Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

April 2014

Europe

United Kingdom

New interim rules introduced in Budget 2014—that allow individuals more choice in accessing pension savings from occupational and personal defined contribution (DC) pension accounts—were implemented on March 27. Industry observers suggest that the rule changes will affect around 400,000 individuals in the fiscal year that began April 1. Another more extensive set of rules (proposed in Budget 2014)—that is under consultation and expected to be finalized by April 2015—would eliminate all withdrawal restrictions and allow retirees to access their total pension savings, subject to their marginal rate of income tax. (Neither set of changes affects defined benefit (DB) plans.)

The recent set of implemented rule changes governing access to pension savings in DC plans includes the following:

- The maximum amount of total pension savings that a person aged 60 or older may take as a lump sum increased from £18,000 (US$29,935) to £30,000 (US$49,891). Individuals with relatively small personal DC pension accounts of £10,000 (US$16,630) or less may withdraw those savings as a lump sum; previously, such withdrawals were only possible for accounts of £2,000 (US$3,326) or less.
- Each individual may withdraw the account balance as a lump sum from up to three small pension accounts at one time (previously two), up to an overall maximum withdrawal amount of £30,000.
- The minimum "secure" pension income was reduced from £20,000 (US$33,261) to £12,000 (US$19,957). A pensioner must maintain that level of income (from a combination of state and other employer-provided pensions) to qualify for withdrawing any amount of funds from a pension account each year. The minimum income is intended to lower the risk that retirees might exhaust their pension savings prematurely.
- Individuals who leave their pension savings invested in a "drawdown" arrangement throughout retirement (instead of purchasing an annuity) are able to withdraw up to 150 percent each year in the amount of an equivalent annuity (the previous limit was 120 percent) that could be purchased with funds in the account.

From April 15 of next year forward, under the more extensive set of rules, the government proposes allowing individuals aged 55 or older access to their DC pension savings accounts in all circumstances, subject to their marginal rate of income tax. The proposed changes include the following:

- Lowering tax rates on withdrawals from pension accounts. Individuals would still be able to take 25 percent of their accumulated funds tax-free at retirement, while additional withdrawals would be taxed at those individuals' much lower marginal income tax rate (on average 20 percent) rather than the current 55 percent. The new rules would apply to annuities purchased after the implementation date.
- Eliminating the requirement in some DC plans that plan members purchase an annuity at retirement (approximately three-quarters of those retiring purchase annuities).
- Gradually raising the age (timetable to be determined) when individuals can access private pension savings, from age 55 to 57 by 2028—when the state pension age will reach 67. (Thereafter, as the state pension age rises, the minimum age for accessing private pension savings will also rise, so that it is always 10 years before the normal retirement age.)
- Requiring pension providers and trust-based fund managers to offer DC plan members free and impartial face-to-face preretirement advice on their financial choices at retirement. The government announced its intention to set aside £20 million (US$33 million) to establish a fund for these services.

The retirement income system in the United Kingdom consists of the basic state pension (a near-universal, flat-rate benefit) and the earnings-related

state second pension. Supplementary programs include voluntary employer-sponsored (DB and DC) pensions and personal pensions, in addition to a low-cost, DC personal account program with an autoenrollment feature and an opt-out provision. Means-tested benefits complement the basic state pension.

Sources: "Taking a Small Pension Pot as a Lump Sum," HM Revenue & Customs, March 2014, http://hmrc.gov.uk/pensionschemes/small-pen.htm; "Freedom and Choice in Pensions," HM Treasury, March 2014; "New Dawn for DC Pensions as Budget Rewrites Tax Rules," Towers Watson *Pensions Digest*, March 2014; "Budget 2014: Osborne Pension Reforms 'End Culture of Annuity as Default Option for Investors'," March 19, 2014, http://whatinvestment.co.uk.

The Americas

Dominican Republic

On February 13, following more than 3 years of discussion, the Social Security Board (CNSS) approved a regulation that requires old-age, survivors, and disability pensions to be adjusted every 2 years according to changes in the minimum wage. Previously, the law stated that pensions would be adjusted "periodically" to increases in the consumer price index (CPI). However, since the inception of the individual account system in 2003, pensions have not been indexed. As a result, the value of those benefits has decreased significantly over time. The government expects the change to improve the purchasing power of pensioners.

For all pensions awarded before the new regulation was approved, the government is providing retroactive adjustments according to changes in the CPI, from the date the benefit was awarded (since 2003) up to February 2014. As a result, many benefit amounts will double and some will increase by as much as 155 percent. Any future adjustments will be based on the new rules. If the increase is more than 10 percent in any one year, both the Superintendent of Pensions (subordinate to the CNSS) and the Superintendent of Insurance will be required to conduct an actuarial study.

The Dominican Republic provides first-pillar individual accounts that are mandatory for private-sector workers who entered the labor force after 2003. (The pay-as-you-go social insurance system for private-sector workers was closed to new entrants in 2003 and is being phased out.) Five pension fund management companies administer the individual accounts and contract with insurance companies for disability and survivors insurance. A retirement benefit—a choice of an annuity or programmed withdrawals—is paid at age 60 with 30 years of contributions. A guaranteed minimum pension is paid at age 65 with at least 25 years of contributions, when the individual account balance is insufficient to finance the minimum old-age pension. A separate program—subsidized individual accounts for self-employed persons and other vulnerable groups—was included in the 2001 law that created the system of individual accounts, but has not yet been implemented. Regulations for the subsidized program were approved by the CNSS in July 2013; the government expects to begin implementation by 2016.

Sources: "República Dominicana: Transición Demográfica y el Impacto de las Pensiones Solidarias," CNSS *Noticias,* el 10 de enero de 2014; "Resoluciones de la Sesión Ordinaria No. 335," CNSS, el 13 de febrero de 2014; "CNSS Destaca el Impacto Aumento Pensiones en la Seguridad Social," CNSS *Noticias*, el 19 de febrero de 2014; "Consejo Nacional de Seguridad Social Aprueba Monto Pensiones Sea Actualizado Cada Dos Años," CNSS *Noticias*, el 19 de febrero de 2014; "El CNSS Aumenta en 155% el Monto de las Pensiones del Régimen Contributivo," *La República Online*, el 20 de febrero de 2014; *Social Security Programs Throughout the World: The Americas, 2013,* US Social Security Administration, March 2014.

Reports and Studies

World Bank Reports

Europe and Central Asia

On February 21, the World Bank released *The Inverting Pyramid: Pension Systems Facing Demographic Challenges in Europe and Central Asia,* which examines the demographic challenges facing pension systems in Europe and Central Asia. According to the report, when pension systems in these regions were first developed, a growing number of workers were financing old-age benefits for a relatively small number of pensioners. As a result, governments could provide generous benefits to pensioners. However, ongoing demographic changes—(such as rising life expectancy and lower fertility rates) combined with the general provisions in many of those pension systems (such as relatively low retirement ages and generous benefits)—led to a much smaller group of workers financing benefits for a growing number of pensioners. The result is an increase in pension expenditures that, in many countries, now comprise the single largest budgetary expenditure.

The report notes that a number of countries have implemented pension reforms over the past 20 years to reduce these expenditures. The reforms include

structural changes (such as individual accounts and notional defined contribution systems) and parametric changes (such as increasing the contribution rate, retirement age, and number of years of required contributions, and lowering the benefit levels). However, some of these countries reversed course during a period of high economic growth in the mid-2000s by increasing benefit levels, while others reversed the reforms entirely following the financial crisis to help meet short-term deficits.

The report argues that the increasing growth in pension expenditures suggests a need for countries to reexamine their existing pension systems to determine whether they will continue to be able to provide the same level of benefits. Specific recommendations include—

- ensuring adequate benefits, by pursuing policies to increase individual retirement savings as a supplement to the government benefit.
- increasing the retirement age coupled with making changes to labor market policies, such as discouraging early retirement, encouraging a combination of part-time retirement benefits and part-time work, preventing discrimination against older workers, and providing older workers with access to retraining.

At the same time, the report urges countries to prioritize spending by providing the following:

- A minimum benefit for all adults aged 65 or older (with or without contributions to a pension system), to keep them out of poverty.
- Resources for people who must stop working before the normal retirement age due to ill health.
- Supplementary benefits for workers who have contributed to the pension system.
- Survivors benefits to dependent family members upon the death of the breadwinner.

Source: *The Inverting Pyramid: Pension Systems Facing Demographic Challenges in Europe and Central Asia,* World Bank, 2014.

Latin America

On March 13, the World Bank launched *Beyond Contributory Pensions in Latin America and the Caribbean* (in Spanish), which examines the trends in pension coverage of older adults (over age 65) in the region during the past decade. From 2000 through 2013, at least 18 countries introduced some type of noncontributory program that incorporated about one-third of the older population not previously covered. This is a paradigm shift from the 1980s and 1990s when the focus of pension reform in the region was to put contributory systems on a more sustainable path. Because coverage in the contributory system has not increased significantly, the shift has been toward inclusion: either through expanding noncontributory programs or making the requirements for the contributory system more flexible.

The report provides in-depth descriptions of the noncontributory programs in 14 countries in the region. Despite the different challenges those countries face, these programs can be classified according to the following three categories:

1. *Universal access.* Bolivia and Trinidad and Tobago introduced a universal benefit where access is possible for all citizens that meet minimum general requirements, such as age.
2. *Inclusion of the excluded.* Argentina, Brazil, Chile, Mexico, Panama, and Uruguay target older adults who are not covered by the contributory program, with the goal of universal social protection.
3. *Targeting the most vulnerable.* Colombia, Costa Rica, Ecuador, El Salvador, Panama, Paraguay, and Peru use means testing to target older adults who are poor and at risk.

The report also compares the level of benefits among the 14 countries studied. Four countries (Argentina, Costa Rica, Trinidad and Tobago, and Uruguay) provide noncontributory benefits that are, on average, more than 50 percent of the contributory benefits. Benefits in the other 10 countries range from 4 percent to 40 percent, on average, of contributory benefits.

The report concludes that the design of new programs and expansion of others must take into account the rapid aging of the population in the region. Life expectancy at birth has increased from age 52 in 1950 to age 74 in 2010, and it is expected to reach age 85 by 2100. In addition, in 1950, there were 6 adults over age 65 for every group of 100 working-age persons (aged 15 to 65); in 2010, there were 10 adults over age 65, and projections for 2100 exceed 50 older adults for every group of 100 working-age persons. As the number of older adults significantly increases, so will the financial needs of the programs.

Source: *Beyond Contributory Pensions in Latin America and the Caribbean (Más Allá de las Pensiones Contributivas: Catorce Experiencias en América Latina*), World Bank, 2013.

Africa

On February 11, the World Bank released *Reducing Poverty and Investing in People: The New Role of Safety Nets in Africa*, a review of safety net programs in 22 Sub-Saharan African countries. Those noncontributory transfer programs are targeted to the poor and vulnerable, such as for emergency food, public works, and old-age assistance. According to the report, over the past two decades, strong economic growth has led to a significant reduction in the poverty rate across the region, from 58 percent in 1995 to 48 percent in 2008. However, high poverty levels persist, particularly in rural areas and among certain subgroups of the population (such as children and the elderly). As a result, the report argues that targeted safety net programs are needed to support the chronically poor and provide extra support when economic shocks occur.

The report finds a wide variation in safety net development across the continent, with some countries (particularly middle-income countries in southern Africa) providing a generous set of benefits to specific groups, and others (particularly lower-income and fragile countries) having few, and less generous, programs that are donor-driven and focus on emergency relief. Furthermore, in most of the countries reviewed, safety net programs are highly fragmented, small and uncoordinated, and incapable of significantly reducing poverty and inequality. The report recommends that countries harmonize and coordinate these fragmented programs into cohesive and effective safety net systems that meet the needs of each individual country. In addition, it recommends that countries improve their implementation tools (such as national registries, payment systems, and monitoring systems) to more effectively deliver support to targeted groups.

Other findings of the report include the following:

- Coverage of safety net programs for the poor and vulnerable is generally very low, but growing. Some countries, such as Ghana, Kenya, and Rwanda, have begun expanding some of their programs on a national scale. In several southern African countries, social pension programs provide significant benefits to the elderly; however, these programs do not specifically target the most vulnerable populations.
- Lack of data collection in addition to monitoring and evaluating safety net programs make it difficult to evaluate the effectiveness of those programs. The report recommends a greater emphasis on collecting basic data on the number and types of beneficiaries covered under these programs and on the impact of that coverage.
- With the exception of middle-income countries in southern Africa, spending on safety net programs is very low, but increasing. The report finds that spending is currently concentrated on scattered emergency and food-based programs, and it recommends a shift to focusing on funding sustainable safety nets that aim to reduce long-term chronic poverty.

Sources: *Reducing Poverty and Investing in People: The New Role of Safety Nets in Africa*, World Bank, 2014.

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

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