Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

January 2014

Europe

Armenia

On January 1, the Armenian government introduced a second pillar of individual accounts that is mandatory for workers born on or after January 1, 1974, and voluntary for those born before 1974. (Once a worker has chosen to participate, the decision cannot be reversed.) The reform is part of a law passed in 2010 that also created third-pillar, voluntary individual accounts (introduced in January 2011) to supplement the first-pillar, pay-as-you-go (PAYG) public program. According to the government, the new second pillar should spur economic development, improve the long-term financial sustainability of the public pension system, and improve the relatively low level of retirement savings in the country. The government estimates that the average first-pillar monthly pension in 2014 will be only 36,000 drams (US$88.94), with many retirees falling beneath the poverty line.

Key provisions of the second pillar include—

- *Contribution rates:* The overall contribution rate is 10 percent of an employee's monthly earnings. For employees with earnings up to 500,000 drams (US$1,235.26), 5 percent is paid by the government and 5 percent by the employee. For employees with earnings exceeding 500,000 drams, the government will contribute 25,000 drams (US$62.76), and the employee will contribute the remainder in order to reach 10 percent of his or her monthly earnings. Workers may continue to contribute to their individual accounts upon reaching the normal retirement age, but the government contribution will cease. Workers born prior to 1974 who voluntarily join the second pillar contribute 5 percent of monthly earnings, with no government contribution.
- *Selection of a pension fund management company and pension fund:* Participants have until March 2014 to choose both a pension fund management company (there are currently two licensed companies in the country) to manage their individual accounts and the specific pension fund where their assets will be invested. Participants may choose from one of three pension funds with varying levels of risk: (1) a fixed-income fund, with no equity exposure; (2) a conservative fund, with up to 25 percent invested in equities; and (3) a balanced fund, with up to 50 percent in equities. (The Central Bank will issue regulations on the specific investment rules under each fund.) Workers who do not make an active choice will default into the conservative fund of a randomly selected pension fund management company.
- *Management fees:* Pension fund management companies may charge the accountholder up to 1.5 percent of assets under management.
- *Payment of retirement benefits:* Upon reaching the normal retirement age of 63, participants may convert their account balances into an annuity, programmed withdrawals, and/or a lump sum. The form of payment depends on the amount of assets held in the individual account. The law also guarantees that participants will receive at least the total amount of contributions (adjusted for inflation), minus management costs.

In addition to the second pillar, other components of the Armenian pension system include a first-pillar PAYG program and third-pillar individual accounts. The PAYG program covers all employed and self-employed persons; it is financed by (1) employee contributions of 3 percent of monthly after-tax earnings and (2) employer contributions of 7,000 drams (US$17.29) a month in addition to an amount based on the employees' income levels. To receive a pension, a worker must be age 63 with at least 25 years of covered employment. (The qualifying conditions are reduced for those employed in arduous or hazardous work.) A social assistance pension is paid at age 65 to workers with less than 5 years of covered employment.

Sources: Law of the Republic of Armenia on Funded Pensions, December 22, 2010; *Social Security Programs Throughout the World: Asia and the Pacific, 2012*, US Social Security Administration, 2013; "Prime Minister Says Introduction of Mandatory Funded Pension System Can Not Be Delayed," *ARKA News Agency*, December 12, 2013; "Armenian Central Bank: March 2014 is Deadline for the Citizens of Armenia to

Choose a Pension Fund," *ARM Info*, December 12, 2013; "Final Passage of Armenia's Second Pillar Pension Bill," *Mercer*, December 16, 2013.

France

On December 18, the National Assembly approved a public pension reform that gradually increases both the contribution rates and the required number of contribution years for a retirement benefit; the reform changes when benefits are adjusted. According to the government, those measures will help keep the system on a more sustainable path; without any changes, the pension deficit was projected to nearly double—from 14 billion euros (US$19 billion) currently—by 2040. A major reason for the deficit is population aging. The old-age dependency ratio, the number of workers per retiree, is expected to fall from 1.7:1 in 2011 to 1.4:1 in 2040. During the same time frame, life expectancy at birth for both men and women is projected to increase by about 4 years (from age 84.4 for women and 77.5 for men in 2010).

The reform measures to help reduce the public pension deficit include the following:

- The old-age contribution rates for employees and employers are gradually increasing by 0.3 percent each by 2017: by 0.15 percent in 2014, and by 0.05 percent a year from 2015 through 2017. Previously, the contribution rates were 6.75 percent of earnings for employees and 8.4 percent for employers.
- The number of required contribution years for a full benefit will rise gradually from 41.5 to 43 years in the 2020–2035 period. (A 2003 law raised the contribution requirement from 40 to 41.5 years by 2020.)
- Retirees who receive a 10 percent supplement for having raised three or more children will have to pay taxes on that benefit, beginning in 2014 for benefits received in 2013. Previously, these benefits were exempt. (Retirement pensions are already taxed.)
- Starting in 2014, most benefits will be indexed to changes in the cost of living in October of every year; the minimum retirement benefit will be adjusted twice yearly—in April and October. Until now, benefits were adjusted once a year—in April.

In addition, the reform sets up a point system for employees who are exposed to one of the ten "hardship" criteria identified in the labor code (such as extreme temperatures, mechanical vibrations, repetitive or night-shift work). As of January 2015, workers with exposure to each of the criteria will earn a point (2 points for workers aged 59 or older) that can be used toward training for less arduous work and full-time pay while transitioning to part-time work at the end of their working lives. Workers aged 55 or older may convert these points into quarters of coverage in order to retire early, beginning at age 58.

Other features of the new reform include—

- *Changing the rules for crediting quarters of coverage* toward a retirement benefit under certain conditions such as maternity leave, training, unemployment, apprenticeship, and part-time work.
- *Simplifying access to retirement*. Beginning in 2016, each insured person will have one electronic account that provides all of his or her relevant information regarding retirement, such as contribution history and projected benefits from different programs (public pay-as-you-go pensions and mandatory supplementary occupational pensions).
- *Creating a new committee to evaluate the pension system:* A new committee composed of four pension experts will monitor the system, highlight any issues facing the public pension system, and propose corrective measures.

Sources: "Focus on France: The 2010 Reform of the French Old-Age Pension Program," *International Update*, US Social Security Administration, December 2010; "Schedule 2: Summary of Rates and Ceilings of Social Security and Unemployment Contributions as at 1st January 2013," CLEISS, January 2013; Réforme des Retraites, decembre 2013; Site Spécial Réforme des Retraites, 18 decembre 2013.

Spain

On December 23, a new law entered into force that (1) introduces a sustainability factor linking initial pensions to changes in life expectancy and (2) changes the way public pensions are indexed. Those two measures are based on the June 2013 report by the Committee of Experts that was appointed by the Prime Minister. According to the government, these measures will enable the public pension system to ensure a balance between contributions and benefits in the near and long term.

The principle of a sustainability factor was introduced in the 2011 reform of the country's pay-as-you-go public pension system, which—coupled with what the government calls an intense economic crisis—sought to address the country's growing deficit that is due to rapid aging of the population, the retirement of the baby boom generation, the system's relatively generous benefits, and increasing life expectancy. (Main provisions of the law included a gradual increase in both the retirement age, from 65 to 67, and the number of contribution years required for a full pension, from 15 to 25 years.) However, the 2011 law did not provide any specific details on the sustainability factor.

Beginning in 2019, the sustainability factor will be based on life expectancy at the normal retirement age during a 5-year period. That factor will be applied only once, when the initial pension is determined, and will be revised every 5 years. Analysts have concluded that as a result, the value of initial pensions could be reduced by 5 percent, on average, every 10 years.

In addition, the new law creates a new indexation method whereby benefits will be adjusted based on the ratio of the social security system's income (that is, contributions) to expenses (that is, benefits) over the past 5 years and projected for the next 5 years (every January starting in 2014). The law also establishes minimum and maximum levels of adjustment. According to the National Social Security Institute estimates, that new adjustment method will save some 33 billion euros (US$45.5 billion) between now and 2022. For 2014, benefits have been increased by 0.25 percent. Previously, benefits were adjusted annually to changes in the consumer price index. (In 2013, benefits were increased by 1 percent even though the inflation rate at the end of 2012 was 2.9 percent.)

In addition, every 5 years, the government will be required to provide Congress and the social partners with a study of these new measures that evaluates their efficacy. One of the responsibilities of the Independent Authority for Fiscal Responsibility—a new public agency created by a November 2013 law—will be to provide appraisals of the government's proposed annual adjustments of benefits and changes in the sustainability factor.

Sources: "Focus on Spain," *International Update,* US Social Security Administration, August 2011; *Social Security Programs Throughout the World: Europe, 2012,* US Social Security Administration, 2012; "The New Sustainability Factor of the Public Pension System in Spain," VoxEU.org, December 11, 2013; "OK Legal a la Reforma de las Pensiones que Elimina la Revaloración con el IPC," *Diario Montañes*, el 14 de diciembre de 2013; Ley 23/2013 de 23 de diciembre de 2013; "Entra en Vigor la Reforma de Pensiones," *Expansion,* el 2 de enero de 2014; "Spain Meets European Commission Deadline with New Pensions Law," IPE.com, January 6, 2014.

Asia and the Pacific

China

On January 1, the Chinese government introduced tax incentives to promote voluntary occupational pensions, known as Enterprise Annuity (EA) plans. The new rules were adopted in an effort to make EA plans more attractive and help develop the country's evolving multipillar retirement system. Introduced in 2004, EA plans are the only approved occupational retirement plans in the country; however, the participation rate is low. In mid-2013, 19.6 million employees (out of an urban labor force of over 280 million) were enrolled in EA plans, with total assets under management of 530 billion yuan (US$87 billion)—roughly 0.1 percent of China's gross domestic product. Industry observers suggest that this low take-up rate is the result of insufficient tax incentives and restrictive portfolio guidelines that typically yield lower returns on investments. According to industry estimates, the new policy could boost EA assets under management by as much as 200 billion yuan (US$33 billion) annually, which would help channel more funds into the country's capital markets.

Employers sponsoring an EA plan must contribute to an employee's account (most plan sponsors contribute from 5 to 8 percent of employee earnings up to a legal maximum of one-twelfth of the previous year's payroll); employees' contributions are voluntary. At retirement (age 60 for men and professional women, age 55 for nonprofessional salaried women, and age 50 for other categories of female workers), employees can withdraw the funds accumulated as a lump sum or annuity.

Under the new tax rules—

- Monthly employer contributions are not taxable. Previously, employer contributions were considered a separate category of taxable monthly payroll.
- Employee monthly contributions on income up to 4 percent of salary (based on their previous year's annual earnings) are now tax deductible; monthly contributions that exceed 4 percent are taxed as income.

- Earnings on investments in the account portfolio remain tax exempt.
- Accumulated contributions and earnings withdrawn at retirement are now taxed as income.

China's pension system consists of basic pension insurance and mandatory individual accounts for urban workers (in enterprises and certain institutions) and the urban self-employed, in addition to two voluntary pension programs—one for rural workers and another for nonemployed urban residents.

Sources: "Retirement and Savings Plans in China," Hewitt Associates, July 2009; *Social Security Programs Throughout the World: Asia and the Pacific, 2012*, US Social Security Administration, 2013; "Tackling the Chinese Pension System," Paulson Policy Memorandum, July 2013; "China Introduces 401(k)-Style Retirement Fund with Tax Benefits, Revamping Outdated Pension System," *International Business Times*, December 9, 2013; "China Introduces Tax-Deferred Annuity System," *Wall Street Journal*, December 9, 2013; "China: New Tax Deferral Treatment for Enterprise Annuity Issued," *Tax Insights*, December 24, 2013.

International Update is a monthly publication of the Social Security Administration's (SSA's) Office of Retirement and Disability Policy. It reports on the latest developments in public and private pensions worldwide. The news summaries presented do not necessarily reflect the views of SSA.

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

SSA Publication No. 13-11712