Social Security Benefits America! 75 Years

# International Update:

Recent Developments in Foreign Public and Private Pensions

March 2010

## Europe

### Finland

The Finnish government presented a bill that would extend existing emergency solvency measures for private pension providers through the end of 2012. In 2008, in response to the international financial crisis, the government relaxed the rules on solvency ratios (pension obligations to pension assets) for pension insurance companies and pension funds for a 2-year period; the higher the ratio, the more leeway providers have to invest in riskier asset classes. The 2008 measures allow pension providers to access certain reserve buffer funds in order to improve their solvency levels. This change has taken some of the pressure off of the investment process for many providers, by allowing them to continue to hold onto riskier assets (with higher potential return), rather than being forced to sell them in an unfavorable market. Two new working groups will consider more permanent changes to the solvency rules.

The retirement system in Finland includes two tiers: (1) a universal pension with means-tested, subsistence level benefits for residents, financed on a pay-as-you-go basis (from employer and government contributions); and (2) a defined benefit system of compulsory occupational earnings-related pensions. The universal pension is reduced by the amount of the earnings-related pension. Occupational pensions are partially funded and provide most retirement benefits. The number of individuals receiving first-tier benefits has declined with the development of the occupational system; approximately 50 percent of retirees in recent years have received the universal pension. Pension providers managed roughly 72 billion euros (US$100 billion) in assets for occupational pensions at the end of 2008. Because of the importance of the two-tiered pension system, voluntary occupational and personal pensions provide relatively less retirement income in Finland.

**Sources:** “Finns Launch Solvency Committee,” *Nordic Region Pensions and Investment News*, April 21, 2009; “Surviving the Global Crisis,” *Global Pensions*, May 28, 2009; “Solvency Thaw Lifts Returns for Finnish Pensions,” IPE.com, December 14, 2009; “Finland,” pensionfundsonline.co.uk, 2010; Finland Ministry of Social Affairs and Health press release, February 11, 2010; “Finland Plans to Extend Solvency Measures to 2012,” IPE.com, February 12, 2010; “Finland Proposes to Extend Pension Solvency Measures Through 2012, Prepares for Permanent Changes,” Mercer Select Global, February 19, 2010.

### Ireland

On February 1, the Irish government implemented the Pensions Insolvency Payment Scheme (PIPS) for a 3-year trial period. PIPS is designed to safeguard benefits of defined benefit pension plan members (those employed and retired) when both the pension plan and plan sponsor have become insolvent. PIPS is administered by the Ministry of Finance and is expected to be cost-neutral.

PIPS allows eligible pension plans to purchase annuities from the government below the cost of annuities on the open market. This permits more money to be available for eventual disbursement to plan members. Each plan’s cost of purchasing PIPS annuities is calculated based on standard mortality assumptions and the interest rate for 10-year Irish government bonds, including the cost to the government for administering the program.

To participate in PIPS, pension plans must undergo a multistage application process. A pension plan must first be certified by the Pensions Board (pension regulator) based on evidence substantiating that the “double insolvency” criterion (insolvent employer and plan scheduled for termination) applies. Once certified, plan trustees may apply to the Minister of Finance to qualify for PIPS payments. After the application is approved, the plan trustees must agree to pay the lump sum quoted by the Ministry in exchange for the government taking on the responsibility for the plan’s pension benefits. The government outsources pension administration to a third party.

The government will review PIPS after the initial 3-year trial period. Should it decide to terminate or modify the program on or after that date, payments to members of pension plans already participating in PIPS will continue according to the original terms.

**Sources:** “Pensions Insolvency Payments Scheme (PIPS)—Guidance Note for Scheme Applicants,” Pensions Board, January 2010; "Pensions Insolvency Payment Scheme (PIPS)," Ireland Department of Finance press release, January 18, 2010; "Irish Gov't Gets Final Say on Exclusion from PIPS," IPE.com, January 19, 2010; "How Will State's New Pension Protection Scheme Operate?" *Irish Times*, January 22, 2010.

## *Romania*

On February 10, the Cabinet approved a draft law for Romania's public pension system that would equalize the retirement age and contribution requirements for men and women, change the calculation of "special pensions" for certain public-sector workers, reduce the incentives for early retirement, and improve the disability assessment process. If approved by Parliament, the law is expected to come into force on January 1, 2011. According to the government, the law is aimed at reducing the growing budget deficit, which reached 36.4 billion lei (US$12 billion), or 7.2 percent of gross domestic product, at the end of 2009.

Under the draft law, the retirement age for women would gradually increase to 65 by 2030. This extends the provisions of the current law, which gradually increases the retirement age to 65 for men and 60 for women by 2014. Currently, men can retire at age 63 and 9 months and women at age 58 and 9 months. In addition, the draft law would equalize the contribution period required for a full pension at 35 years for men and women by 2030. At present, men can retire with a full pension with 32 years and 6 months of contributions, rising to 35 years by 2014; women can retire with a full pension with 27 years and 6 months of contributions, rising to 30 years by 2014. (The minimum contribution period for a reduced old-age pension will continue to gradually increase from 12 years and 6 months at present to 15 years by 2014, pursuant to existing legislation).

Other provisions of the draft law include—

- Changing the calculation of "special pensions" paid to certain public-sector workers including members of Parliament, judges, and policemen. The new calculation would link benefits to a worker's lifetime contributions, instead of the current benefit formula, which is equal to a percentage of wages in the month (or 6 months for certain occupations) immediately preceding retirement. Approximately 180,000 out of 5.8 million public-sector pensions are special pensions.
- Reducing the incentives for early retirement. Workers retiring before the full retirement age would have their pensions reduced by 45 percent, rather than the current 30 percent. According to government figures, the number of workers taking early retirement has tripled since 2001.
- Improving the disability assessment process to reduce opportunities for abuse. From 2001 through 2009, the total number of disability pensions increased from 600,000 to 900,000. According to the Ministry of Labor, Family, and Social Protection, nearly a quarter of these pensions have been obtained fraudulently.

**Sources:** "Romania Aims for Pension Reforms by December," IPE.com, October 9, 2009; Government of Romania press release, February 10, 2010; "Romania '09 Budget Gap at 7.2% of GDP, Below IMF Cap," *Dow Jones Business News*, February 15, 2010; "Early Retirement Sanctions: Romania Ups Penalties for Early Retirement to 45% from 30%," *Mediafax News Brief Service*, February 18, 2010; "Labour Minister: Quarter of Disability Pensions Illegally Obtained," *Rompres*, February 19, 2010.

# The Americas

## *Chile*

On February 1, the Superintendent of Pensions announced that Modelo was selected as the pension fund management company (AFP) to cover all new entrants to the labor force for 2 years beginning in August. Modelo, a new AFP not yet operational, offered the lowest monthly administrative fee in the bidding process that began last November. The winning bid was 1.14 percent of an account holder's taxable earnings, 24 percent lower than the average fee charged by the five current AFPs of 1.51 percent. (The other AFPs that participated in the competition also offered fees below the current average). The bidding process is part of the 2008 pension reform provisions to improve competition among the AFPs. Modelo is the first AFP to enter the market in 15 years. The government estimates some 700,000 new workers will enter the labor force during the 2-year period.

According to the pension reform law, the bidding process is to be held every 24 months. The AFP selected must maintain the lowest fee among all AFPs for 2 years, with all of its account holders being charged the same fee. New workers must remain with the winning AFP for 2 years unless: (1) another AFP offers a lower fee for at least 2 consecutive months; (2) another AFP provides a higher rate of return sufficient to make up for a higher administrative fee; or (3) the winning AFP does not maintain the required minimum rate of return, is declared insolvent, or must liquidate its assets. Workers already in the system may switch to the winning AFP.

Workers are required to contribute 10 percent of earnings each month to an individual account, and employer's contributions are voluntary. Effective January 1, 2010, the limit on mandatory contributions is adjusted annually according to changes in the real wage index for the previous year. For 2010, the ceiling is 64.7 unidades de fomento (UF). The UF is a monetary unit adjusted daily to reflect changes in the consumer price index. (For March 1, 2010, the UF was 20,924 pesos, or US$39.) From the inception of the program in 1981 until 2010, the ceiling was set at 60 UFs.

**Sources:** Superintendencia de Pensiones, Comunicado de Prensa, el 8 de enero de 2010 y el 1 de febrero de 2010; "Valor Diario de la UF, Año 2010," UF.CL, febrero de 2010 "Adjudicación de Afiliados a AFP Modelo Crearía Conciencia de Precios, Según Ex Regulador-Chile," Business News Americas, el 2 de febrero de 2010; " A Partir del 1 de Agosto: Nuevos Afiliados a AFP's Accederán a la Administradora con la Comisión Más Baja del Mercado," Gobierno de Chile Noticias, el 6 de febrero de 2010.

# Asia and the Pacific

## *Australia*

The Treasury recently released its *Intergenerational Report 2010,* which assesses the expected impact of population aging on fiscal and other federal government policies during the next four decades. This report, the third in a series, projects a decline in the ratio of working-age people to those aged 65 or older, from 5 to 1 today to 2.7 to 1 by 2050, presenting significant long-term risks to the sustainability of government finances. To address these challenges, the report calls for a broad agenda that includes overhauling the health care system, controlling expenditures on old-age pensions and other age-related income transfers, increasing labor force participation rates, and increasing the productivity of a shrinking labor force, by other measures.

According to the report, government spending on health, age-related pensions, and long-term care services will almost double by 2050, from approximately 25 percent of total government spending at present (rising health costs are by far the largest contributor to this increased spending, accounting for approximately two-thirds of the overall increase). As a consequence, government expenditures are projected to exceed revenue by 2.75 percent of gross domestic product (GDP) in 40 years' time. To respond to the economic and fiscal pressures of an aging population, the report recommends that sustainable economic growth be supported by policies that improve productivity, better manage population growth (especially net overseas migration), and increase labor participation rates, especially for older workers. The report concludes that there are barriers to workforce participation for older workers who wish to delay retirement; Australia's older-worker participation rate is below that of comparable countries (including the United States, United Kingdom, Canada, and New Zealand).

With regard to pensions, in 2009 the government announced a gradual increase in the retirement age for the Age Pension to 67 (men and women), beginning in 2017. (Currently, the retirement age for the Age Pension is 65 for men and 63 for women, rising gradually for women to age 65 by 2013). Taking this reform into account, the report projects that total spending on pensions will increase from 6.5 percent of GDP in 2015 to 6.9 percent of GDP in 2050. The report's assessment—based on the fact that the Age Pension is means-tested and targets poverty alleviation—is that Australia is somewhat better positioned to cope with rising pension costs as compared with other countries in the Organisation for Economic Co-operation and Development. In addition to the announced increase in the retirement age, it is also anticipated that a lower proportion of persons will be eligible for the Age Pension, as they will have increased resources from other retirement saving vehicles, especially from the mandatory occupational pension program (Superannuation).

The full report is available at http://www.treasury.gov.au/igr/igr2010.

**Source:** *Intergenerational Report 2010*, Treasury of the Commonwealth of Australia, January 2010.

***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.

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SSA Publication No. 13-11712