Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

May 2009

Europe

Latvia

Effective May 1 a new law in Latvia temporarily lowers the combined employer/employee contribution rate to second-pillar individual accounts and increases the rate for the state-run first pillar. Under the law, the contribution rate for the second pillar decreases from 8 percent to 2 percent through 2010, then increases to 4 percent on January 1, 2011, and 6 percent on January 1, 2012, where it will remain fixed. Since the total employer/employee contribution rate of 20 percent of earnings—divided between the first and second pillars—will remain the same, contributions to the first pillar will increase proportionally to: 18 percent through 2010, 16 percent on January 1, 2011, and 14 percent on January 1, 2012 onwards. According to the government, reallocating a higher proportion of contributions to the state-run system will reduce the financial pressure on the state budget and allow the government to meet its obligations to current pensioners under the first pillar. The government estimates that the measure will increase state revenues by approximately 106.3 million lats (US$200.7 million) in 2009.

Latvia has a two-pillar pension system consisting of first-pillar notional accounts and second-pillar individual accounts. The second pillar is mandatory for workers who were under age 30 when the system was implemented in July 2001 and for all new entrants to the labor force since then. Participation is voluntary for workers who were aged 30 to 49 in 2001. When the second pillar was introduced in 2001, the contribution rate for the individual accounts was set to increase incrementally from 2 percent to 10 percent by 2010 when the total contribution rate of 20 percent would have been equally divided between the two pillars.

Sources: "Mandatory State Funded Pension Scheme," State Social Insurance Agency, 2003; "Pensiju Sistema Krustceles?" Ministry of Welfare, March 7, 2009; "Latvian Parliament Supports Cutting Contributions to Second-Level Pension Funds in Final Reading," *Baltic Business Daily*, April 23, 2009.

Slovak Republic

Attempting to protect participants of the second-pillar individual account system from the effects of the financial crisis, the Slovak parliament March 11 adopted a law that changes the fees that pension fund management companies (DSSs) may charge and introduces a principal guarantee for account holders. Beginning July 1, the fixed fee for administering individual accounts will be lowered from 0.065 percent to 0.025 percent of the average monthly net value of account assets. To offset this decrease and to encourage good performance, a DSS will be allowed to charge a second fee if its rates of return are positive.

Under the new legislation, DSSs are required to create a separate guarantee account for each pension fund that will contain all of that fund's earnings. If DSS investments yield a positive rate of return following a six-month monitoring period, it will be allowed to charge 5.6 percent of the appreciation of pension assets for that time period. The remaining 94.4 percent will be distributed to the individual account holders. However, if a fund managed by a DSS has a negative rate of return following the six-month monitoring period, the DSS will be responsible for making up the difference to ensure that workers' accounts do not fall below the principal amounts they have contributed. The first six-month monitoring period begins July 1, with DSSs permitted to start charging this second fee on January 1, 2010.

The Slovak Republic has a two-pillar pension system, consisting of a state-run PAYG pillar and individual accounts. There are six DSSs licensed to manage individual accounts, each of which must offer three types of pension funds—growth, balanced, and conservative—with varying degrees of risk depending on the percentage they are allowed to invest in equities. The net value of all account assets was €2.46 billion (US$3.21 billion) as of April 17, 2009. Of this amount, 66 percent was invested in a growth fund, 29 percent in a balanced fund, and 5 percent in a conservative fund. According to data from the Association of Pension Fund Management Companies, the six DSSs earned on average a rate of return of -3.8 percent in 2008, with growth funds losing 8.2 percent, balanced funds losing 6.1 percent, but conservative funds gaining 2.8 percent. In an OECD comparison, pension funds in the Slovak Republic were found to be among the best performers.

Sources: *Private Pensions Outlook*, OECD, 2008; "Fico Set to Change Pension Fund Fee Structure," IPE.com, March 12, 2009; "Safer, But at What Cost? New Fee Structure Will Change Private Pension Fund Strategies," *The Slovak Spectator*, March 30, 2009; "Slovakia Economy: Mixed Signals for Foreign Investors," *The Economist Intelligence Unit*, April 3, 2009; "Assets in Pension Funds at Over EUR 2.46 Bln Last Week," *Slovenska Tlacova Agentura*, April 21, 2009.

Asia and the Pacific

Australia

The Australian government and key pension industry groups issued a "Communique of Principles" April 28 in which they agreed to conduct an evaluation of the country's mandatory private pension system called compulsory superannuation. Compulsory superannuation supplements the country's noncontributory, means-tested age pension, funded by general revenues.

According to the communique, even though the system's fundamental structure is "strong and well regulated," a review of the nearly 20-year old system's operation is warranted since many features have been added over time. The review will evaluate the structure, operation, and efficiency of the system. One goal of the review is to reduce the cost of superannuation to individuals and raise their retirement income; thus, a major focus will be administrative fees and commissions that generate about A$14 billion (US$10 billion) a year. Other topics to be studied are default investment funds and fund governance.

Employers are required to contribute 9 percent of an employee's earnings up to A$50,000 (US$35,814) per year to either an employee's registered superannuation plan (either occupational or personal) or a retirement savings account. Employee contributions are voluntary. To encourage employee participation, the government provides a superannuation co-contribution that matches a worker's contributions to a superannuation account on earnings up to A$60,342 (US$43,221) per year. The maximum government co-contribution is A$1,500 (US$1,074) per year.

Current superannuation assets under management declined by an average of 20 percent in 2008 and currently equal A$1.1 trillion (US$800 billion). Most of the approximately 400,000 superannuation funds in Australia are defined contribution plans.

Sources: Treasurer Media Release No. 059, September 24, 2008; Country Profiles—Australia, International Organisation of Pension Supervisors, October/November 2008; "Statistics: Quarterly Superannuation Performance," Australian Prudential Regulatory Authority, December 2008; Australian Government, "Communique of Principles," April 28, 2009; "Australian Government, Industry to Examine Pension Savings Scheme," Dow Jones International News, April 28, 2009; "Challenge to $14b Superannuation Fee Fest," *Sydney Morning Herald*, April 29, 2009.

India

India May 1 expanded the New Pension System (NPS) of individual accounts to allow voluntary participation for all private-sector workers. The goal is to extend old-age security coverage to more citizens since only about 12 percent of the working population in India is currently covered by some form of retirement plan. Since January 1, 2004, the NPS has been mandatory for new public employees of the central government and has been adopted by most state governments.

The Pension Fund Regulatory and Development Authority (PFRDA) has selected six pension fund managers and licensed 22 points of presence (PoPs), which act as the initial point of contact with private-sector workers, collect pension contributions, and sell pension products. PoPs include banks, post offices, and insurance companies. Although the voluntary NPS for the private sector has separate pension fund managers and somewhat different investment guidelines, it shares the same recordkeeping agency with the NPS system for public employees.

The NPS for private-sector workers covers Indian citizens (both residents and non-residents) from ages 18 through 55. Participants must contribute a minimum of 6,000 rupees (US$122) each year, including at least 4 payments of at least 500 rupees (US$10) each. Account holders decide the frequency and amount of contributions during the year. There is no maximum limit on the amount or frequency of contributions in a given year. Employers are not obligated to contribute to a worker's individual account.

Account holders have the option to decide how their account funds are invested among approved assets by choosing a pension fund manager. All six pension fund managers provide three types of funds representing different asset classes (equities, central and state government securities, and credit riskbearing fixed-income instruments). If no pension fund manager is selected, contributions are invested in an age-based lifecycle fund. While contributions and investment returns are exempt from tax, withdrawals are taxable. Individuals will be allowed to change pension fund managers at regular intervals starting April 2010.

At the normal retirement age of 60, individuals must invest a minimum of 40 percent of their account funds to purchase a life annuity from a regulated life insurance company, and any remaining amount may be taken in a lump sum or as a phased withdrawal. The annuity also provides an option for a survivor pension to a spouse. Individuals may exit the NPS system before age 60 provided they annuitize at least 80 percent of the funds accumulated in their account. All funds must be withdrawn upon reaching age 70. Between the ages of 60 and 70, a phased withdrawal is allowed provided a minimum 10 percent of the account is withdrawn each year.

Sources: "India's Pension Reforms Initiative," *Indian Journal of Public Audit and Accountability*, April-June 2007; "Reduce Tension," *Financial Express*, February 19, 2009; "NPS Launch Rescheduled for May," *Global Pensions*, March 30, 2009; India Pension Fund Regulatory and Development Authority, "Welcome to the New Pension System," April 2009; India Pension Fund Regulatory and Development Authority, press release, April 30, 2009; "New Pension System to Shield the Aged," *Business Line*, May 3, 2009.

New Web Resource

European Union

The new Web site of the European Data Center for Work and Welfare (EDACwowe) provides data on research and policy in the areas of work and welfare in Europe. EDACwowe was created by the European Union in collaboration with the University of Tilburg in the Netherlands and the Danish National Center for Social Research. The site includes information on, and direct links to, various national and cross-national databases on work and welfare and closely related fields (such as demographics, trade, education, taxes, health and safety, and migration). For example, a comparative data section contains links to cross-national opinion surveys, socio-economic surveys, and international databases and reports. A subsection entitled "income and benefits" provides links to sites with social protection data and reports from a variety of institutions around the world. In addition, the site has links to national data archives (about 50 sites), national statistical offices (about 80 sites), and a wide array of national survey data. The Web site is at http://www.edacwowe.eu.

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 the SSA.

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SSA Publication No. 13-11712