Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

October 2009

Europe

France

The French government recently announced that by January 1, 2010, all companies with at least 50 workers must conclude an agreement with its worker representative groups or set up a plan of action for employing older workers, aged 50 or older. These agreements or plans may be for individual companies or groups of companies. Those companies that do not comply will be subject to a fine of 1 percent of payroll, which will be transferred to the National Old-Age Insurance Fund. Each agreement or plan must contain elements from the following list:

- A goal for how many older workers each employer will retain and how many they will recruit
- A mentoring system where older workers can help train younger workers
- Professional training for older workers, especially where re-training is required
- Identification of occupational risks related to older workers and development of a plan to improve conditions
- Management of the transition between full-time work and retirement, such as providing the opportunity for part-time work and phased retirement

The requirement for employing older workers was established in the 2009 Social Security Financing Law, passed in November 2008. The specific elements and procedures were issued recently. Other provisions of the 2009 law relating to older workers include—

- Allowing workers to remain in the labor force until age 70. Currently, even though workers may remain in the labor force until age 70, they have no protection against forced retirement at age 65.
- Removing any limit on income from a professional activity for pensioners aged 60 or older who are receiving a full pension. Those aged 65 or older must have applied for all mandatory pensions, both basic and supplementary. This provision includes eliminating the 6-month waiting period for those pensioners to return to their former employer and still retain their pension. Working for a new employer will continue to be permitted at retirement.
- Increasing the pension bonus system for older workers who are eligible for a full pension. Under the new rules, a worker will receive an additional 5 percent bonus per year for every year worked (beginning in 2009) beyond age 60. Currently, the bonus is 3 percent for the first year and 4 percent for each additional year.

France's population is aging rapidly. The percent of the population over age 60 is expected to rise from 21 percent in 2005 to more than 30 percent by 2050. In the next 10 years, the ratio of workers to retirees is projected to decrease from 2.2:1 to 1.5:1.

Sources: "Retention And Reintegration Of Older Workers Into Employment," ISSA Technical Seminar, June 18–19, 2009; "France Retraite Et Le Plan D'actions En Faveur Des Séniors," France Retraite, août 2009; "Mesures En Faveur De L'Emploi Des Seniors," Ministère de Travail, août 2009; "Pour L'Emploi Des Seniors," Ministry of Labor, août 2009.

The Americas

Brazil

On September 24, Brazil's National Monetary Council raised investment limits for closed pension funds, allowing them to shift more of their assets into riskier investments with potentially higher returns. Closed pension funds are sponsored by one or more companies in the same sector or industry, by labor unions and by professional groups for their employees. Because of the current macroeconomic environment—low inflation and declining interest rates—government officials suggest that fund managers assume additional portfolio risk to ensure that pension fund returns keep pace with future obligations for employee benefits.

Under the new rules, closed pension funds are able to increase the overall percentage of managed assets in riskier investments from 50 percent to 100 percent. In particular, these funds are allowed to invest—

- As much as 70 percent of their assets in equities, an increase from 50 percent previously. Officials expect the higher investment limits to generate an additional 90 billion reais (US$51 billion) of pension fund investments in equities.
- Up to 20 percent in structured funds (which invest in infrastructure or real estate) and 8 percent in real estate. Fund assets were previously limited to 8 percent in any kind of real estate.
- Up to 10 percent in international funds, approved by the securities regulator, or in similar funds trading on the Sao Paulo exchange; the limit had been 3 percent.

Closed pension funds currently manage about 450 billion reais (US$257 billion) in assets. Open pension funds—operated for the general public by insurance companies, bank subsidiaries, and nonprofit organizations are not governed by the same rules as closed funds. In July, open funds managed approximately 390 billion reais (US$223 billion). Closed and open pension funds supplement the mandatory public pay-as-you-go system.

Sources: "Private Pensions in Brazil," Working Party on Private Pensions of OECD, July 2004; "Brazil Pension Funds Can Invest Up to 70% in Equity," Bloomberg.com, September 24, 2009; "Brazil Raises Limits for Pension Investments in Equities," *Wall Street Journal*, September 24, 2009.

Ecuador

As of August 1, employers are required to pay their reserve account contributions—8.33 percent of a worker's monthly earnings—directly to employees who have worked for their company for at least 1 year. Previously, employers deposited these contributions into a separate reserve account for each employee, managed by the Ecuadorian Social Security Institute (IESS). Workers who do not wish to receive the contributions directly may petition the IESS to continue depositing these contributions to their account. As of early September, about 11 percent of covered workers had requested that the contributions continue going to their reserve account.

In addition, until July 29, 2011, workers with at least 24 accredited monthly contributions to their reserve account may withdraw all or part of the account balance. Those who have been unemployed for at least 2 months can also receive their account balance. Some 1.1 million workers out of 1.6 million with reserve accounts are eligible under these provisions.

Reserve accounts were first set up in 1938. Over the years, the rules have ranged from allowing workers to withdraw their funds for certain contingencies such as during periods of unemployment or the purchase of a house to only withdrawing the funds at retirement. From 2005 until now, workers were permitted to withdraw their funds every 3 years. The government adopted the most recent law in an effort to boost workers' take-home pay during hard economic times.

The IESS also regulates and administers Ecuador's pay-as-you-go old-age, survivors, and disability insurance program. The program is financed by employee, employer, and government contributions: 6.64 percent of earnings, 3.10 percent of payroll, and 40 percent of the cost of pensions, respectively. These employee and employer contributions also help finance other social security programs.

Sources: "Nebot: Convenio Con IESS No Usará Fondos de Reserva," *El Universo*, el 25 de mayo de 2004; "Fondos de Reserva," *Diario Hoy*, el 29 de julio de 2005; *Social Security Programs Throughout the World: The Americas, 2007*; "Pago De Fondos De Reserva De Acuerdo A Nueva Ley," IESS Boletín de Prensa, N-182, agosto de 2009; "Preguntas Frecuentes Devolución De Fondos De Reserva," IESS, agosto de 2009; "IESS Emprenderá Operativos De Control Por Pago De Fondos De Reserva En Octubre," ecuadorinmediato.com, el 2 de septiembre de 2009.

Africa

Ghana

On September 16, Ghana's president introduced the country's new pension system, created by the 2008 National Pensions Act. The new system, which will be implemented on January 1, 2010, consists of three pillars: (1) an earnings-related defined benefit pay-as-you-go (PAYG) public program; (2) a privately managed occupational pension program; and (3) a privately managed program that includes provident funds and personal pension plans. Participation in the first two pillars will be mandatory for both public- and private-sector workers, and the third pillar will be voluntary for public- and private-sector workers and for workers in the informal sector. (Participation will be optional for workers aged 55 or older at the time of implementation). According to the government, the new system seeks to improve retirement security and increase coverage to include informal-sector workers (constituting approximately 85 percent of the total workforce) who are not covered by the current PAYG program.

Under the new system, employees will contribute 5.5 percent of earnings, and employers will contribute 13 percent. Of this combined 18.5 percent contribution, 11 percent will be directed to the first pillar, 5 percent to the second pillar, and the remaining 2.5 percent to the National Health Insurance program. (Currently, employees and employers together contribute 17.5 percent of earnings, of which 15 percent is directed to the public PAYG system and 2.5 percent to the National Health Insurance program.) Voluntary contributions to the third pillar will be supported by tax incentives. To qualify for a first-pillar old-age pension, workers must be aged 60 or older and have at least 15 years of contributions, instead of the 20 years required under the current system.

The current PAYG pension system in Ghana is made up of two parts: (1) the Social Security and National Insurance Trust (SSNIT) program for workers in the private sector and some civil servants; and (2) the CAP 30 system for public-sector workers. The new mandatory first pillar will combine these two programs under a restructured SSNIT. The Pensions Regulatory Authority, also established by the 2008 National Pensions Act, will regulate the activities of the SSNIT to ensure compliance with the new laws. In addition, the regulator will approve and license trustees to manage the second and third pillars.

Sources: *Social Security Programs Throughout the World: Africa, 2009*; "Why There Should Be Pension Reforms in Ghana," *Modern Ghana News*, September 3, 2009; "Government of Ghana Launches Pension Scheme," *IHS Global Insight Daily Analysis*, September 17, 2009.

South Africa

On September 10, the National Assembly passed a package of laws that simplify the tax treatment of lump-sum benefits from occupational pension plans and provide tax incentives to encourage people to preserve their savings until retirement. The laws affect all lump-sum benefits from March 1, 2009, onward.

Under the new laws, the first 22,500 rand (US$3,028) of preretirement lump-sum withdrawals are tax free. Withdrawals exceeding 22,500 rand are taxed at a rate from 18 percent to 36 percent, depending on the size of the withdrawal; the highest rate applies to withdrawals exceeding 900,000 rand (US$121,106). Individuals who do not make lump-sum withdrawals before retirement will receive the first 300,000 rand (US$40,369) tax free, with the tax rates also ranging from 18 percent to 36 percent on payments above this amount. In addition, workers who are laid off from their jobs during the current economic crisis are also allowed to withdraw up to 300,000 rand tax free before retirement. The tax exemption can only be used once in a taxpayer's lifetime, which creates a strong incentive to postpone lump-sum withdrawals until retirement.

Under the previous law, the tax-free portion of lump-sum benefits was based on the highest 5 consecutive years of annual salary and the number of years of membership in a private pension plan. The maximum tax-free amount was limited to the greater of either 120,000 rand (US$16,147), or 4,500 rand (US$606) multiplied by the number of years of membership.

The South African pension system consists of a noncontributory, means-tested old-age grant financed by general revenues and supplemented by employer-sponsored occupational pension plans. The old-age grant provides up to 1,010 rand (US$136) a month to men aged 61 or older and women aged 60 or older. (The retirement age for men will be lowered to age 60 in April 2010). Occupational pension plans are established on a voluntary basis by an employer or group of employers.

Sources: *Complementary and Private Pensions Throughout the World*, 2008; *Social Security Programs Throughout the World: Africa, 2009*; Taxation Laws Amendment Bill, 2009; Pravin Gordhan, "Introductory Speech By Finance Minister Pravin Gordhan on Taxation Laws Amendment Bills in the National Assembly," September 1, 2009; "South Africa: Bills to Provide Tax Relief to Citizens," allAfrica.com, September 2, 2009.

Reports and Studies

World Economic Forum

The World Economic Forum recently released *Transforming Pensions and Healthcare in a Rapidly Ageing World: Opportunities and Collaborative Strategies,* its second report on how countries need to address the challenge of rapidly aging societies. The report, prepared in cooperation with Mercer and the OECD, is based on the input of some 200 experts and decision-makers asked to develop scenarios relating to health care and pensions, up to 2050. The report is global in its focus, but it places considerable emphasis on aging in the developing world, pointing out that most persons aged 60 or older presently live in the developing world.

According to the report, the aging of societies should not be viewed by policymakers as a risk but rather as a series of opportunities to formulate more integrated retirement and health care solutions and to shift thinking toward incentives that reward long-term planning and honor old age as a productive life phase. The report develops strategic options for transforming countries into "silver societies," including the following:

- Promote work for older cohorts. For many people, better health in old age means that productive employment is possible and desirable well into their seventies.
- Provide financial education and planning advice. Financially literate individuals are more likely to plan responsibly for their old age by taking actions to better understand and use public and private pensions.
- Encourage higher levels of retirement savings. As governments come under pressure to slow future public pension increases, incentives and opportunities need to be provided to expand participation in private pension systems.
- Facilitate the conversion of property into retirement income. Reverse mortgages allow elderly individuals to release equity in their home without the need to sell.
- Stimulate microinsurance and micropensions for the poor. As an extension of the microcredit movement, micropensions—pensions for low-income individuals—are a combination of microinsurance and microsavings products, which have retirement income as their primary objective.
- Enhance pension fund performance. Use measures to optimize the design of investment strategies and improve the quality of pension funds' governance and administrative efficiency.
- Promote annuities markets and instruments to hedge longevity risk. The functioning of annuities can be improved by further developing longevity indexes and issuing longevity-indexed bonds.

The full report is available online at http://www.forumblog.org/blog/2009/09/transforming-pensions-and-healthcare-in-a-rapidly-ageing-world.html.

Sources: *Transforming Pensions and Healthcare in a Rapidly Ageing World: Opportunities and Collaborative Strategies,* World Economic Forum, 2009.

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