Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

May 2013

Europe

Ireland

On April 22, the Organisation for Economic Co-operation and Development (OECD) released *Review of the Irish Pension System*, a report commissioned by Ireland's Ministry of Social Protection that covers all aspects of Irish pension provision. The review provides a comprehensive analysis and range of options for reforming and updating Ireland's pension systems. Its recommendations address four objectives: (1) system sustainability, given population aging and financial-market risk; (2) adequacy of future retirement incomes (including the potential for private pensions); (3) enhanced capacity of pensions to provide for labor market flexibility and extend working lives; and (4) fairer treatment across demographic groups within pension systems. Although Ireland spends less than most European Union countries on public pensions (7.5 percent of gross domestic product), the percentage is projected to rise to 11.7 percent by 2060.

The review describes the Irish public pension system as an "outlier" among OECD countries, as the country generally has a basic pension system, without an earnings-related pillar or any mandatory (or quasi-mandatory) occupational or personal pension. Consequently, over 900,000 workers (more than 40 percent of the labor force) have no retirement provision for old age except the public State pension. To ensure greater retirement income adequacy, the report suggests adding either a universal basic pension or a single means-tested pension to the State pension and supplementing those benefits with a compulsory private pension. Based on international experience, compulsion is viewed as a less costly and more efficient method for increasing coverage rates across income groups compared with automatic enrollment, which demands greater attention to design and administration. In addition, the report proposes other measures to increase the adequacy of retirement income, including linking the retirement age to life expectancy.

The report urges additional steps to increase individual savings to reduce future reliance on the State pension. For low earners, the report recommends a government subsidy or matching contribution to an individual's retirement savings. Changing pension-related incentives in the tax code—to make pension savings more attractive to low and middle earners—is also recommended. Meanwhile, the decline in both defined benefit (DB) and defined contribution (DC) pension plans remains a concern. Noting the underfunding of DB plans since the financial crisis, the report urges stronger laws to protect plan members (chiefly workers) should trustees decide to close a plan and to allow greater risk sharing among plan members, pensioners, and sponsors. For DC pension plans, the report favors improving plan designs in line with OECD guidelines, which include default investment strategies (with a default life-cycle investment strategy as an option for protecting those close to retirement) and annuitization to protect against longevity risk.

Ireland's retirement system comprises several components. The State pension system includes (1) an earnings-related contributory benefit paid at age 66 (but gradually increasing to age 68 by 2028) that is complemented by a 1-year "transition" benefit (to be abolished next year) from age 65 (for nonworkers), and (2) a noncontributory means-tested benefit for residents aged 66 or older who are ineligible for the contributory benefit. Voluntary occupational pensions cover roughly half of workers in the private sector.

Sources: Ireland Department of Social Protection, press release, April 22, 2013; *Review of the Irish Pension System*, Organisation for Economic Co-operation and Development, April 22, 2013; "OECD Reviews Ireland's Pension System," *Mercer Select News*, April 26, 2013.

Sweden

On April 9, the Government Commission for Longer Working Life and Retirement Age (also called the Pension Age Group) released its report *Measures for a Longer Working Life (ÅtgärderförettLängreArbetsliv*—"English summary"), which discusses ways to encourage older workers to remain in the labor force. According to the report, about 80 percent of current pensioners retire at age 65 or younger and the employment of workers aged 60 or older is not increasing fast enough to keep up with the increase in life expectancy. The report urges the government to adopt measures that extend working life in order to reduce the fiscal burden on the pension system, improve the level of benefits, and put the system on the path to sustainability.

These new measures are in addition to Sweden's major reform in 1999 that introduced first-pillar, pay-as-you-go notional defined contribution (NDC) accounts intended to restore financial sustainability. Workers and employers contribute to a "hypothetical account," which contains all contributions made during an individual's working life and is credited with an annual notional interest rate equal to the growth of average earnings. A retirement benefit is based on the worker's life expectancy at retirement. The reform also changed the retirement age from 65 to a flexible age, ranging from 61 to 67. Those workers who retire at younger ages receive a lower benefit. Second-pillar mandatory individual retirement accounts supplement the NDC benefit. The third pillar consists of quasi-mandatory, occupational pension plans that are based on collective agreements covering 90 percent of employees and voluntary private pension plans.

The report introduces a new concept, the "recommended retirement age," which would be adjusted annually to life expectancy and would form the basis for any changes to the retirement age for the various types of programs. Based on the recommended retirement age, the retirement ages for the country's pension programs are expected to rise—

- from age 61 to 62 by 2015 and to age 63 in 2019 for the earliest NDC retirement age.
- from age 67 to 69 in 2016 for the latest NDC retirement age. (The age limit for employment and for making social security contributions will be increased first.)
- from age 65 to 66 for the means-tested guarantee pension. Income earned after age 65 would not change eligibility for the guarantee pension or the housing supplement.
- from age 55 to 62 in 2017 for the earliest retirement age for supplementary occupational pensions and private pensions.

The report also recommends a number of changes that (1) adapt the working environment for people with a reduced work capacity, (2) combat age discrimination, and (3) allow older workers opportunities for professional development (including financial aid). In addition, the report suggests ways to educate older workers about the financial benefits of postponing retirement and remaining in the labor force. Finally, the report urges the government to closely monitor and evaluate the effectiveness of these measures.

Sources: *Social Security Programs Throughout the World: Europe 2012*, US Social Security Administration; *ÅtgärderförettLängreArbetsliv* (English summary), SlutbetänkandeavPensionsåldersutredningen, April 9, 2013; "Swedish Pension Commission Proposes Retirement Age Hike," Mercer International Headlines, April 12, 2013; "Working Environment One Important Key to Get Swedes to Work for Longer," *Nordic Labor Journal*, April 16, 2013.

The Americas

Canada

On April 17, the Expert Committee on the Future of the Quebec Retirement System released *Innovating for a Sustainable Retirement System*, a report that analyzes the state of third-pillar, voluntary pension programs in Quebec. (Third-pillar programs examined in the report include defined benefit (DB) and defined contribution (DC) supplemental pension plans and personal savings plans, such as registered retirement savings plans and tax-free savings accounts.) The report presents current and projected data (using a 40-year time horizon) on retirement savings and proposes a series of reforms to improve the financial security of workers in the province.

According to the report, Quebec's public pension system—consisting of the federal Guaranteed Income Supplement and Old-Age Security programs and the earnings-related Quebec Pension Plan (QPP)—provides good protection for lower-income workers, but that protection drops rapidly as income increases. (The QPP is similar to the earnings-related Canada Pension Plan, which covers the other provinces.) At present, the gross replacement rate at age 65 for beneficiaries with an annual income of C$20,000 (US$19,787, or half the average earnings in Quebec) is around 80 percent of prior earnings, compared with around 50 percent for those workers with average earnings (and even lower as income increases).

The report projects that these replacement rates will continue to decline over the next 40 years because of the indexation method, which does not keep up with wage growth. As a result, voluntary savings through supplemental pension plans and personal savings will become increasingly important to help workers maintain their preretirement standard of living.

Some of the report's other key findings include the following:

- At present, the majority of workers either do not have a supplementary pension plan or have a plan that provides inadequate retirement benefits. DB plans, which the report argues provide the best financial security, only cover 35 percent of workers and are increasingly being replaced by DC plans that provide lower after-tax returns and do not guarantee a pension.
- DB plans are under significant pressure because of factors such as faulty risk management, inaccurate valuations of plan liabilities, and a legal and regulatory framework that is too restrictive. The situation has been compounded by increases in life expectancy, an aging population, early retirements, declining interest rates, and financial market volatility.
- There has been a rapid deterioration in the degree of solvency for DB plans: From 2007 to 2011, the percentage of plans with assets that covered less than 80 percent of their liabilities increased from 12 percent to 72 percent, respectively.

The report makes a series of recommendations to increase the financial security of older workers and to improve the long-term sustainability of the retirement system as a whole, including—

- introducing a longevity pension to the public pension system, which would provide a benefit to workers upon reaching age 75. All workers from ages 18 to 74 would be covered, and the value of the pension would vary according to the number of contributions (with higher benefits for those who started contributing at younger ages). The pension would be financed through equal contributions from employers and employees.
- adopting new measures for DB plans, including an "enhanced funding" method to ensure that funding more closely reflects costs and a new restructuring mechanism to eliminate plan deficits.
- promoting voluntary savings outside of DB plans through personal savings plans, such as registered retirement savings plans and tax-free savings accounts.

Sources: *Innovating for a Sustainable Retirement System*, Expert Committee on the Future of the Quebec Retirement System, April 2013.

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