Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

December 2014

Europe

Czech Republic

On November 12, the three-party coalition government announced that the second pillar of voluntary individual accounts will be closed in 2016. The second pillar is funded in part by contributions diverted from the first-pillar, pay-as-you-go (PAYG) public pension program. According to the government, the take-up rate was low; there were approximately 84,000 accountholders since its introduction in January 2013, compared with the 500,000 that the government had projected. Also, the short-term impact on the state budget will be small because of the low volume of money accumulated in the second pillar—approximately 250 million koruna (US$11 million) diverted from the first pillar in 2013, expected to reach 700 million (US$31.5 million) in 2014.

The schedule to liquidate the assets was recommended by a cross-party working group. In March 2016, pension management companies will inform their accountholders that the second pillar will close. Accountholders will have until the end of September to indicate whether they want their accrued savings to be sent to a private bank account (with an option to send it to the first pillar) or to an existing third-pillar voluntary account (privately managed).

Until the second pillar is closed, the rules remain the same. Even though the decision to enroll in the second pillar has been voluntary, once a worker is enrolled, the decision may not be reversed. Currently, five licensed pension management companies must offer four types of funds of varying risk, including a fund invested in government bonds. Participants contribute a total of 5 percent of earnings—2 percent of earnings plus 3 percent from the combined employer/employee contribution of 28 percent of covered earnings for the PAYG program. At retirement, a lifetime annuity is paid. In addition to the second pillar, the Czech Republic's retirement system includes a first-pillar PAYG program for all employed and self-employed workers (covering around 5 million workers) and third-pillar voluntary individual accounts, which receive government subsidies and favorable tax treatment (with nearly 5 million accountholders).

Sources: "Czech Republic," IBIS News, March 13, 2014; "Czech Government Cancels Second Pensions Pillar as of 2016," CTK Daily News, November 12, 2014; "Czech Second-Pillar Pension System to Close by January 2016," ipe.com, November 13, 2014; "Government Decides on the Way to Terminate Second Pillar," Macroeconomic News, December 11, 2014.

Netherlands

Effective January 1, 2015, a new law will be implemented that makes a number of changes to occupational pension plans. The new law lowers the maximum benefit; establishes a cap on earnings used to calculate the pension (also called pensionable earnings); creates a new type of voluntary retirement plan for higher earners; and sets up a voluntary plan for certain self-employed persons.

According to the government, the goal of these changes is to achieve more intergenerational equity so that active workers and retirees equally share the costs and risks of pensions. The country's population is rapidly aging. The proportion of the population aged 65 or older is expected to increase from 16 percent in 2011 to 22 percent by 2025.

The new law will modify the benefit formula for most occupational pension plans (career average) by further reducing the maximum annual accrual rate from 2.15 percent to 1.875 percent of average earnings. In 2013, the rate was 2.25 percent. In addition, the maximum accrual rate for final pay plans, which represents about 1 percent of all occupational plans in the country, will decrease from 2 percent in 2013 to 1.657 percent in 2015. As a result, the government expects the funds to adjust the premiums downward. (The contribution rate for all members of a single plan is called the uniform premium because it is the same regardless of age, sex, health, or income.) The Dutch Central Bank will monitor the premium levels and will impose penalties for what it considers "excessively high premiums."

Another measure will set a ceiling on pensionable earnings at €100,000 (US$124,467) a year (except for disability pensions). For those workers who earn more than the maximum amount, a new type of voluntary supplementary plan will be established. The "net annuity plan" will be funded with after-tax income and will have some tax advantages. The accrual rate for the new plans will be 1.875 percent of average earnings.

An additional measure will create a separate voluntary pension plan for self-employed persons who do not have any employees. An investment institution will administer the plan. If a member applies for social assistance benefits, the member's pension plan assets will be exempt and will not be considered part of the member's "property."

An earlier law raised the retirement age for occupational pensions from age 65 to 67 in January 2014. Beginning in 2015, the retirement age will be adjusted to reflect changes in life expectancy. Most employees are members of an employer-sponsored pension plan; more than 90 percent of those plans in the country are defined benefit plans. Occupational pension plans may provide old-age, survivor's (partner's and orphan's), and disability benefits. The retirement age for the first-pillar public pension is gradually rising from age 65 to 67 by 2023. Proposed legislation currently in parliament would accelerate that increase by 2 years.

Sources: "The Netherlands," *International Update,* April 2012, U.S. Social Security Administration; "Dutch Pension Plans–Changes for 2015," Bogaard International Benefit Consultants, 2013; *OECD Pensions at a Glance 2013,* OECD, December 2013; "The Netherlands Pension Summary," European Actuarial & Consultancy Services, 2014; "Netherlands Economy: Mixed Prospects for Dutch Pension Funds," *Economist Intelligence Unit,* January 14, 2014; *National Reform Programme 2014 The Netherlands,* Ministry of Economic Affairs, May 14, 2014; "Netherlands," *IBIS News*, July 31, 2014; "Dutch Bill Includes Accelerate Retirement Increase, Financial Bridge for Early Retirees," Mercer Select, November 21, 2014.

Asia and the Pacific

Australia

On December 7, the government released the *Financial System Inquiry Final Report,* which evaluates Australia's financial system and provides recommendations for improvement. Superannuation is one of the major themes of the report. Other themes cover strengthening the economy, promoting innovation, creating an environment that boosts consumer confidence, and improving the regulatory system.

According to the report, superannuation plays an integral part in meeting the needs of a rapidly aging population. However, the report highlights the following areas where the superannuation system needs improvement:

- The government has not clearly stated the long-term objectives of the superannuation system. This has resulted in a series of short-term changes that contribute to inefficiency and higher costs. For example, the government gives much more support and guidance to workers during the accumulation phase than during the decumulation phase.
- The superannuation market is fragmented, which results in increased costs. Economies of scale are not fully utilized and the fees charged to members remain high. Even though it is too early to assess the effectiveness of StrongerSuper reforms—a comprehensive reform of the system being implemented in stages since 2011—the report indicates those reforms may not be sufficient.
- The role of employers in choosing a default fund could be problematic. The cost of searching for a fund could be high. Those employers who search for funds themselves might not have the appropriate background or information and could choose a fund based mainly on features that could benefit the employer (such as low administrative fees) and not the employee.
- The process of converting superannuation assets into retirement income is not efficient. There is not enough risk pooling and too many account-based pensions (the member withdraws funds according to a schedule based on his or her age, instead of taking the assets as a lump sum).

In order to increase both the value of the superannuation system as a whole and individual retirement income, the report makes a number of recommendations, which include the following:

- *Clearly define the objectives of the system.* A clear objective that has broad political acceptance will help provide a more balanced approach instead of the current focus on the accumulation phase.
- *Make the accumulation process more efficient*. Set up a competitive process that assigns new entrants to the labor force to MySuper products (a simple, low-cost default product set up as part of the StrongerSuper reforms) if a review of the existing process determines the need for additional reforms.

- *Allow employees to choose a fund.* All employees should be permitted to choose a superannuation fund for themselves and have only one account throughout their working life. This would eliminate the administrative costs and inconvenience of tracking multiple accounts.
- *Increase the use of risk pooling for retirement benefits.* Plans should offer a comprehensive product for retirement option, a low-cost flexible product that provides a regular income stream and longevity risk management.
- *Provide retirement income projections.* All funds should include retirement income projections in the statements they send out to members.

Source: *Financial System Inquiry Final Report,* Commonwealth of Australia, November 2014.

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