Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

May 2016

Europe

United Kingdom Introduces the Single-Tier State Pension

On April 6, the United Kingdom implemented a single-tier state pension (STP) as provided under the Pensions Act 2014. The flat-rate STP replaces the previous two-tier system, which consisted of the basic State Pension (BSP) and the earnings-related State Second Pension (S2P), for workers reaching the normal retirement age (age 65 for men and age 63 years and 3 months for women) on or after April 6, 2016. Elimination of the S2P also effectively removes the option of "contracting out" into a private pension. According to the government, the new system will cost no more than the previous two-tier system and will be easier to understand. In addition, the government designed the STP to be more generous to the self-employed, low earners, and caregivers who spend time in and out of the labor force. By contrast, individuals younger than age 40 are forecasted to receive less under the new system, as will those who fail to qualify with enough contribution years.

The benefit level for the STP is set above the previous basic level of means-tested support (initially £155.65 [US$227.48] per week), with a full benefit based on 35 qualifying years of National Insurance Contributions (NICs). (Previously, 30 years of paid or credited contributions were required to qualify for a full benefit under both the BSP and S2P.) Individuals with less than 35 years of NICs receive a prorated amount for each contribution year equal to 1/35th of the full benefit up to a maximum of £155.65 per week; individuals with less than 10 years of contributions do not receive a pension. A deferred pension is still possible under the new STP rules, but the accrual rate for deferrals has been lowered to 1 percent for every nine weeks the benefit claim is postponed beyond the normal retirement age, or 5.8 percent for each year of postponement (down from 10.4 percent under the BSP). As before, accrued pension benefits are indexed annually to the growth in average earnings, price increases, or 2.5 percent, whichever is higher.

Under the previous two-tier system, it was possible for plan sponsors of occupational defined benefit pension plans to replace a portion of the earnings-related S2P with a private pension arrangement (a process known as "contracting out"), provided the plan paid benefits that were at least as much as the foregone state benefit. In the process, individuals (and their employers) would pay lower NICs; the reduction in the level of NICs was labeled as a rebate. By introducing the STP, contracting out is no longer possible, and affected plan sponsors can now offset the lost rebate by either increasing plan member contributions or reducing future benefit accruals. For contributions, this means, on average, a 3.4 percentage-point increase in the contribution rate for employers and a 1.4 percentage-point increase for employees.

For individuals who have paid or credited contributions under the old system and who have not yet reached the normal retirement age at the STP's implementation date, their contributions are placed into a notional "foundation amount," reflecting their accrued state benefit. Individuals whose foundation amount is less than the amount required for a full benefit under the new system may continue to accrue benefits until they reach the normal retirement age. For individuals whose foundation amount exceeds the full STP benefit at the implementation date, the government pays the additional amount on top of the STP benefit (referred to as "protected payment") and increases it each year with inflation until retirement.

Mandatory workplace pension plans that meet minimum standards, with an auto-enrollment feature and opt-out provision, supplement the United Kingdom's public pension system. Additional means-tested benefits provide a safety net for lower income pensioners.

Sources: "United Kingdom," *International Update*, U.S. Social Security Administration, June 2014; "The Pensions Primer: A Guide to the UK Pensions System—Introduction," Pension Policy Institute, June 2015; "Guide to the Introduction of the Single-Tier State Pension," law-now.com, January 20, 2016; "Millions of Younger Workers to Be 'Worse Off' Under the New State Pension," BBC News, April 4, 2016; "Winners and Losers Under the New State Pension," BBC News, April 4, 2016; "The New (Not Yet Flat Rate) State Pension," Institute for Fiscal Studies, April 5, 2016; "The New State Pension," gov.uk, April 15, 2016.

Poland Allows Workers to Transfer Into or Out of Second-Pillar Individual Accounts

From April 1 through July 31, Polish workers may opt into or out of the country's second pillar of privately managed individual accounts. Workers who currently contribute to the public first-pillar notional defined contribution (NDC) pension program only, and who choose to participate in the second pillar, will have 2.92 percent of their earnings (from the total employer/employee contribution for old-age benefits of 19.52 percent of earnings) diverted to an individual account managed by an Open Pension Fund (OFE). Workers who already participate in the second pillar may choose to opt out and have their account balances transferred to the NDC program managed by the Polish Social Insurance Institution (ZUS). (Decisions to opt out of the second pillar cannot be reversed.) This so-called "transfer window" was part of a major 2014 pension reform law that also made second-pillar individual accounts voluntary for all new entrants to the labor force and transferred all government bond investments held by OFEs to ZUS. (OFEs are now required to hold at least 75 percent of their portfolios in equities.) Under this law, the government scheduled transfer windows for 2014, 2016, and every 4 years thereafter.

During the current transfer window, workers must submit a written request to opt into or out of the second pillar; no action is required for those who do not want to make a change. This is in contrast to the first transfer window in 2014, when individual account holders were automatically transferred out of the second pillar unless they submitted a written request to maintain their individual accounts. Workers who are within 10 years of the normal retirement age may not participate in the transfer window. (As part of the 2014 law, individual account balances of workers within 10 years of retirement are gradually transferred to subaccounts managed by ZUS.)

Poland's pension system consists of the first-pillar NDC program, voluntary second-pillar individual accounts, and voluntary third-pillar retirement savings accounts. Workers participating in the second pillar contribute 6.84 percent of covered earnings to the NDC program and 2.92 percent of earnings (plus up to 1.75 percent of contributions for annual administrative fees) to individual accounts; employers contribute an additional 9.76 percent to the NDC program only. (Employees who opt out of the second pillar contribute the full 9.76 percent to the NDC program.) New entrants to the labor force must choose within their first 4 months of employment whether they would like to participate in the second pillar. The normal retirement age for workers born before January 1, 1949, is age 65 for men and age 60 for women; for workers born after December 31, 1948, the retirement age is gradually increasing until it reaches age 67 in 2020 for men and in 2040 for women.

Sources: "Poland," *International Update*, U.S. Social Security Administration, March 2014; *Social Security Programs Throughout the World: Europe, 2014*, U.S. Social Security Administration, September 2014; "Poland: Constitutional Tribunal Releases Ruling on 2014 Pension Reform Law," *International Update*, U.S. Social Security Administration, November 2015; "Social Security in Poland," Polish Social Insurance Institution, 2015; "Poland: Life Begins with Equities," *IPE Magazine*, January 2016; "CEE Roundup: Polish OFE System, Bulgarian Review, LHV Group," IPE.com, April 4, 2016; "Okno Transferowe 2016 r.—Krok Po Kroku," Polish Social Insurance Institution, April 15, 2016.

Africa

Tanzania (Zanzibar) Introduces New Universal Pension

On April 15, the semi-autonomous archipelago of Zanzibar introduced a new universal flat-rate pension for all residents aged 70 or older. (Zanzibar is officially part of Tanzania, but has its own elected government that is responsible for many of the islands' policies.) As a result, all eligible residents now receive a government-financed, monthly noncontributory pension of 20,000 shillings (US$9.16). The government pays the pension regardless of an individual's income or assets and hopes that the new pension will reduce poverty and inequality by providing vulnerable persons with a stable source of retirement income. According to a government survey conducted in 2004/2005, around 49 percent of Zanzibaris live below the poverty line of 20,185 shillings (US$9.24) per month, while 13 percent live beneath the so-called "food poverty line" of 12,573 shillings (US$5.76) per month. (The food poverty line measures an individual's ability to afford basic dietary requirements.) In addition, most older persons have never been employed in the formal labor market, and are therefore not covered under the public pay-as-you-go (PAYG) pension program.

The new universal pension supplements Tanzania's PAYG social insurance program for employed and self-employed persons in the formal sector. To receive an old-age pension under the PAYG program, an individual must be aged 60 or older and have at least 180 months of contributions. (An early pension is possible at age 55 with at least 180 months of contributions.) The monthly pension is based on the number of months of contributions and the insured's average annual earnings in the best three of the last 10 years before retirement. Those with less than 180 months of coverage are eligible to receive an old-age grant, which is based on the number of months of contributions and the average of the insured's last 60 months of contributions before retirement.

Sources: "Zanzibar Strategy for Growth and Reduction of Poverty," The Revolutionary Government of Zanzibar, January 2007; "Social Protection Policy: Responses to Older People's Needs in Zanzibar," *HelpAge International*, 2009; *Social Security Programs Throughout the World: Africa, 2015*, U.S. Social Security Administration, September 2015; "Zanzibar's New Universal Pension the First of Its Kind in East Africa," *HelpAge International*, April 14, 2016; "East Africa: Region's First Universal Pension Takes Off in Zanzibar," *The Citizen*, April 15, 2016.

The Americas

Peru Adds Disbursement Options to Mandatory Individual Accounts

On April 14, Peru's Congress overrode a presidential veto to enact legislation that adds new disbursement options to the country's Private Pension System (SPP), a mandatory individual-accounts program. Among other things, the new legislation allows SPP members to withdraw nearly all of their account balances (95.5 percent) as lump sums when they reach the normal retirement age (currently age 65) or meet the requirements for early retirement. (Early retirement is possible at any age if an individual account balance is sufficient to replace at least 40 percent of the holder's average indexed earnings in the last 120 months.) In addition, it is now possible for SPP members to make withdrawals from their accounts before retirement without penalty to cover the costs of major life events, including using 25 percent of their account balances as collateral for home purchases and 50 percent of their account balances in the event of a terminal illness. Prior to the recent changes, which became effective immediately, SPP disbursements were limited to periodic or annuitized payments and could not be used for purposes other than retirement. Supporters of the new disbursement options contend that giving SPP members greater access to their account balances will encourage SPP's private fund management companies (AFPs) to lower their administrative fees and improve their investment performance. Opponents claim, however, that the new disbursement options will undermine SPP's role as a stable source of old-age income.

Over the past several years, there have been concerns about the administrative costs and investment performance of the SPP program. In addition to contributing 10 percent of their gross earnings to fund their individual accounts, workers pay an average of 1.25 percent of their gross earnings in fees to the four AFPs that manage the individual accounts. Although the fees have decreased in recent years (in 2011, the average fee was 1.80 percent), they are still generally considered high. At the same time, the returns generated by the AFP's investment funds have often been low. In March 2016, the funds' average rates of return for the prior 5 years ranged from 2.34 percent (Type 1 funds, more conservative investments) to −2.55 percent (Type 3 funds, more aggressive investments).

Since its introduction in 1992, the SPP has become an important component of Peru's pension system. It operates in parallel with Peru's National System of Pensions (SNP), a pay-as-you-go, defined-benefit pension program. Participation in either the SPP or SNP is mandatory for all private- and public-sector employees and voluntary for self-employed persons. Workers who do not opt to participate in the SNP within 10 days of first becoming employed are automatically enrolled in the SPP. SNP members may switch to the SPP at any time, but it is generally not possible for SPP members to switch to the SNP (though some exceptions have been made for older workers who voluntarily switched from the SNP to the SPP and who have not accumulated significant account balances before retirement). Peru also offers a means-tested social pension to residents aged 65 or older who are not covered by either the SPP or SNP and are members of extremely poor households.

Sources: *Social Security Programs Throughout the World: The Americas, 2011*, U.S. Social Security Administration, February 2012; "Peru 2015," *IBIS Country Manual*, July 22, 2015; *Social Security Programs Throughout the World: The Americas, 2015*, U.S. Social Security Administration, March 2016; "Aprueban Proyecto de Ley que Permite el Retiro del 95.5% de Fondos de las AFP," *RPP Noticias*, April 15, 2016; "Gobierno Promulgó Ley de Retiro del 95,5% de Fondos de AFP," *El Comercio*, April 21, 2016; Ley Nº 30425, *El Peruano*, April 21, 2016; "Rentabilidad de los Aportes Obligatorios," Superintendencia de Banca y Seguros del Perú, May 9, 2016.

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