Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

June 2012

Europe

Austria

On May 16, Austria's Parliament passed a law that amends the Pension Fund Act governing voluntary funded occupational pension funds (known as Pensionskassen) to provide employers and employees with more pension options that supplement the pay-as-you-go public (PAYG) pension system. The financial burden of the PAYG system on the government is growing because the benefits are generous (80 percent of final salary with 45 years of contributions) and the population is aging rapidly. With only about 20 percent of the labor force (approximately 800,000 workers) covered by some type of funded pension provision, the new measures are expected to encourage more voluntary participation.

The amended law, expected to become effective in 2013, is based on recommendations made by a recent government pension reform commission. The law creates two new types of benefits for defined contribution (DC) plans: (1) a "security pension" with a conservatively invested portfolio that offers a lower but guaranteed pension benefit and (2) a life-cycle fund option that adjusts the portfolio to an age-based risk profile. Other measures of the new law include the following:

- Providing employers with greater flexibility in pension plan design and allowing them to adapt contribution levels to business needs and changing economic conditions.
- Permitting DC plan members to transfer to another type of occupational plan.
- Reducing the vesting period for employees to qualify for a pension from 5 years to 3 years.
- Improving information disclosure requirements to provide greater fund transparency and allow participants to more easily compare different vendors.

Since the beginning of the financial crisis in 2008, pension fund (mostly DC plans) member benefits have decreased. (Under the Pensionskassen system, pensions may be reduced when investment returns are lower than the calculated rate negotiated in the original contract.) In 2011, investment returns for occupational pension funds declined by 3 percent on average. However, the historical annual rate of return (since 1991) is just over 5.5 percent.

According to current rules, occupational retirement plans in Austria (both defined benefit (DB) and DC) may be set up by a single employer or a group of employers through a collective bargaining agreement with their employees or another financing vehicle, such as internally financed book reserves or pension insurance contracts. Industry experts estimate that current retirement savings in Austria amount to roughly 50 billion euros (US$63 billion) in traditional life insurance products, 15 billion euros (US$19 billion) in Pensionkassen, and 22 billion euros (US$28 billion) in other savings vehicles.

Sources: "Austria Unveils Revised Pension Fund Law After Protracted Negotiations," ipe.com, November 24, 2011; "Austrian Pension Funds Report Negative Results for 2011," ipe.com, January 19, 2012; "Amendment to Austrian Pensions Law Clears First Hurdle," ipe.com, April 19, 2012; "Austrian Parliament Approves Second Pillar Pension Reforms," PlanSponsorEurope.com, May 17, 2012.

The Americas

Brazil

On May 2, a new law entered into force that creates a second-pillar defined contribution (DC) pension program for federal employees. The new second pillar supplements the first pillar pay-as-you go (PAYG) public pension program for federal employees, which underwent major reforms in 2003. (Federal employees hired since the 2003 reform was implemented have to work longer and will receive a less generous benefit than under the old rules.) Despite continuing opposition to the proposal to set up the DC program (first introduced in Congress in 2007), the bill was passed because of the rising financial burden of federal employee pensions on the government. New federal employees hired since May 2 are covered by the new DC program as well as the reformed first pillar. Current employees under the 2003 rules have 24 months to opt in.

The new law requires the government to set up the Complementary Social Security Foundation for Federal Public Servants (Fundação de Previdência Complementar do Servidor Público Federal or FUNPRESP) with one fund for each branch of the government: executive, legislative, and judicial. PREVIC, the regulatory agency for private pension plans, will oversee FUNPRESP.

The new law also introduces a ceiling on earnings used to calculate contributions to the first pillar, currently 3,916.20 reais (US$1,940) per month. To receive a higher benefit, an employee has to contribute to FUNPRESP and can choose what percentage of income to contribute each year, up to a maximum of 26,000 reais (US$12,877). The employer (government agency) provides a matching contribution of up to 8.5 percent of an employee's earnings (up to the same maximum). In addition, the 2012 Budget contains a government start-up contribution of 100 million reais (US$49.5 million) to FUNPRESP: Half goes to the executive fund and the other half is divided equally between the other two funds. At retirement, a worker will receive an annuity based on the account balance in FUNPRESP.

Sources: "Brazil," *International Update,* US Social Security Administration, January 2004; OECD Economic Survey of Brazil, October 2011; "Funpresp: Senado Aprova Projecto de Novo Modelo de Previdência," *Jornal do Brasil*, 28 de março de 2012; "Brazil's Mantega: Pension Reform Approval to Aid Public Accounts," Dow Jones International News, March 29, 2012; Lei Nº 12.618, 30 de abril de 2012; "Dilma Sanciona Lei Que Cria o Funpresp," ANDES-SN, 3 de maio de 2012.

Africa

South Africa

On May 14, the government released "Strengthening Retirement Savings," which describes its proposals in the 2012 Budget to improve household and retirement savings in the country. The paper—which begins a consultation process with trade unions, retirement funds, and the public—provides an overview of technical discussion papers to be released later in the year.

The paper highlights the following four main areas of concern with the current private pension system in South Africa:

1. *Inadequate retirement savings.* Only about 10 percent of current South African pensioners can maintain their preretirement standard of living. Based on the results of a 2010 private-sector survey, only about 10 percent of current workers who are members of a pension fund are projected to have enough money to live on in retirement.
2. *Low levels of asset preservation and portability.* About 80 percent of workers withdraw their retirement funds when changing jobs. In recent years, the outflow of assets from funds, both pre- and post-retirement, appears to have been greater than total new contributions to retirement funds.
3. *High fees and charges.* Multiple types of charges (administrative and investment management) and fees (brokerage, advisor, and performance-related) make comparisons across companies difficult. The relatively high cost structure of South Africa's retirement industry can significantly erode benefits over time.
4. *Low levels of annuitization*: Currently, workers are required to purchase either a conventional or "living annuity." Most workers opt for a living annuity, a phased withdrawal retirement savings account with no longevity risk protection.

Technical papers (to be released in the coming months) will consider reforms in those areas. Among the key proposals are the following:

- *Reducing retirement fund costs.* Standardizing retirement products to increase competition on price rather than product design, mandating charging structures to prevent price discrimination against small firms or employers of lower-paid workers, and harmonizing disclosure requirements.
- *Reforming the annuities market.* Developing cost-effective and accessible standardized products, which share risks between providers and plan members and could serve as default options with an automatic enrollment feature.
- *Requiring preservation and portability.* Phasing in a preservation requirement so that employees who change jobs may either keep their account balances with the previous employer's fund or transfer them to the new employer's fund, rather than withdrawing the balance as a lump sum.
- *Improving fund governance and the role of trustees.* Putting in place a documented code of conduct and statutory training requirements for trustees, an investment statement, a communication strategy for plan members, and a performance appraisal system for trustees.

- *Creating tax incentives to promote retirement and other investment products*. Introducing a new tax-preferred savings vehicle, similar to the Roth individual retirement account in the United States, that would target middle-income workers. Additional measures would aim to increase savings among low-income workers.

According to the paper, the current retirement system (occupational pensions) in South Africa favors employed higher earners. However, even though South Africa has the most developed private pension system in the region, more than half of the formal labor force is not covered; the level of coverage depends on the industry and the trade union. The country has no earnings-related public pension system; it only provides a means-tested pension benefit.

Sources: "South Africans Face a Bleak Retirement," Mail and Guardian Online, August 10, 2010; "Strengthening Retirement Savings: An Overview of Proposals Announced in the 2012 Budget," National Treasury, May 14, 2012; "National Treasury Gets Serious About Retirement Reform," FA News, May 24, 2012.

Reports and Studies

United Nations Economic Commission for Latin America and the Caribbean (ECLAC)

ECLAC released "Ageing, Solidarity and Social Protection: Time for Progress Towards Equality," during the Third Regional Intergovernmental Conference on Ageing in Latin America and the Caribbean. The main focus of the report is the role of social protection in achieving equality for individuals aged 60 or older throughout the region.

According to the report, in general, countries in Latin America and the Caribbean have not adapted to the rapid aging of the population (which is occurring at a much faster pace than in the developed world) and have not increased coverage for a large proportion of the older population that is underprotected. The region's population aged 60 or older represents 10 percent of the total population and is expected to double by 2040 and rise to nearly 36 percent by 2100. In addition, the current dependency ratio (potential workers per person aged 60 or older) of 6 to 1 is projected to reach 3 to 1 by 2040 and 1.5 to 1 by 2100. Regarding low rates of coverage, in 2009, 40 percent of individuals aged 65 or older in the region received some kind of retirement benefit (compared with 75 percent in developed countries), and 11 percent of older men and 25 percent of older women in urban areas had no source of income.

The report found that during the recent economic crisis, countries with higher rates of coverage for the older population (an average of 65 percent in Argentina, Brazil, Chile, Costa Rica, and Uruguay) fared better economically than countries with much lower rates (close to 14 percent in Ecuador, El Salvador, Guatemala, Honduras, Nicaragua, Paraguay, and Bolivia.) The latter countries have weak social security institutions that prevented them from responding quickly enough to help the vulnerable older populations. The report warns that if those countries do not improve their social security systems in a timely manner, they are not likely to reduce inequality because access to the system is related to formal employment. Throughout the region, a large percentage of workers are not covered because they are in the informal sector.

The report concludes that pensions funded by general revenues are effective in reducing poverty for the indigent who are generally excluded from social security. The basic principle for any pension program for that group should be that all older people are entitled to a minimum basic level of income. A government could establish a basic pillar that provides a minimum benefit, expands an existing program, or consolidates other noncontributory programs in operation. The report supports a universal pension for all older individuals regardless of income level or amount of other social benefits they already receive. ECLAC estimates the average cost of such a program in the region at 1.7 percent of gross domestic product (GDP), ranging from 0.8 percent of GDP in Panama to 2.6 percent of GDP in Nicaragua.

Source: "Ageing, Solidarity and Social Protection: Time for Progress Towards Equality," United Nations Economic Commission for Latin America and the Caribbean, Third Regional Intergovernmental Conference on Ageing in Latin America and the Caribbean, in San José, Costa Rica, May 8–11, 2012.

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