Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

January 2011

Europe

Bulgaria

On January 1, major changes to Bulgaria's pension system went into effect that increase employer and employee contribution rates and provide for future increases in the retirement age and in the number of contribution years required for a full pension. According to the government, the measures aim to reduce the 2 billion leva (US$1.3 billion) deficit in Bulgaria's public pension system by 2016 and to ensure the system's solvency until 2035.

Under the new rules, the contribution rates for employers and employees rose by 1.8 percent—from 8.9 percent to 10 percent of covered payroll for employers and from 7.1 percent to 7.8 percent of earnings for employees. For workers born before 1960, contributions are directed entirely to the first-pillar social insurance program; contributions for workers born in or after 1960 are divided between the first-pillar and the second-pillar mandatory individual accounts. (Details on the percent allocated to each pillar are not yet available; previously, employers contributed 2.8 percent to the mandatory individual accounts and employees contributed 2.2 percent, with the remainder going to the social insurance program.) According to the Ministry of Labor and Social Policy, the increase in contribution rates will reduce the budget deficit by 370 million leva (US$249 million) in 2011.

In addition, starting January 1, 2012, the number of contribution years required for a full pension will gradually increase by 4 months a year by 2020 for both men and women, from 37 years to 40 years for men and from 34 years to 37 years for women. The full retirement age will gradually increase by 6 months a year starting in 2021, from age 63 to age 65 for men (by 2024) and from age 60 to age 63 for women (by 2026).

Bulgaria's pension system consists of a first-pillar, earnings-related pay-as-you-go program, second-pillar mandatory individual accounts, and third-pillar voluntary individual accounts. Currently, nine pension insurance companies are licensed by the Financial Supervision Commission to administer the mandatory individual accounts.

Sources: *Social Security Programs Throughout the World: Europe 2010;* "Bulgaria Raises Pension Contributions to Cover Budget Deficit," *Global Pensions*, October 20, 2010; "Bulgaria Hikes Pension Contribution Payments in 2011," *Reuters News*, October 20, 2010; "Bulgarian Parliament Approves Pension Reforms," *Reuters News*, December 11, 2010; "New Retirement Requirements Enforced in Bulgaria," *Sofia News Agency*, January 1, 2011.

Ireland

On December 15, the Irish parliament approved an 85 billion euro (US$113.4 billion) bailout package with the European Union and the International Monetary Fund, including a 10 billion euro (US$13.3 billion) contribution from the National Pension Reserve Fund (NPRF). (The NPRF was established in 2001 to provide partial prefunding of future public pension costs.) The bailout requires Ireland to deal with losses incurred by the Irish banking system and to restore prospects for growth following the recent financial crisis.

To comply with the bailout package requirements, a law was passed that allows the government to skip annual contributions to the NPRF (previously 1.5 percent of gross national product) and transfers power to direct NPRF investments (24.4 billion euros, or US$32.6 billion, at the end of 2010) from a separate commission to the Ministry of Finance. In addition, separate laws introduced major changes in the tax treatment of retirement savings that include the following.

- Employer contributions to both public and private pensions are no longer fully tax deductible for the employer and are treated as taxable income to the employee.
- The exemption from contributing to the public pension system for employees earning less than 352 euros (US$470) per week is eliminated. All employees are now required to contribute to the public pension system.

- Tax relief for employee contributions paid to private pension plans is reduced. Previously, employee contributions to approved private pension plans were fully tax deductible up to an individual's income tax rate. While employee contributions will still receive tax relief, the maximum allowable rate will be gradually reduced—from 41 percent to 34 percent in 2012, to 27 percent in 2013, and to 20 percent in 2014 and subsequent years.
- The maximum annual earnings on which employee contributions to private pensions are permitted tax relief is reduced from 150,000 euros (US$200,216) to 115,000 euros (US$153,499) for contributions made after December 31, 2010. In addition, the lifetime upper limit on tax-favored retirement savings is reduced from some 5.4 million euros (US$7.2 million) to 2.3 million euros (US$3.1 million).
- The limit on tax-free, lump-sum withdrawals was reduced to 200,000 euros (US$266,954), from December 31, 2010. Lump-sum withdrawals of 200,000 euros to 575,000 euros (US$767,493) are taxed at the rate of 20 percent in 2011, while lump sums in excess of 575,000 euros are taxed at the highest marginal tax rate of 41 percent.

Ireland's social insurance system consists of an old-age, contributory flat-rate benefit supplemented by a means-tested benefit. Voluntary occupational pensions cover approximately half of private-sector employees.

Sources: "Opposition Condemns Use of Pension Fund in €85 Billion Bailout," *Irish Times*, November 29, 2010; *Global Benefits Legislative Update*, Mercer, December 2010; "Irish Parliament Approves Bailout and IMF Ratifies the Program," Roubini Global Economics, December 16, 2010; "New Law Allows a Halt to NPF Contributions," *Global Pensions*, December 17, 2010; "Significant Changes in the Tax Treatment of Pensions and Share Schemes Due to Take Effect in 2011," IBIS eVisor, December 29, 2010.

Asia and the Pacific

Australia

On December 16, 2010, the government released *Stronger Super*, a report outlining proposed changes to the nearly 20-year-old superannuation system—the country's mandatory occupational pension system. *Stronger Super* is based on the July 2010 recommendations of the Super System Review panel, also known as the Cooper Review. In early 2011, the government will set up a working group made up of representatives of the superannuation industry, employers, employees, and consumer groups, to review the proposed changes and subgroups to study design and implementation issues.

The report includes a proposal to introduce MySuper, a simple, low-cost fund with a single diversified investment strategy, to replace the default fund. The Cooper Review found that the current "one-size-fits-all" regulatory infrastructure does not protect the interests of all members (anyone with a superannuation account) and may be too complex and too costly for certain groups. (About 80 percent of the nearly 12 million members do not make active investment choices.) MySuper would also provide life insurance and total and permanent disability insurance with an opt-out provision.

Another group of recommendations in the report (called SuperStream) aims to improve the administration of superannuation accounts. These recommendations include establishing industry-wide standards to improve the quality of data, increasing the use of technology, adopting the worker tax-file number as the identifier for the entire system, and simplifying administrative processes and eliminating duplication. Currently, the industry has no standards for producing data and no uniform systems for processing contributions and identifying members. Many employers still use a manual process, and about 38 percent of companies still use checks to submit their fund contributions.

As a result of these proposed changes, the government expects major improvements to the superannuation industry, which include the following.

- Member fees would decrease by about A$550 million (US$548 million) per year initially and by A$1.7 billion (US$1.69 billion) in subsequent years. The average cost of each transaction is now about A$35.00 (US$34.88).
- The number of accounts would decrease. Currently, each worker has an average of three superannuation accounts, and unidentified or "lost" member accounts amount to some A$11 billion (US$11.16 billion) in assets.

In September 2010, total assets under management for Australian superannuation funds were about A$1.3 trillion (US$1.29 trillion), roughly equal to the country's gross domestic product. This figure represents seven times the assets under management in 1993 when the mandatory system was introduced.

The full report is available at http://strongersuper.treasury.gov.au/content/Content.aspx?doc=publications.htm.

Sources: "Australia," *International Update,* January 2010, April 2010, and August 2010, US Social Security Administration; *Stronger Super*, Commonwealth of Australia, December 2010; Assistant Treasurer, Minister for Financial Services and Superannuation, press release, December 16, 2010; "Proposed Rule Changes Will Help Recovery of 'Lost' $11 Billion," *Sidney Morning Herald,* December 17, 2010.

New Zealand

On December 7, 2010, New Zealand's Retirement Commission released its *2010 Review of Retirement Income Policy*, its second 3-year evaluation of New Zealand's retirement income system and other related areas (such as savings, the effect of the global financial crisis on household income, and the economic well-being of the population aged 65 or older). The report examines the retirement income system's two main components: (1) Superannuation (NZS)—the flat-rate, universal public pension funded by general revenues and (2) KiwiSaver—voluntary, government-subsidized retirement savings plans (introduced in 2007) that supplement NZS.

According to the commission, the sustainability of the NZS is threatened by a rapidly aging population. The ratio of workers to retirees is expected to fall from 4.5:1 to 2.2:1 by 2036. Without any changes to the NZS, the cost is projected to rise from about 4.5 percent of gross domestic product (GDP) to 6.5 percent by 2035. In order to ensure long-term affordability of NZS, the commission recommends the following.

- A gradual increase in the normal retirement age from 65 to 67 for both men and women, by 2 months each year from 2020 to 2033.
- The introduction of a transitional, means-tested benefit for those aged 65 to 66 who may not be able to support themselves until age 67.
- The indexation of NZS benefits using the average of the change in consumer prices and earnings, rather than the change in annual wages alone.

The report also identifies increasing government subsidies to KiwiSaver accounts as a major concern; to date, these subsidies represent 40 percent of the total amount deposited in KiwiSaver accounts. In future years, the subsidies are projected to account for approximately 0.5 percent of GDP.

The commission's recommendations regarding KiwiSaver plans include the following.

- Default fund investment settings should remain conservative, regardless of the member's life stage. (Workers who do not choose a KiwiSaver provider are assigned to one of the six government-appointed default providers.) As of March 2010, approximately one-third of participants belonged to default funds, with those aged 18 to 25 most heavily represented.
- The government should adopt a standardized method of calculating provider fees and measuring fund performance to allow consumers an easy comparison of KiwiSaver providers and funds.
- The government should closely monitor withdrawal patterns under KiwiSaver. From July 2012, members aged 65 or older can make lump-sum withdrawals from their accounts. The market for "decumulation" products is very limited, and KiwiSaver has no specific requirements for how to use these funds (such as mandatory annuitization).

The report is available at http://www.retirement.org.nz/retirement-income-research/policy-review/2010-review/2010-review-report.

Sources: "2010 Review of Retirement Income Policy," New Zealand Retirement Commission, December 7, 2010; "Raise Super Age to 65, Report Recommends," *New Zealand Herald*, December 8, 2010; "NZ Super Policy Needs Total Rethink," *Scoop News,* December 9, 2010.

Reports and Studies

International Labour Organization

The International Labour Organization (ILO) recently released the *World Social Security Report 2010/11: Providing Coverage in Times of Crisis and Beyond*, the first in a biennial series assessing social security coverage across 184 countries. The report presents various means of evaluating the "scope, extent, level, and quality" of social security coverage, as well as program effectiveness and efficiency. It also identifies gaps in coverage and discusses the role of social security in mitigating the impact of economic crises.

Almost all of the countries surveyed provide some level of social protection; however, only 20 percent of the world's working-age population (and their families) has access to comprehensive social protection systems, including old-age, survivors and disability, sickness and maternity, work injury, unemployment, and family allowances. Moreover, overall social security

expenditures account for approximately 20 percent of gross domestic product (GDP) in high-income countries, compared with only 4 percent of GDP in low-income countries.

The following are some additional findings of the report related to pensions.

- Seventy-five percent of individuals aged 65 or older receive old-age pension benefits in high-income countries, compared with less than 20 percent in low-income countries (with a median value of just over 7 percent in low-income countries). In Africa, less than 10 percent of individuals aged 65 or older are entitled to a pension.
- While 40 percent of the world's working-age population is legally covered under contributory old-age pension programs, effective coverage rates (measuring the number of people actually contributing to a program as a percentage of the total working population, or the number of beneficiaries as a percentage of those aged 65 or older) are far lower, especially in low-income countries. In sub-Saharan Africa, only 5 percent of the working-age population is covered, compared with nearly 80 percent in North America and Europe and 20 percent in Asia, the Middle East, and North Africa.
- In countries with large informal sectors, introducing or expanding noncontributory social security programs may help remedy immediate gaps in coverage, as well as reduce poverty. These programs may also counter the effects of future economic downturns.

In light of the recent economic crisis, the report argues that public defined benefit (DB) programs appear more secure than defined contribution (DC) programs, but recommends reforms to make DB programs sustainable as populations age, including making adjustments in the retirement age and the minimum time period to qualify for a full pension. The report also recommends changes to DC pension programs (including guaranteed rates of return to provide targeted replacement rates upon retirement) to help reduce the unpredictability of DC pension levels as the result of market fluctuations. In addition, the report warns against benefit reductions to counterbalance increased deficits and public debt, arguing that such cuts would only decrease the standard of living for a large portion of the population and delay economic recovery by decreasing aggregate demand.

The report is available online at http://www.ilo.org/global/publications/ilo-bookstore/order-online/books/WCMS_142209/lang--en/index.htm.

Sources: *World Social Security Report 2010/11: Providing Coverage in Times of Crisis and Beyond*, International Labour Organization, November 16, 2010.

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