Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

January 2012

Europe

Italy

On December 22, Italy's parliament approved the new government's austerity and growth package (including pension reforms), amounting to 30 billion euros (US$39 billion), or around 2 percent of gross domestic product in the 2012–2014 period. The new fiscal plan, the latest of several passed in 2011, is part of a broad effort to reduce Italy's sovereign debt and balance the budget by 2013. Changes to the pension system include higher retirement ages, a temporary freeze on the indexation of most pensions, and an extension in the minimum contribution period to qualify for retirement. Italy's public pension system, the most expensive in Europe, comprises the government's largest single budget expenditure at 30 percent.

Some of the major changes to pensions contained in the austerity package follow:

- A freeze in 2012 and 2013 on the inflation adjustment of monthly pensions greater than 1,400 euros (US$1,825); indexation will continue for lower pensions
- An increase in the retirement age; starting in 2012, the retirement age increases from age 65 to 66 years for men and from age 60 to 62 for women and then will gradually rise to age 66 in 2018; the retirement age will increase to 67 for all workers in 2022—4 years earlier than scheduled under the Stability Law passed on November 12
- More stringent requirements for seniority pensions beginning in 2012. Until now, seniority pensions were available (1) to those aged 62 or older who had contributed for 35 years and (2) to those who, regardless of age, contributed for 40 years. From 2012 forward, seniority pensions are only available to men who contribute for 42 years and 1 month and to women who contribute for 41 years and 1 month. In addition, seniority pensions for workers retiring before age 62 are reduced for each year that the worker is younger than age 62. Beginning in 2013, those requirements will be automatically linked to increasing life expectancy (previously scheduled to begin in 2015)

Sources: "Italy PM Unveils Sweeping Austerity Package," Reuters, December 4, 2011; "Italy: Some Thoughts on Monti's Plan," Unicredit *Economic Flash*, December 5, 2011; "Italy 'Takes Axe' to Pension System," *Financial Times*, December 6, 2011; "Italy to Raise Minimum Retirement Age, Curb Pension Cost-of-Living Increases," *Pension & Benefits Daily*, December 19, 2011.

Switzerland

In January, the concluding phase of the 2010 second-pillar pension reform law took effect with a major restructuring of the regulatory framework for occupational pensions. A newly created supreme supervisory commission, the *Oberaufsichtskommission* (OAK), now oversees cantonal (state) and regional authorities, which in turn have assumed direct supervision over the pension funds. (Formerly, oversight of the pension funds was the responsibility of the Federal Office for Social Security.) Other provisions of the law implemented last year strengthened pension fund governance and transparency requirements for pension plan administrators and asset managers, including spot checks, higher ethical standards, and greater disclosure of fund-related transactions in annual financial reports.

The primary functions of OAK—which is directed by a 7-member board including pension fund employees, academics, and trade union representatives—are to harmonize the fragmented Swiss occupational pension system and to ensure that the more than 2,300 registered pension funds comply with existing federal rules. OAK has the power to issue binding standards for the cantonal and regional pension bodies, pension fund administrators, asset managers, and auditors.

In the Swiss multi-pillar retirement system, mandatory occupational pensions complement the first-pillar, universal state pension. It is expected that those first two pillars combined will provide a benefit of at least 60 percent of final salary. A third pillar, consisting

of various voluntary tax-exempt savings vehicles, is operated by the country's banking and insurance institutions.

Sources: "Update on Swiss Pension Legislation," Towers Watson, February 14, 2011; "Switzerland Unveils Board for New Federal Pensions Regulator," ipe.com, November 2, 2011; "Hopes and Expectations for the New Supervisory Body," *BVG Focus Newsletter*, December 2011; "Switzerland: The Super Regulator," ipe.com, December 1, 2011.

The Americas

Canada

On January 1, a number of changes to the Canada Pension Plan (CPP)—the country's compulsory earnings-related old-age, survivors, and disability insurance program—went into effect that aim to reduce the barriers to workforce participation for older workers. The changes, which were passed as part of a 2009 pension reform law, include a reduction in benefits for workers who retire before the full retirement age of 65, an increase in benefits for workers who delay retirement past age 65, and the introduction of a new benefit for workers who receive CPP retirement benefits while continuing to work.

Under the new rules, pensions for those who retire early (from age 60 to 64) are reduced by 0.52 percent (up from 0.50 percent) for each month before age 65 that a worker claims benefits. (This penalty will gradually increase by 0.02 percent a year, from 2013 to 2016, until reaching 0.60 percent.) Conversely, pensions for workers who delay retirement are now increased by 0.64 percent (up from 0.57 percent) for each month after age 65 (up to age 70) that they defer claiming benefits. (In 2013, this increase for delayed retirement will rise to 0.70 percent.) According to government calculations, once these changes are fully implemented in 2016, a worker retiring at age 60 will receive a pension that is 36 percent lower than the full pension, while workers retiring at age 70 will receive a pension that is 42 percent higher.

The second measure that went into effect is the introduction of a Post-Retirement Benefit (PRB) for persons who continue to work while receiving CPP retirement benefits. (Previously, once a worker claimed benefits, his or her contributions to the CPP ceased.) Contributions for the PRB are mandatory for workers aged 60 to 64 and their employers, and voluntary for workers aged 65 to 70. (Once workers aged 65 to 70 choose to contribute, their employers must also do so.) The contribution rate is the same as that of the CPP: 4.95 percent of covered earnings for employees and 4.95 percent of payroll for employers. Once a person leaves the workforce, he or she will receive the PRB as a supplement to the CPP retirement benefits.

Finally, in a change that benefits all workers eligible for retirement in 2012 or later, the percentage of months with low (or zero) earnings throughout a worker's career that are automatically dropped when calculating the CPP retirement pension increased from 15 percent to 16 percent. (The percentage will increase further to 17 percent in 2014.) As a result, up to 7.5 years of low earnings (increasing to 8 years in 2014) are excluded in the calculation of a worker's average career earnings. Previously, up to 7 years of lowest earnings were dropped.

Sources: *Social Security Programs Throughout the World: The Americas, 2009*, US Social Security Administration; "Changes to the Canada Pension Plan Retirement Pension," Parliamentary Information and Research Service, Publication No. 2011-54-E, May 20, 2011; "Changes to the Canada Pension Plan," Service Canada, June 7, 2011; Amendments to the Canada Pension Plan," Human Resources and Skills Development Canada, October 14, 2011.

Chile

On January 2, a measure went into effect that gradually extends mandatory coverage of the individual account system to certain self-employed workers. This measure, part of the 2008 pension reform law, only applies to self-employed workers who provide professional services, such as doctors, dentists, accountants, and lawyers. (Previously, participation was voluntary for those workers.) The government estimates that approximately 1.1 million professionals are affected by the new law, about 700,000 of whom were already enrolled voluntarily in the system. Participation remains voluntary for other types of self-employed workers such as fishermen, farmers, and street vendors.

Self-employed professionals will be incorporated into the individual account system in two phases. The first phase, which started January 2, requires self-employed professionals who earn at least the minimum monthly salary (182,000 pesos or US$350) to contribute 10 percent of a portion of their taxable earnings up to a maximum of 1,471,549 pesos

(US$2,832) a month. That portion is 40 percent until 2013 when the share will increase to 70 percent and then reach 100 percent in 2014. Opting out of the system (in writing) each year is permitted until 2015. The only exceptions are for persons who are within 10 years of retirement (at least age 55 for men and age 50 for women) as of January 2012. Self-employed account holders are also covered for survivors and disability insurance as long as they contribute the month prior to the onset of a disability or death; the premium is 1.49 percent of taxable earnings up to the same ceiling as old-age benefits.

Another provision of the 2008 pension reform allows all self-employed account holders to participate voluntarily in both the health care system and work injury program until 2018. At that time, those workers who are enrolled mandatorily will be required to contribute 7 percent of covered earnings for health care coverage, and they will be required to contribute 0.95 percent plus up to 3.4 percent, depending on the occupation, for work injury.

Sources: *Social Security Programs Throughout the World: Americas, 2009*, US Social Security Administration; "Pensiones y Protección para Independientes," Fondo Para La Educación Previsional, diciembre de 2011; "Hasta 400.000 Nuevos Cotizantes Se Sumarán a AFP en Próximos Tres Años," *Diario Financiero Online,* el 28 de diciembre de 2011.

Reports and Studies

International Labour Office

At the end of 2011, the International Labour Office (ILO) released *Social Protection Floor for a Fair and Inclusive Globalization*. The report was prepared by the Social Protection Floor Advisory Group, headed by Michelle Bachelet, former President of Chile and the Under-Secretary General of the United Nations (UN). It examines the UN's current social development policies and makes recommendations on the future direction of social protection policies to alleviate world poverty. The main purpose of the report is to present the Social Protection Floor Initiative, which encourages countries to introduce a minimum guarantee to all citizens for basic income security and for access to essential social services. Basic income security may take the form of pensions for the elderly and persons with disabilities. The ILO estimates that 75 percent of the world's population is not adequately covered by social security.

The report asserts that a "social protection floor approach" differs substantially from the social safety nets promoted by many governments and international financial institutions since the late 1980s. In general, the safety net approach considers that social protection policies are usually temporary and target the most vulnerable in a needs-based framework to help cushion the poor from the effects of economic restructuring. In contrast, a social protection floor approach stresses a rights-based approach, with guaranteed basic social rights as a precondition for citizenship.

In addition, the social protection floor differs in the way it attempts to alleviate poverty. Currently, poverty-reduction strategies in many countries focus on "vertical expansion" of coverage, with social insurance programs often reaching only a minority of the working population in the formal sector of the economy. The report recommends that governments devote their efforts to "horizontal expansion" of coverage, by providing income security and social services to previously uncovered citizens.

The report notes that social protection in most countries is currently administered by a multitude of different government institutions (such as ministries of health, social security, and labor), each operating within its own separate sphere. The Social Protection Floor Initiative argues in favor of more integrated planning and service delivery by breaking down institutional barriers. The key to success in this regard is better data availability on the living situation of populations and diverting public resources to those subgroups of the population that most lack access to health, education, or income security in their old age.

In terms of financing, the report asserts that a social protection floor may be affordable even in the midst of the worldwide economic recession. According to the report, the cost to governments to cover unprotected citizens for access to health, family benefits, and old-age pensions is projected to range from 2 percent to 3 percent of gross domestic product (GDP) in Africa and from 4 percent to 5 percent of GDP in the more developed Asian and Latin American economies. However, the challenge to governments is to find the "fiscal space" that would permit them to introduce new protection or reallocate existing expenditures.

The report concludes that the introduction of new social protection measures needs to be accompanied by adequate capacity to deliver the benefits. The issue

is particularly difficult in those countries with existing social insurance and social service programs that serve only part of the population. Related remaining questions posed by the report include the following:

1. How would these existing social insurance programs be coordinated with more universal tax-financed old-age benefits?
2. Can the existing social security institutions be used to extend coverage to noncovered populations?
3. At what level should old-age benefits, both noncontributory and contributory, be fixed to avoid disincentives to continue to work?

Source: *Social Protection Floor for a Fair and Inclusive Globalization*, International Labour Office, October 26, 2011.

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