Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

October 2012

Europe

Ireland

On September 17, the Minister of Social Protection released the latest edition of *Actuarial Review of the Social Insurance Fund*, which examines the fiscal position of Ireland's Social Insurance Fund (SIF) as of December 31, 2010, and presents projections for the 2011–2066 period. (Social insurance contributions are paid to the SIF, which finances the country's old-age, disability, and survivors pensions along with various other benefits.) The review also updates the *2005 Actuarial Review*, taking into account policy, economic, and demographic changes from 2005 through 2010. According to the government, the purpose of the review (conducted by KPMG, following a competitive tendering process) is to determine the adequacy of current contributions to finance the country's various social insurance programs and to inform discussion of policy options to ensure the long-term sustainability of the SIF.

Among the report's key findings is that the SIF faces significant shortfalls in revenues compared with expenditures: for 2011, provisional data show a shortfall of €1.5 billion (US$1.9 billion), with expenditures of €9.0 billion (US$11.6 billion) compared with income of only €7.5 billion (US$9.7 billion). In the absence of any policy changes, these shortfalls, which the government finances through general revenues, are projected to double by 2019 and reach €25.7 billion (US$33.1 billion) by 2066. (As a percentage of gross domestic product, this represents an increase from 1.1 percent in 2011 to 5.7 percent in 2066.)

The report finds that the main driver of these shortfalls is the significant increase in the cost of the country's public pension programs, which is expected to rise from 58 percent of all SIF expenditures in 2011 to 85 percent by 2066. According to the report, the cause of this increase is Ireland's rapidly aging population: from 2010 through 2060, the percentage of the population aged 65 or older is projected to increase from 11 percent to 24 percent. As a result, the ratio of workers to pensioners is projected to decline from 5.3:1 to 2.1:1 over this same period.

Finally, the report considers the impact of a variety of policy options on the long-term sustainability of SIF, including the—

- adoption of alternative indexation rules, ranging from indexing benefits to real earnings growth to indexation linked to the consumer price index.
- use of credited social insurance contributions for periods spent outside the labor force (for example, unemployment; early retirement; or the provision of care to children, the disabled, or the elderly).
- cost of expanding coverage of the Jobseeker's Benefit and Invalidity Pension to the self-employed.

Sources: *Actuarial Review of the Social Insurance Fund: 31 December 2010*, KPMG, June 7, 2012; "Minister for Social Protection Launches the 2010 Actuarial Review of the Social Insurance Fund," Public Affairs Ireland, September 17, 2012.

United Kingdom

On October 1, the government began implementing a new low-cost, defined contribution personal account system with an auto-enrollment (AE) feature and an opt-out provision. The new system, which will be phased in over 5 years, targets the approximately 7 million workers that, according to the government, are not saving or not saving enough for retirement. The government expects the AE system to promote long-term retirement savings especially in low-income households and reduce the financial burden on the public pension system as life expectancy continues to increase.

Workers aged 22 up to the state pension age (currently 61 for women and 65 for men) who earn from £8,105 (US$13,025) to £42,475 (US$68,197) annually are automatically enrolled in the AE system. Those who already have a qualifying pension plan (meeting minimum standards in terms of contributions paid by employer and employee) are exempt, and the self-employed are excluded from the system. Workers aged 16–22 and those older than the state pension age who earn from £5,564 (US$8,941) to £42,475

(US$68,197) may choose to opt in to a qualifying plan and receive an employer contribution. Workers earning less than the income threshold must also be allowed to opt in to the new system, but employers are not required to make contributions on those workers' behalf; those opting out are re-enrolled every 3 years by the employer (employees may choose to opt out each time).

Employers can enroll workers in their own company plan, a default provider, such as the state-run National Employment Savings Trust (NEST) or a private-sector provider. NEST, a not-for-profit trust designed to cover its own costs from the low fees it charges, targets low to moderate earners and must accept any employer wishing to enroll employees. Other providers are allowed to limit access to their plans.

The Pensions Regulator is responsible for ensuring that employers comply with the new auto-enrollment rules and is providing guidance to help employers accomplish this. The initial enrollment schedule for workers depends on employer size and is occurring in stages. Table 1 shows the enrollment schedule.

Table 1.
Timetable for auto-enrollment in the United Kingdom

Scheduled date	Type of employer	Number of employees
October 2012–February 2014	Large firms	250 or more
April 2014–April 2015	Medium firms	50–249
June 2015–April 2017	Small firms	49 or less
May 2017–February 2018	New firms (established after April 2012)	--
Up to September 30, 2017	Firms with defined benefit or hybrid plans	--

SOURCE: "Automatic Enrolment into a Workplace Pension: Key Facts," Department for Work & Pensions, September 2012.

NOTE: -- = data not available.

The AE system requires minimum contribution rates for both employees and employers that are being phased in over time. (Employees benefit from a tax credit of roughly 20 percent of the required contribution, so they contribute 80 percent of the statutory rate.) Table 2 provides the timetable for increasing the minimum contribution rates.

Table 2.
Timetable for raising the minimum contribution rate under auto-enrollment

	Contribution rate		
Scheduled date	Employee	Employer	Total
October 1, 2012–September 30, 2017	1	1	2
October 1, 2017–September 30, 2018	3	2	5
October 1, 2018, onward	5	3	8

SOURCE: "Automatic Enrolment into a Workplace Pension: Key Facts," Department for Work & Pensions, September 2012.

NOTE: Data shown as a percentage of qualified employee earnings.

The new AE system supplements the country's state pension system, which includes the basic state pension, a near universal flat-rate benefit, and the earnings-related state second pension (S2P). Means-tested benefits complement the basic state pension. Voluntary pension arrangements not directly funded by the state are also available, including employer-sponsored and personal private pension arrangements.

Sources: "Automatic Enrolment & NEST," http://www.advancedcomputersoftware.com/autoenrol/AdvBS393_WP.pdf, December 2011; "Automatic Enrolment Into a Workplace Pension: Key Facts," Department for Work & Pensions, September 2012; "The Pensions Primer: A Guide to the UK Pensions System," Pension Policy Institute, September 13, 2012.

The Americas

Colombia

On October 1, a new family pension was introduced for married couples or permanent companions who individually are not eligible for an old-age pension, but together qualify for a minimum benefit. In order to receive a family pension, both spouses or permanent companions must be at least age 62 (men) or age 57 (women) and must have been married or in a permanent relationship for at least 5 years before reaching age 55. In addition, neither spouse nor companion may receive any other type of pension or subsistence benefit.

A family pension is available under both the public, pay-as-you-go (PAYG) pension system and the system of individual accounts. (Workers may choose between the two systems and may switch from one system to the other every 5 years, up to 10 years before retirement.) If the spouses or companions are not affiliated with the same system, one of them has to transfer his or her account balance or contributions to the other's system. The family pension, equal to the legal monthly minimum wage (566,664 pesos or US$315), is split evenly between the couple. If one member of the couple dies, the surviving member continues to receive 50 percent of the family pension; the benefit for surviving children younger than age 18 (age 25 if a student, no age limit if disabled) will be 50 percent of the family pension and 100 percent if both members die. The benefit ceases in the case of divorce or legal separation.

A recent study of the country's pension system by the Colombian pension fund association concluded that 28 percent of current workers in the individual account system will be eligible for a pension when they reach retirement age compared with 13 percent under the PAYG system. The retirement age is 62 (men) and 57 (women) for the individual account system, and age 60 (men, rising to 62 by 2014) and age 55 (women, rising to 57 by 2014) for the PAYG system.

Sources: *Social Security Programs Throughout the World*: The Americas, 2011, US Social Security Administration; "Se Crea la Pensión Familiar en Colombia," gerencie.com, octubre de 2012; "Asofondos Pide Ganar Cobertura en Pensiones," elcolombiano .com, el 1 de octubre de 2012; Ley No. 1580, el 1 de octubre de 2012.

Peru

From October through December 2012, all new entrants to the system of individual accounts will be assigned to Prima, the pension fund management company (AFP) that offered the lowest administrative fee in the tender held in September. As a result, Prima is expected to enroll close to 80,000 workers during that period and must charge both new and old account holders the same administrative fee for 1 year. Before that year is over, new account holders may switch to another AFP that offers a lower fee or higher rate of return.

As a result of the competition, all four AFPs slightly reduced their administrative fees. The following table compares the new fees (October) with the old fees (September). However, the average decrease among all four AFPs was lower than government expectations.

Administrative fees by AFP, September and October 2012

AFP	Fees	
	September	October
Prima	1.75	1.60
Integra	1.80	1.74
Horizonte	1.95	1.89
Profuturo	2.14	2.10

SOURCE: "Comisiones de las AFP Bajaran Solo 4% en Promedio con Licitacion," Peru21, el 13 de septiembre de 2012.

NOTE: Data shown as a percentage of monthly earnings, up to a maximum of 7,948.50 nuevos soles (US$2,977.64).

This first competition is a smaller version of the tender required by the new pension reform law passed in July 2012. (The AFP regulator expects to implement the law in 2013, despite a constitutional challenge to a few provisions of the law.) Under the new law, a tender will be held every 2 years. The government expects to hold the first "full" tender on December 31, which will be open to any existing AFP or qualified company (domestic or foreign) that plans to enter the market. The winning AFP must maintain the fee for 24 months, and new account holders may switch to another AFP that offers a lower fee or higher rate of return before the 2 years are over.

The four existing AFPs manage more than 92 billion nuevos soles (US$34.5 billion) in assets; each of those AFPs has close to 25 percent of all account holders. The July 2012 pension reform law includes measures to encourage greater competition in the pension fund industry and broaden the types of investment funds available to account holders.

Sources: "Peru," *International Update*, US Social Security Administration, July 2012; "El TC Admitió a Trámite Demanda Contra Reforma de las AFP," *Gestión*, el 24 de agosto de 2012; "AFP Reform: Prima Wins First Tender with 1.60% Bid," Business News Americas, September 13, 2012; "Credicorp Unit Wins Peru's First Auction of Private Pension Fund Accounts," Dow Jones Global New Select, September 13, 2012; "Prima AFP Captará 80 Mil Nuevos Afiliados Tras Ganar Primera Subasta," *Gestión*, el 13 de septiembre de 2012; "Comisiones de las AFP Bajarán Solo 4% en Promedio con Licitación," Peru21, el 13 de septiembre de 2012.

Reports and Studies

United Nations and HelpAge International

On October 1, the United Nations and HelpAge International released its report, *Ageing in the 21st Century: A Celebration and a Challenge*, which praises the achievement of increasing longevity and examines the major challenges an aging society poses to health care, retirement, living arrangements, and intergenerational relations.

According to the report, countries around the world are aging rapidly: in 2000, for the first time in history there were more people older than age 60 than younger than age 5; by 2050, the older population will also be larger than the population younger than age 15. Developing and emerging economies are particularly affected: currently, two out of three people aged 60 or older live in developing and emerging economies, and by 2050, that will rise to nearly four out of five people.

The report finds that increasing life expectancy is a major cause of this rapid aging, with life expectancy at birth exceeding 80 years in 33 countries, compared with 19 countries 5 years ago. At present, Japan is the only country where the older population makes up more than 30 percent of the total population; by 2050, 64 countries are expected to join Japan with an older population above that level.

The report addresses major challenges countries face in the context of these demographic changes, including income security in old age and low coverage. According to estimates of the International Labor Organization, only about 20 percent of the world's older population is currently eligible to receive any social security or social assistance benefit. While industrialized countries routinely cover more than 80 percent of the working population, the coverage rate is far lower in developing countries. Some countries in Sub-Sahara Africa have coverage rates lower than 5 percent of the labor force.

The report concludes that the gradual extension of social security protection is driving countries to look for new and more immediate solutions to old-age poverty. Noncontributory "social pensions" (either means-tested or universal) have helped alleviate old-age poverty in over 20 countries during the past decade and have played a major role in extending pension coverage. An increasing number of countries have endorsed the concept of a "social protection floor"—a set of social policies that guarantee income security and access to basic services for all generations. According to the report, developing countries face a double challenge of ensuring social protection for the rapidly growing proportion of older people threatened by poverty, while building stable and solvent social security systems for workers in the formal employment sector.

Sources: *Ageing in the Twenty-First Century: A Celebration and A Challenge*, United Nations Population Fund and HelpAge International, September 2012.

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