Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

May 2011

Europe

Poland

On May 1, a new law went into effect that diverts a portion of employee contributions from second-pillar individual accounts, managed by open pension funds (OFEs), to newly created first-pillar subaccounts, managed by Poland's social insurance institution (ZUS). As a result, employees now contribute 2.3 percent of their monthly salaries (down from 7.3 percent) to the second pillar and 5 percent to the new subaccounts. (Contribution rates to the first-pillar, pay-as-you-go (PAYG) program remain the same, with employees contributing 2.46 percent and employers contributing 9.76 percent; employers do not contribute to the second pillar.) Starting in 2013, second-pillar contributions will gradually increase until reaching 3.5 percent in 2017, with contributions to the new first-pillar subaccounts decreasing proportionally. According to the government, the diversion of contributions to ZUS is necessary to lower Poland's budgetary deficit, which was approximately 8 percent of gross domestic product (GDP) in 2010, and to keep the national debt below the limit of 55 percent of GDP set by Poland's constitution. The Ministry of Finance estimated Poland's debt in 2010 at 53.3 percent of GDP.

Other key provisions of the new law include the following:

- The newly created subaccounts will be indexed according to the average of the previous 5 years' nominal GDP growth (excluding any decline in GDP).
- Investment limits for the second pillar will be changed, including an increase in the percentage of assets OFEs can invest in equities—from 40 percent currently to 62 percent by 2020.
- A new third-pillar voluntary savings vehicle, called individual pension insurance accounts (or IKZEs), will be introduced in 2012. (IKZEs will complement current voluntary individual retirement accounts (or IKEs), which differ slightly in terms of tax preferences and contribution limits.) Workers may set up an IKZE with an authorized institution, such as an investment company, insurance company, bank, or OFE; contributions on the first 4 percent of gross wages are tax free.

In 1998, Poland adopted pension reform legislation introducing a new three-pillar system, including a mandatory government-managed notional defined contribution program, second-pillar mandatory individual accounts, and third-pillar voluntary retirement savings accounts. Participation in the system is mandatory for all economically active persons born after December 31, 1968, and voluntary for those born from January 1, 1949, to December 31, 1968.

Sources: "IKZE Kontra IKE. Nowy Pomysl na Emerytury," *Money.pl*, February 6, 2011; "Sejm Przeglosowal Zmniejszenie Skladki do OFE," *Money.pl*, March 25, 2011; "Controversial Polish Pensions Revisions Signed into Law," *IPE.com*, April 8, 2011; "Ostatnia Walka OFE o Klientow," *Gazeta Prawna*, April 13, 2011; "Zmiany w OFE od 1 maja 2011 r.," *Gazeta Podatkowa*, April 26, 2011; "IKE I IKZE, Czyli Dwa Producty do Dodatkowego Oszczedzania," *Parkiet*, April 27, 2011; "Mniej na Emerytury w OFE," *Gazeta Prawna*, April 29, 2011.

The Americas

Chile

Beginning June 1, new rules for employer-sponsored voluntary pension (APVC) plans will go into effect that aim to encourage more employers to set up those type of plans and more employees to participate. APVC plans are intended to supplement the mandatory individual accounts managed by pension fund management companies (AFPs). Since October 2008, when these defined contribution plans were introduced, the take-up rate has been extremely low, with only five companies offering APVC plans to a total of 188 workers (as of February 2011). The new APVC rules will make several changes, including the following:

- For an APVC plan to be put into place, the minimum percentage and number of employees in one company that must sign up will be lowered to 15 percent of a company's employees or 100 workers, whichever is lower. Currently, the minimum figures are 30 percent or 300 workers, respectively.

- Vesting requirements (rights to permanently own the money an employer contributes to an account) will change from 24 consecutive months of contributions to 24 months within 60 months of employment with the same company.
- Both the process for setting up a plan and for enrolling employees will be streamlined.

APVC plans must be set up by agreement between an employer and an institution authorized to administer the plans, such as AFPs, banks, insurance companies, mutual fund administrators, and investment fund administrators. Employers must contribute to all participants' accounts; the amount of the contribution depends on the terms of the specific plan. (Employer contributions are tax exempt.)

As another incentive to promote voluntary savings, the government provides an annual subsidy of 15 percent of the total amount employees contribute to all types of voluntary retirement savings: (1) APVC plans; (2) voluntary employee contributions to mandatory individual accounts, managed by AFPs; and (3) separate retirement savings accounts with an AFP. The maximum annual subsidy is currently 229,038 pesos (US$497) per employee. To be eligible for the subsidy, employees must be contributing regularly to a mandatory individual account, and their total voluntary retirement contributions cannot exceed 10 times their mandatory contributions per year. However, employees have to return the subsidy to the government if they withdraw any of their voluntary contributions before retirement (age 65 for men and age 60 for women).

Source: "Recent Changes to the Chilean System of Individual Accounts," *Social Security Bulletin*, 2001/2002; "Chile," *International Update*, October 2008, US Social Security Administration; "Número de Contratos Vigentes Según Actividad Económica," Superintendente de Pensiones, el 28 de febrero de 2011; "Norma de Carácter General Número 305," Superintendencia de Pensiones, Superintendencia de Bancos e Instituciones Financieras, and Superintendencia de Valores Y Seguros, el 12 de abril de 2011; "Reguladores Modifican Normative Sobre Ahorro Previsional Voluntario Colectivo," Superintendiente de Pensiones, el 12 de abril de 2011.

Ibero-American Multilateral Agreement

On May 1, a new multilateral agreement that provides social security benefits to migrant workers and their families in eight countries (Bolivia, Brazil, Chile, Ecuador, El Salvador, Spain, Paraguay, and Portugal) entered into force. These countries are members of the Ibero-American Social Security Association (OISS), an organization made up of the Spanish- and Portuguese-speaking countries in Latin America, Spain, Portugal, and Andorra. Although 16 other member countries have not yet ratified the agreement, a minimum of 7 countries was required for the agreement to be implemented. (The remaining countries are expected to ratify the agreement soon.)

Under the agreement, migrant workers (employees and the self-employed) who have worked in multiple countries covered by the agreement but do not meet the minimum eligibility requirements for a social security benefit (old-age, survivors, disability, and work injury) in any one country may qualify for a benefit based on their combined contributions across participating countries. The agreement does not apply to noncontributory or social assistance benefits. In addition, the Technical Administrative Committee, made up of representatives and technical advisors (if needed) from each of the signatory countries, will: (1) ensure that the agreement is carried out uniformly among the countries; (2) resolve administrative questions; (3) promote and develop collaboration among the countries; and (4) promote the use of new technologies, such as modernizing procedures and adopting the electronic exchange of information.

Source: "Convenio Multilateral Iberoamiercano de Seguridad Social," el 10 de noviembre de 2007; "Ibero-American Multilateral Agreement," *International Update*, December 2007, US Social Security Administration; "Convenio Multilateral Iberoamericano de Seguridad Social Entrará en Vigor el 1 de mayo de 2011," *FIAP Boletín,* Abril 2011; Government of Spain press release, April 30, 2011; "International Headlines," *Mercer*, May 11, 2011.

Reports and Studies

World Bank

On April 6, the World Bank released the report *Becoming Old in an Older Brazil*, which examines Brazil's socioeconomic transition as the population ages. The report notes that a projected aging of the population is expected to exert fiscal pressures on social security, as well as on the health and education systems. According to the report, the country can take advantage of this transition to foster economic and social development and to avoid bottlenecks that might hinder further economic growth and strain the country's capacity to fund social services.

The report finds that Brazil's demographic transformation is going to be very rapid in the next 40 years. The country currently has a very favorable population

structure, with the size of the "mature labor force" (those aged 25 to 59) expected to continue growing until the late 2030s and the size of the "junior labor force" (those aged 15 to 24) continuing to decline. This should result in a greater share of individuals reaching a more productive phase of their working lives, with a potential for increased income and tax revenues to finance public programs. After 2030, however, the overall growth rate in the combined groups (aged 15 to 59) is projected to decline, and negative effects of population aging on productivity can be expected with a larger share of the labor force moving beyond its peak in productivity. According to the report, Brazil will need to rely more on productivity growth than labor market entrants to sustain future economic growth.

The report also finds that Brazil's pension expenditures are higher than those in other middle-income countries and countries with a similar age profile. The causes for these high costs include the following:

- Social protection benefits (social security and public transfers) are provided to a higher percentage of the population. These benefits have greatly reduced poverty among the elderly.
- The program design encourages retirement at relatively young ages, excessively high replacement rates, and opportunities to receive benefits from several programs at the same time. Early retirees often continue to work, primarily in the informal sector where they do not contribute to the social security system or pay other taxes. Although the system is currently affordable, future demographic changes are bound to make it increasingly more expensive.

The report concludes that a reform of the social protection system is inevitable and recommends that Brazil move toward a more integrated system, avoiding the dualism between informal workers targeted by social assistance and formal workers with access to social insurance. Such a reformed system would ensure a more direct relationship between contributions and benefits, greater equity and program transparency, increased participation in social insurance programs, and greater savings.

Sources: *Becoming Old in an Older Brazil: Implications of Population Aging on Growth, Poverty, Public Finance and Service Delivery*, World Bank, April 2011.

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Editor: Barbara E. Kritzer.

Writers/researchers: John Jankowski, Barbara E. Kritzer, and David Rajnes.

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

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