employees who switch receive an inflation-indexed bond that represents the value of their accrued rights under the PAYG system. Public employees represent about 5 percent of the labor force. Pensionissste, a newly created public institution, will manage the public employees' individual accounts for the first 3 years. In the fourth year of operation, public employees may switch to any of the pension fund management companies (AFOREs) that handle the private-sector individual accounts. Pensionissste will continue to manage the individual accounts for public-sector employees who have not chosen an AFORE. An 18-member executive commission directs Pensionissste and includes representatives from labor organizations and government agencies, as well as the director general of the Institute of Social Security and Health for public-sector employees (ISSSTE). The National Commission for the Retirement Savings System (CONSAR), which serves as the regulatory and supervisory agency for the individual account system for private-sector workers, also oversees Pensionissste.

Sources: "Mexico," *International Update*, U.S. Social Security Administration, May 2007; "Instalan Comisión de Pensionissste," Radiotrece.com.mx, el 11 de marzo de 2008; "Mexico's Pensionissste to Invest $9.3 Billion by 2012," bloomberg.com, March 24, 2008.

Asia and the Pacific

New Zealand

New rules for New Zealand employers regarding KiwiSaver contributions went into effect on April 1, 2008. KiwiSaver is the new type of government-subsidized retirement savings plan introduced on July 1, 2007. All new entrants to the labor force and anyone starting a new job are automatically enrolled in a KiwiSaver plan, and may opt out of the plan between the second to the eighth week of employment. Anyone younger than age 65, including the self-employed and anyone not in the labor force, may also choose to set up a KiwiSaver account. Employer contributions to their employees' accounts are now mandatory and will increase gradually from the current 1 percent of their employee's gross earnings until reaching 4 percent by April 1, 2011. Employers also receive a tax credit of up to NZ$20 (US$16) per week per employee. Account holders may contribute either 4 percent or 8 percent of their gross earnings and receive a tax credit of up to NZ$20 (US$16) a week and NZ$1,040 (US$836) a year that is deposited directly into their KiwiSaver account. For those who do not earn a salary or wage, the amount and frequency of contributions depends on the provisions of the contract. The government provides account holders with a one-time tax-free payment of NZ$1,000 (US$804) and an NZ$40 (US$32) annual fee subsidy to defray administrative costs.

Sources: "Overview," *The Independent Financial Review*, April 2, 2008; "April 1st Typically Brings in Policy Changes, Being the First Day of the New Financial Year," *New Zealand Herald*, April 5, 2008.

International Update is a monthly publication of the Social Security Administration's (SSA's) Office of Retirement and Disability 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 SSA.

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SSA Publication No. 13-11712