FROM THE AMERICAN PEOPLE

FINANCIAL SECTOR DEVELOPMENT PROGRAM (USAID/FINREP-II)

Global Experience In Pension Reform

Issue 2

Kyiv, December 2013

This document on developments in the pension sector in the period ending 31 October 2013 has been prepared by the staff of the USAID Financial Sector Development Project. The interpretation of articles in the media is made by the Project's professional pension experts. Links are provided so that individuals can read the full article.

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PILLAR II

Romania

Pillar II pension funds have surged in asset size and profitability in 2013.

The pension regulator, Private Pension System Supervisory Commission says total net asset value of the 8 pillar II funds was €2.9bn an annual rise of 45.6% in local currency terms. The number of participants grew by 3.2% to nearly 6 million.

Most of the asset increase is due to the government implementing the planned increase in contributions from 3.5% to 4% gross wages. Of the increase in net assets, 73% represents contributions and the rest (€337 mn) is investment income.

Total performance since inception remains strong with a net annualised average return of 11.7%. (€513 mn) has been earned from investment income since 2008.

The current legislation, whereby pillar II participation was mandatory for those up to 35 years old in 2008 and voluntary for those between 35 and 45 years, sees yearly increases in the contribution rate.

The government has still to finalise the 2014 Budget but experts say that in the short term the most important action to support continuing these results would be to increase the contribution rate to 4.5%.

The regulator said the weighted annual average return rose over the year from 6.2% to 10% largely due a heavy investment in state bonds. The average portfolio was 76% invested in bonds at the end of September. Bond prices had risen significantly during 2013.

For pillar III schemes, which have operated since 2007, net assets grew by 35.2% to (€160 mn) and membership by 8% to 305,796 as of the end of September.

Returns for balanced funds rose from 5.3% to 9.6%, and those for the higher risk funds from 5.3% to 10.5%[1].

Romania's pension system – a PAYG pillar I, a Pillar II of privately managed compulsory and Pension Pillar III of voluntary contributions of the insured to non-state pension funds or insurance companies

PILLAR II

PILLAR III

United Kingdom

The Government has proposed a cap of 0.75% of assets under management as the ceiling on administration costs in both pillar II and pillar III schemes. This move would boost retirement funds by hundreds of thousands of pounds.

In a move that has angered financial advisors the government launched a consultation paper proposing a cap of between 0.75% and 1% a year for charges on the £275bn assets of workplace pensions (pillar III) and the recently introduced pillar II.

The pensions minister said that the government believes that enough is enough on charges. People need to know they are getting value for money when they save in a pension and are not being ripped off by excessive charges. He added that he was confident that the system will become fairer for anyone in a workplace pension and will finally address the issue of charges, which has been neglected for far too long.

The proposed cap of 0.75% is lower than that proposed by the Opposition party (1%).

[1] http://www.ipe.com/10000348.article?adfesuccess=1

The government default scheme, NEST, has charges of 0.3% a year, far below the rates typically charged by competitors.

The Minister said that while 1% may sound low, in reality the impact it has on returns is large. In a scenario where a person paid in £100 a month throughout their working life to a fund with a 1% charge cap the difference between having no charges and a 1% charge on a £100 a month contribution is a £160,000 reduction in your pension accumulation.

Financial advisers argued that a cap on would force pension schemes to switch to tracker funds replicating the performance of an index such as the FTSE100. It would stop active management whereby asset managers pick individual companies to invest in.

Gina Miller of SCM Private, a fund management firm that has campaigned on excessive charges in the investment industry, said that over the past year, the True and Fair campaign launched by SCM had found that charges could take as much as 40% of a pension pot. She said that there is no agreement on what should be disclosed as the annual management charge and no requirement to publish it. The Anti Monopoly Commission has admitted that it's almost impossible to determine what the charges are. For example Miller said pension firms typically leave out dealing costs when calculating their charge. This can have a large impact on the outcome of an individual's pension fund[2].

UK pension system. Pillar I – a flat universal based on years of contributory service. Pillar II (eventually) a compulsory system with at least a total of an 8% contribution to an employer chosen private pension fund or the government default fund. Employers already paying a contribution of at least 3% can make their compulsory payment into their own Pillar III scheme. Pillar III scheme can corporate or open funds. An open fund can accept voluntary contributions by individuals.

PILLAR I

Switzerland

On June 21, the Swiss Federal Council announced a package of pension reform proposals (known as Retirement 2020) to address the mounting fiscal pressure on the public pension system from population aging. According to government estimates, the financing gap in the public pension system will grow from US$1.3 billion in 2020 to US$9.1 billion in 2030. Since 1990, average life expectancy in Switzerland has increased 3 years, and one-third of the population is projected to be above retirement age by 2050. Consultations on the legislative package will conclude by the end of this year and a draft law will be introduced into parliament in 2014. If parliament passes the proposed reform, a nationwide referendum (required because reforms include an amendment to the constitution) must take place before planned implementation of the law in 2020.

The government's proposal outlines a comprehensive reform of both the first-pillar pay-as-you-go public pension and second-pillar mandatory occupational pensions that includes—

- *Retirement ages*. The retirement age for women (currently 64) for both pillars I and II would rise 1 year (at the rate of 2 months per year) to that for men (age 65). Early retirement for men and women (age 58 under current law) would be delayed by 4 years to age 62, but could still be possible under certain conditions for workers with low average annual incomes, provided they made social security contributions

[2] http://www.theguardian.com/money/2013/oct/30/pension-scheme-charges-cap-ministers-consultation

from ages 18 to 21. Although 65 would remain the official retirement age (workers can already defer receiving a pension until age 70), greater flexibility would be provided for exiting the labor force from ages 62 to 70; for example, workers would have the option at age 62 and older of working part time while drawing a partial pension.

- *Funding the first-pillar pension*. To close most of the expected financing shortfall of the first-pillar pension, a gradual increase in the value-added tax (VAT) from 8 to 10% in 2 steps is proposed: 1% in 2020 and a further 1% closer to 2030, based on actuarial projections and financing needs.

PILLAR II

- *Benefit calculation for second-pillar pensions*. The conversion rate—the proportion of worker lifetime contributions paid as an annual annuity—would gradually decline 0.2% a year from 6.8% to 6.0% over 4 years. To prevent pensions from falling below current levels (official estimates are that the lower conversion rate would reduce pillar II pensions by 12%), the government recommends various compensatory measures, including subsidies for older workers and strategies to encourage pillar II savings at younger ages.
- *Guaranteed interest rate for occupational plans*. The method of calculating the minimum interest rate of accounts in pillar II, currently set in advance for the next year based on assumptions for future returns, would be switched to a year-end calculation that reflects observed rates of return for that year[3].

Switzerland has a 3 pillar system. Pillar I is a national PAYG scheme. Pillar II is a compulsory scheme financed by employee and employer contributions into corporate or open pension funds. Pillar III is voluntary contributions by individuals into open pension funds

PILLAR I

Paraguay

On June 5, 2013, after 10 years of discussion, a new law was enacted that will allow self-employed workers, employers, female heads of household, and domestic workers to voluntarily participate in the country's pay-as-you-go (PAYG) public pension system. The new law entered into force on August 5. According to the Social Security Institute, the administrator of the PAYG system, about 40% of the economically active population (3.5 mn workers) will be eligible to enroll in IPS for old-age, survivors, and disability insurance. Currently, less than 20% of the economically active population is covered by IPS, including more than one-third of employees. According to an IPS official, even though participation is mandatory for private-sector employees with an employment contract (either written or verbal), the penalties for noncompliance cost the employers much less than the actual contributions.

The contribution rate for voluntary participation will be 13% of gross earnings, including 0.5% percent for administering disability benefits. Currently private-sector workers are covered for disability, sickness and maternity, and work injury benefits—with employee contributions of 9% of gross earnings and employer contributions of 14%. The minimum monthly earnings used to calculate all contributions—the legal monthly minimum salary, currently

[3] **Sources:** "Switzerland," *International Update*, US Social Security Administration, January 2012; "2013 Update on Swiss Pension Legislation," Towers Watson *Hot Topics*, March 12, 2013; "Bern Proposes Later Retirement Age for Women," *The Local*, June 21, 2013; Swiss Federal Social Insurance Office, press release, June 21, 2013; "Government Announces Pension Plans," swissinfo.ch, June 21, 2013; "Switzerland Plans VAT Hike to Fund Pensions," tax-news.com, June 24, 2013; "Swiss Federal Council Adopts Pension Reform Proposals," Mercer *Select News*, June 27, 2013.

US$365 will be the same for both mandatory and voluntary participation.

The qualifying conditions for old-age pensions will also be the same:

- A full retirement benefit, payable at age 60 with 25 years of contributions;
- An early pension, payable at age 55 with 30 years of contributions; and,
- A reduced proportional benefit, payable at age 65 with 15 years of contributions.

However, the benefits are expected to be lower for the voluntary groups. The benefit formula will be based on average contributions during the past 120 months, compared with the past 36 months for private-sector workers[4].

The contributory social protection system in Paraguay is composed of a pension system and a national health system. Hence, the contributory pension system excludes to a large extent informal workers (both in urban and rural areas) and persons who do not manage to make contributions to the system.

There are a number of funds that are primarily occupational pension schemes run by employers. The public pension system is called the Institute of Social Security or IPS using the Spanish initials.

The IPS provides both retirement pensions and health coverage for its participants and their families, protecting them against diverse risks, including illness, accidents, maternity, old age and disability. The old age retirement fund is funded by a contribution of 12.5% of wages.

Paraguay has the lowest rate of coverage of social security and pensions in Latin America. In 2008, coverage of the pension system was about 13% of the Paraguayan occupied population. Within the public sector, almost all workers are covered by a pension fund, but in the private sector, coverage is only about 30% of workers (40% in urban areas and less than 15% in rural areas).

Economic Commission for Latin America and the Caribbean (ECLAC) - Social protection systems in Latin America and the Caribbean: Paraguay[5]

PILLAR I

Australia

On July 1 2013, changes to the mandatory accumulation superannuation system went into effect that gradually increase the employer's mandatory contribution to an employee's superannuation fund and abolish the age limit for making contributions to a superannuation account. These changes are meant to increase the level of retirement savings in the country as eligibility rules are tightened (beginning July 2014) for the budget funded Old Age Pension. According to government projections, by 2047, the percentage of Age Pension beneficiaries that receives a full benefit will fall from the current 75 percent to 50 percent. In addition, because life expectancy at birth is increasing (currently 79.7 years for men and 84.2 years for women, projected to rise to 85 years and 88 years, respectively, by 2056), people are more likely to spend more time in retirement and will require additional savings.

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[4] **Sources:** *Manual del Asegurado,* Edición 2011, Instituto de Previsión Social, octubre de 2011; "Informalidad Laboral en Paraguay Deja Sin Cobertura A Cerca Del 80% de los Trabajadores," *América Economía*, el 30 de abril de 2013; Ley Número 4933, el 5 de junio de 2013;"Promulgan Ley que Permite Jubilacion por IPS a Trabajadores Independientes," *ABC Paraguay*, el 16 de junio de 2013.

[5] http://www.eclac.org/publicaciones/xml/4/48744/Social-protection-systems-Paraguay.pdf

PILLAR II

The SG contribution rate will increase gradually from 9% percent of basic wages to 12% by 0.25% in 2014 and 2015 and then by 0.50% in 2016, 17, 18 and 19. Government estimates that this measure will benefit some 8.4 million employees and will add some US$460 billion) in superannuation savings by 2035.

The government also abolished the age limit to encourage older workers to remain in the labor force and to give them more time to increase their retirement savings. Previously, employers could stop contributing on behalf of employees aged 70.

PILLAR I

Employee contributions to a superannuation fund are voluntary whereas employer contributions are mandatory. To encourage employees to contribute, the government provides a matching contribution (called co-contribution) of up to US$457 for workers earning from US$30,609 to US$44,309 a year. The government also provides a tax rebate of up to US$457 for lower earners. (No worker contribution is required.) As of March 31, 2013, total superannuation assets under management were US$1.44 trillion, the fourth largest of countries in the world[6].

Australia's Pension System – Pillar I – a revenue funded flat benefit subject to individuals not exceeding limits for income and/or assets. Pillar II – compulsory system of employer contributions, predominantly to multi-employer defined contribution schemes but contributions to other types of defined contribution scheme or define benefit schemes are allowed provided the employer cost is at least the minimum prescribed

PILLAR I


Andorra

On July 16, 2013 the cabinet approved changes to the country's pay-as-you-go (PAYG) public pension program that will help improve the program's finances. The measures are part of a law that also includes changes to other branches of the country's social security system, including sickness and maternity and work injury. According to a 2009 government report, without any changes the pension program would have a deficit beginning in 2017. The new law will be implemented on January 1, 2014.

Until next year, employees may choose among three contribution rates for an old-age benefit: 2.5, 5 or 7% of gross earnings; they also pay 3% for disability, survivors, sickness, maternity and work injury benefits. Employers contribute 7.5% for old-age benefits and 7% for the other benefits. (There is no government contribution.) A full retirement benefit is paid at age 65 with 40 years of contributions, and a reduced benefit is paid with at least 13 years of contributions. Early retirement is permitted from age 58 with 40 years of contributions and deferred retirement is permitted until age 72. The insured person's lifetime contributions are used to calculate the pension amount. An additional benefit, the spouse's supplement, is paid for a spouse aged 65 or older who is not eligible for a pension in his or her own right. Benefits are adjusted annually according to changes in the consumer price index.

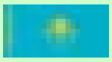
[6] **Sources:** "Population Projections, Australia, 2006 to 2101," Australian Bureau of Statistics, September 4, 2008; *Intergenerational Report 2010: Australia to 2050: Future Challenges*, Commonwealth of Australia, January 2010; "Australia," *International Update,* US Social Security Administration, January 2011; *Retirement Outcome Projections Under 12% SGC*, Enterprise Metrics, July 2012; "Gender Indicators, Australia, Jan 2013," Australian Bureau of Statistics, January 30, 2013; "Statistics, Quarterly Superannuation Performance," Australian Prudential Regulation Authority, March 2013 (issued May 23, 2013); "Make the Most of the New Dawn in Superannuation," *The Australian*, June 30, 2013.

Provisions of the new law include the following:

- *Contribution rates*. Employees will no longer have a choice of contribution rates. The old-age rate will be increased by 1% for both employees and employers (to 3.5 and 8.5% respectively), and the rate for other social insurance benefits will be lowered by the same amount (2% and 6% respectively).
- *Qualifying conditions*. The minimum number of contribution years will rise from 13 to 15. The age limit for a deferred pension will be abolished, and the early retirement age will increase to 61.
- *Benefit levels.* Pensions greater than 150% of the monthly minimum (US$1,914)—will be reduced. Higher benefits will be reduced more than lower benefits, according to a sliding scale for benefits that exceed the maximum. In addition, the spouse's supplement will be eliminated.
- *Government guarantee.* A guaranteed minimum monthly pension equal to the monthly minimum wage (US$1,276) a month will be introduced. The government will also maintain a minimum balance of US$1.2 billion in the pension reserve fund.
- *Indexation.* Benefits will be adjusted according to changes in a combination of the consumer price index, wages, and a sustainability factor (the ratio of contributors to pensioners).
- *Noncontributory pension.* The government will create a pension program for people who have lived in Andorra for at least 10 years and are not insured in their own right and are not eligible for the statutory contributory pension program[7].

Andorra's pension system – Pillar I a PAYG pension scheme. Pillar III – voluntary contributions by employees and/or employers

PILLAR II



Kazakhstan

On June 21, 2013 Kazakhstan's president signed a pension reform bill into law that will equalize the retirement age for men and women. It also merges assets in the system of mandatory accumulation individual accounts—currently managed by 10 private funds and the State National Pension Fund (GNPF)—into the single state-run Centralized Accumulation Pension Fund (CAPF). According to the government, the new law will improve the long-term sustainability of the pension program, guarantee adequate retirement income for future retirees and provide more effective and secure management of the country's pension savings.

PILLAR I

Under the new law, the retirement age for women will gradually increase from 58 to 63 by 6 months a year starting in January 2018. (The first version of the bill passed by the Kazakhstan Parliament—but ultimately returned for reconsideration by the president—would have started the gradual increase in January 2014.)

[7] **Sources:** *Proyección de Ingresos y Gastos del Sistema de Pensiones de Andorra, Período 2010–2025*," Gabinete de Asesoramiento Económico y Social SL, septiembre 2009; Social Security Programs Throughout the World: Europe, 2012, US Social Security Administration, September 2012; "Salari Mínim," Circular Informativa, Govern d'Andorra, 24 del octubre del 2012; "Projecte de Llei de Modificació de la Llei 17/2008, del 3 d'octubre, de la Seguretat Social," presentacio, Governo d'Andorra, 3 de Juillol del 2013; "Andorra Extends Pension Contribution Period," lawandtaxnews.com, July 8, 2013; "Andorran Cabinet Approves Social Security Reform Bill," Mercer *International Headlines,* July 9, 2013; "Projecte de Llei de Modificació de la Llei 17/2008, del 3 d'octubre, de la Seguretat Social," Butlletí del Consell General, núm 36/2013, 16 de juillol del 2013.

PILLAR II

The law also consolidates the current 11 pension funds (10 private funds and the public GNPF) into a single centralized pension fund, or CAPF. Over the past 5 years, pension fund investment returns have averaged well below inflation partly because of regulations that limit investment options. Government sources indicate that the CAPF will have a more diversified portfolio. The government had initially planned to merge the assets of the private pension funds with those of the GNPF (holding roughly 19 percent of total pension assets) by July 1; however, the process is only just finishing (as of October). The merger would put the CAPF in charge of approximately US$20.1 billion in assets (as of December 2012), or around 10% of gdp. Existing pension funds managing mandatory individual accounts will be permitted to manage voluntary pension fund accounts.

PILLAR I

In addition to mandatory individual accumulation accounts implemented on January 1, 1998, Kazakhstan's public pension system includes a solidarity pension for people who worked at least 6 months under the old pay-as-you-go system and social benefits for individuals with pensions below the minimum pension specified by the government (currently 40% of the minimum wage), as well as those ineligible for benefits from the mandatory individual accounts. Employees contribute 10% of monthly earnings to the mandatory individual account (there is no employer contribution); employers contribute 11% of monthly payroll for the solidarity pension and 5% for disability, survivor, and unemployment benefits. The government pays the total cost of guaranteed minimum pensions (under the mandatory individual account program) and of social benefits[8].

Kazakhstan's Pension System – For older people a PAYG pillar I pension plus voluntary contributions by the employer and/or employee . For younger people a compulsory pillar II contribution of 10% into a central accumulation fund plus possible pillar III contributions.

PILLAR I

New Zealand

On July 11, 2013 the New Zealand Treasury released "Affording our Future" its report on the country's future fiscal challenges. The report finds that the rapid aging of the population—because of declining birth rates and increasing life expectancy—is among the major fiscal challenges. Since 1980, the number of people aged 65 or older has doubled (to currently more than 600,000) and by 2036, the number is projected to double in size again. In addition, from February 2012 to February 2013, the number of individuals receiving New Zealand Superannuation (NZS)—the country's flat-rate universal pension, which is funded by general revenues— grew by more than 27,000 beneficiaries (five times the average annual growth rate in the previous decade). By 2020, more than 150,000 new pensioners are projected. As a result, the Treasury estimates that spending will increase from 4.3% of nominal GDP in 2010 to 7.9% by 2060.

To help put superannuation on a more fiscally stable path, the report presents a number of options including the following:

- Gradually raising the retirement age from 65 to 67, or raising the age to 67 and linking further increases to life expectancy.

[8] **Sources:** Social Security Programs Throughout the World: Asia and the Pacific 2012¸ US Social Security Administration, 2012; "Kazakhstan," International Update¸ US Social Security Administration, March 2013; "Kazakhstan: Protests Over Plans to Raise Women's Retirement Age," Financial Times, May 13, 2013; "Kazakh President Returns Bill on Reform of Pension System to Parliament," Trend News Agency¸ June 7, 2012; "Kazakhstan's Parliament Adopts, Passes Pension Reform Counterproposal," Mercer, June 21, 2013; "Kazakhstan Adopts Controversial Pension Reform," CACI Analyst, June 28, 2013

- Changing the method of indexing benefits from changes in wages (the current method) to one that uses the inflation rate or a mix of inflation and wages.
- Introducing a means test because the first two options would disproportionately affect lower earners.
- Requiring KiwiSaver (a voluntary subsidized retirement savings plan) account holders to annuitize half of their account balances at retirement (this will increase the income people will have and as benefits are means tested will therefore reduce their State Pension)and providing government subsidies to top up the benefit for people with low account balances.
- Change the State Pension System from a pay-as-you-go system to an accumulation system[9].

New Zealand's Pension System – A PAYG Pillar I system subject to test on income and assets. Pillar III is either voluntary contributions by individuals to "Kiwisaver" or voluntary contributions by employees and/or employees to a corporate pension plan. Eligible participants of the above accumulation pension fund get annual tax credit and get the first home deposit subsidy through Housing New Zealand. KiwiSaver is not guaranteed by the Government.

PILLAR II

Malaysia

In August, 2013 the Employees Provident Fund (EPF) announced changes to help the workforce save more for retirement and prevent old-age poverty in future decades. The government has indicated that ensuring adequate retirement savings is a major concern as the population rapidly ages. By 2030, the share of the population aged 60 or older will more than double from the current 7% to 15% and life expectancy will increase from 72.6 years (men) and 77.5 years (women) to 74.2 years and 79.1 years, respectively.

Effective August 5, 2013 the age limit for mandatory employer and employee contributions to the EPF increased from age 55 to 60. This measure follows the July 1 increase in the minimum retirement age for private-sector workers from age 55 to 60. (Previously, there was no statutory retirement age, although age 55 retirement was the norm.) The government anticipates that more than 6 million EPF active members could benefit from the higher savings level.

Another measure to help raise the level of retirement savings will take effect on January 1, 2014. The basic savings amount Malaysians must accumulate in their retirement account by age 55 will rise from US$36,527 to US$59,803. The basic amount increases with age, starting at US$304 at age 18 and aims to provide a retirement benefit of US$250 a month (the current minimum pension for public employees), for 20 years from ages 55 to 75. The EPF divides total contributions into two types of accounts: 70% is directed to Account 1 for retirement (a portion can be drawn down periodically to purchase approved investments before retirement); and 30% is directed to Account 2, which can be drawn down before retirement for the purchase of a house, for education costs, and certain health-related expenses. At retirement, funds can be withdrawn from both accounts as a lump sum payment, periodic payment, or a combination of the two. While the EPF guarantees a minimum return of 2.5% per year, annual dividends on fund assets US$163 billion at the end of March 2013 have been at least 4.5% over the past decade.

[9] **Source:** Affording Our Future: Statement on New Zealand's Long-term Fiscal Position, New Zealand Treasury, July 11, 2013.

Malaysia's public pension system includes the mandatory EPF for private-sector employees and certain public-sector workers not covered by the separate public-sector system. It provides lump-sum old-age, survivors, and disability benefits for its 13.7 million members (of which 6.4 million are active contributors). Employers contribute 13% of monthly salaries of US$1,519 or less and 12% for employees earning above that amount, while employees must contribute 11% of their monthly salaries until age 60. As an incentive to keep older workers in the labor force, contributions for employees aged 60 or older are reduced by 50% for both workers and employers. People who continue working after age 60 must contribute to an EPF account until they retire or reach age 75, whichever comes first[10].

Malaysia's Pension system – Pillar I - compulsory contributions by employees and employers. Pillar III - Voluntary contributions by employees and/or employers to corporate or open pension funds.

PILLAR III

South Africa

On July 11, 13 the National Treasury of South Africa released "Charges in South African Retirement Funds," the last in a series of discussion papers on promoting household savings and improving the country's retirement savings industry. The paper analyzes the current level of management costs and administrative fees, compares them with other countries and examines the causes of the relatively high costs and fees in the country. The paper was subject to public consultation until September 30. The government plans to present draft pension legislation incorporating proposals from all five discussion papers in 2014.

Among the paper's main findings is that structural factors—such as a large number of retirement funds (approximately 3,000 active funds), the voluntary nature of the system and low account balances—are significant drivers of the retirement system's costs, which are high when compared to other countries. To reduce costs and fees in the retirement industry, the paper discusses various reform options that include—

- encouraging fund consolidation by moving toward multiemployer arrangements;
- improving fund governance;
- strengthening fund regulation;
- simplifying plan design;
- making enrollment into retirement funds mandatory; and
- establishing a default fund for employers who do not select a fund themselves.

The previous four discussion papers, each of focusing on a separate retirement related issue were:-

- "Enabling a Better Income in Retirement" reviewing the current market of retirement income products and proposing measures for low-cost and easily accessible products.

[10] **Sources:** Employee Benefits Reference Manual 2013—Malaysia, Swiss Life Network, 2013; "Few Embrace Malaysia Retirement Plan," The Wall Street Journal Asia Edition, July 25, 2013; "New EPF Rates for All," The Sun Daily, August 7, 2013; "EPF Basic Savings Revised to Avoid Old-age Poverty," The Malaysian Reserve, August 23, 2013; "Malaysia's EPF Announces Steps to Boost Retirement Savings," Pensions & Investments, August 23, 2013; "Overview of the EPF," Employees Provident Fund, August 29, 2013; "EPF to Raise Members' Basic Savings Level," Business *Times*, September 13, 2013.

- "Preservation, Portability and Governance for Retirement Funds," discussing the low rate of preservation of retirement savings and proposing various improvement, the portability of retirement savings and government attempts to improve the governance of pension funds.
- "Incentivising Nonretirement Savings" proposing tax-deferred individual savings and investment accounts to improve short- and medium-term savings, reduce dependency on credit and encourage savings in lower-income households.
- "Improving the Tax Incentives of Retirement Savings" proposing harmonizing the tax treatment of contributions so that all contributions to annuities, pension, and provident funds—and all benefits from those funds receive the same tax treatment.

According to the government, the current occupational pensions retirement system favors employed higher earners. However, even though South Africa has the most developed private pension system in the region, more than half of the formal labor force is not covered. The level of coverage depends on the industry and the trade union. The country has no earnings-related public pension system; it only provides a means-tested, old-age pension of up to US$116 a month to workers aged 60 or older[11].

South Africa's Pension System – A budget funded pillar I scheme subject to tests on income and assets. Pillar III – voluntary contributions by employers and/or individuals to corporate pension funds, multi-employer funds or open pension funds.

PILLAR II

Poland

There has been much activity on possible changes to Poland's pillar II system recently. The articles below, given the significance of the matters dicussed, are presented in detail and in date order so that the reader can follow the trail of events.

On June 26, 2013, the Ministry of Labor and Social Policy and the Ministry of Finance jointly released a report that provided a wide-ranging review of Pillar II. It analyzes its effectiveness in ensuring adequate retirement income for pensioners as well as its influence on public finance, capital markets, and economic growth since 1999. In addition, it presents a number of possible reform options to increase economic growth and reduce the costs and risks of pillar II.

(Background information: In 1999, Poland introduced a multi-pillar pension system consisting of a first-pillar mandatory notional defined contribution (NDC) program, managed by the Social Insurance Institution (ZUS); mandatory second-pillar individual accounts, privately managed by open pension funds (OFEs); and voluntary third-pillar retirement savings accounts. In addition, a law implemented in May 2011 created new first-pillar subaccounts funded through contributions that had previously been diverted to the second pillar.

A few of the key areas analyzed in the report include the following:

- *Pension fund management fees:* The report finds that management

[11] **Sources:** "South Africa," *International Update*, US Social Security Administration, June 2012; "Enabling a Better Income in Retirement" and "Preservation, Portability and Governance for Retirement Funds," National Treasury, September 21, 2012; "Incentivising Nonretirement Savings" and "Improving Tax Incentives for Retirement Savings," National Treasury, October 4, 2012; "Charges in South African Retirement Funds," National Treasury, July 11, 2013; National Treasury press release, July 11, 2013.

fees charged by OFEs have been extremely high and unconnected to investment performance. For example, OFEs charged members around US$602 mn during the financial crisis of 2008 when assets under management fell by US$6.02 bn.

- *Pension funds and public finance:* The report estimates that public debt would have been 38% GDP rather than the current 56% had pillar II not been implemented in 1999. The report notes that this would have led to a higher credit rating for Poland and consequently lower debt-servicing costs.
- *Pension funds and the Warsaw Stock Exchange:* The report notes that OFEs have played an important role in developing the capital market, accounting for 18% of stock exchange capitalization at present. However, this role is expected to lessen as the privatization of state-owned companies winds down.

The report concluded by suggesting three possible reforms to pillar II, including—

- Transferring all government bond investments from OFEs to ZUS and limiting future OFE investments to investments in what the government terms the “real” economy, including stocks and corporate bonds. (The value of the redeemed bonds would be credited to workers' subaccounts managed by ZUS.) The report estimates that such a bond transfer would reduce public debt by approximately 11% of GDP.
- Making participation in pillar II voluntary. Current participants would have 3 months to inform ZUS in writing of their intention to remain in pillar II; those who fail to do so would have their pillar II account balances transferred to pillar I subaccounts. In addition, new entrants to the labor force would have to “opt-in” to pillar II.
- Making participation in pillar II voluntary but increasing the contribution rate for those who choose to participate. Participants would have 3 months to choose to participate in pillar II and the contribution rate for those who opt-in would increase by 2% of earnings. As a result, the total employer/employee contribution rate for old-age pensions would increase from the current 19.52% to 21.52%; of these contributions, 4% would go to individual accounts (up from 2.3% currently) and the rest would go to ZUS.

The report specifically ruled out other reforms, such as a partial or total liquidation of the second-pillar program and maintaining the status quo[12]. This report was open for 2 months of public consultation before being drafted into legislation.

21 August 2013. The Polish securities sector urged the government to find a solution that preserves the stability of the local capital markets as the consultation period for reforming second-pillar pension funds (OFEs) closed.

A document co-authored by the Chamber of Brokerage Houses, the Polish Association of Listed Companies, Polish Association of Brokers and Investment Advisers, Polish Private Equity and Venture Capital Association and the

[12] **Sources:** “Poland,” International Update, US Social Security Administration, May 2011; Social Security Programs Throughout the World: Europe, 2012, US Social Security Administration, September 2012; “Polish Private Pension Funds: Outlook for 2013 After Strong 2012,” Ministry of Treasury, March 1, 2013; “Przegląd Funkcjonowania Systemu Emerytalnego,” Ministry of Labor and Social Policy and Ministry of Finance, June 2013; Ministry of Labor and Social Policy, press release, June 26, 2013; “Government Presents Three Options for Future of OFEs,” *Warsaw Business Journal*, June 26, 2013; “Polish Government Unveils Plans for Second-Pillar Pensions Reform,” *IPE.com*, June 27, 2013.

Individual Investors' Association stressed that one of the original purposes of the 1998 pension reforms that ushered in pillar II was to increase future retirement income by diversifying risk through investment in Polish business and industry, thus underpinning the country's economic growth.

The document notes that OFEs have more than €24bn invested in Polish companies.

They hold shares in 372 companies listed on the primary Warsaw Stock Exchange (WSE) market, many of which would have been too small to raise capital abroad, but have since become international successes.

The authors argue that the OFEs were the main motor for the Polish capital market's growth, stimulating inflows of overseas capital and drawing in foreign private equity and venture capital firms.

"Without the OFEs, Poland would not be a regional financial centre," the document states.

At the end of 2012, OFE investment accounted for 19% of the Warsaw Exchange’s capitalisation, including 15% of the main WIG20 index, and 29% of small and medium-sized companies listed elsewhere, alongside 40% of the free float.

At the same time, the OFEs have proved to be long-term investors, accounting for only 6% of turnover, while their strategic holdings – the sector holds more than 25% of the equity in 62 companies – make them an influential player in corporate governance and maximising share value.

In addition to their role in equity investment, the OFEs are also the country's main investors in Polish bonds, including bank and corporate bonds.

The paper is highly critical of the government's options for pension reform – transferring OFE assets prior to retirement to ZUS to service payouts, alongside barring the funds from state bond investment (this would be done by ZUS) and introducing voluntary membership, with or without additional contributions – and the government's exclusive focus on pillar II.

The authors believe the introduction of voluntary participation could lead to the effective transfer of all OFE assets to ZUS.

It insists that OFE must be able to continue investing in state bonds to maintain portfolio stability, as restricting OFE investments – to all intents and purposes to shares – would expose the portfolios to massive fluctuations and lead to the eventual liquidation of pillar II.

Meanwhile the takeover of OFE assets by ZUS or any other non-investing public institution could undermine the capital markets through an oversupply of stock and dramatic price falls.

The authors also want the government to reconsider two earlier proposals that sought to resolve the issue of pension fund state bond investments. The first option would separate OFE bond holdings into individual pension member sub-funds under ZUS ownership, but managed by the pension companies, with their value treated as part of the total OFE portfolio and included in any performance benchmark. The second option would shift OFE state bond holdings to a newly created retirement debt unit and convert the assets into retirement bonds that would not count towards public debt calculations.

This retirement bond fund would be passively managed – indexed to nominal GDP growth – thus protecting the payout value from market volatility. Finally, the authors wants the government, as a matter of urgency, to stimulate the development of the third pillar, without which, states the document, pensions will fall to a level unacceptable for a large section of society[13].

5 September 2013. Poland's prime minister, Finance Minister and Minister of Labour and Social Policy have confirmed the pensions industry's worst fears regarding the proposed continuation of the pension reform.

Now, the government has selected both the bond removal and an end of hitherto mandatory membership.

The payout system proposed at the time, which would see members' funds incrementally transferred 10 years before retirement to ZUS sub-accounts set up in 2011 after OFE contributions were slashed, remains unchanged, with ZUS responsible for payouts from both pillars.

The Government insists this would generate higher pensions than if the funds were left in the OFEs and, crucially, that the pensions would be paid out over a retiree's lifetime.

This was a pointed response to the industry's controversial proposals for payouts that would have provided a retirement income from their OFE accounts for only 15 or so years.

The Polish state and state-guaranteed bonds currently in OFE portfolios would be transferred to ZUS at their value on 31 December 2012, and then redeemed.

These account for around half the funds' portfolios, which at July 31 totalled €66.5bn.

The OFEs would no longer be able to invest in these securities, although they could still buy municipal bonds.

The government estimates this would reduce the public debt's share of GDP by some 8 percentage points.

Following changes in investment legislation, OFE’s could invest up to 100% of their assets in shares.

The government also proposes to abolish the minimum return benchmark. Other investment changes include allowing OFEs to lend stock and use derivatives.

The prime minister stressed that there would be no transfer or nationalisation of what assets remained in the portfolios, but, as he added, the government does not want to take on stock market risk.

Contributions to OFEs would be set at 2.92% of gross wages. The original contribution of 7% was cut to 2.3% in 2011 to contain a rising budget deficit and debt. It rose to 2.8% in 2013 and was set to increase to 3.5% by 2017.

Additionally, the government intends to halve administrative and other costs generated by both ZUS and the OFEs.

The Polish Chamber of Pension Funds (IGTE), in its initial response, described the proposals as "deeply disillusioning". It pointed out that the government, having taken no account of legal, economic or other specialist advice on alternative solutions to the problems inherent in the overall pensions system, proposed changes that would undermine the capital base of compulsory retirement savings, to the cost of all future pensioners.

It challenged the Finance, and Labour and Social Policy ministries to publicise the evidence for their assertions that diverting social security contributions to second pillar funds over the last 13 years had resulted in lower retirement pensions.

[13] http://www.ipe.com/polish-securities-sector-comes-out-swinging-against-pension-reform-plan/55959.article

The Chamber also disagreed with the government's belief that its proposal would result in a more secure retirement system. On the contrary, it said forcing OFE's to invest almost exclusively in stocks would increase their risks and prevent them from protecting the assets' capital value during economic downturns.

It questioned the constitutional legality of the proposal to take over OFE's state bond holdings. It says this plan amounted to nationalisation of assets privately owned by the pension funds. In July it warned it would refer the reform plans to Poland's Constitutional Tribunal but as yet no decision in this has been taken.

The government's schedule is to have the proposals enshrined in law by the end of this year and in operation by mid-2014[14].

10 September, 2013. Concern over Poland's proposed changes to its privately funded pillar II pension system has spread beyond its borders, according to Matti Leppälä, secretary general and chief executive at PensionsEurope.

Leppälä told IPE of his fears that other governments might follow suit and take over the assets of their pillar II pensions to fix their short-term fiscal problems.

"The major concern is that, if Poland, as the biggest economy in the region, goes ahead with such drastic changes, it could impact, in the long run, the future of privately funded workplace pensions," he said. "Other governments might see this as a tempting option."

Many Central and Eastern European (CEE) countries adopted pillar II pensions to address demographic challenges and, in the long term, reduce pressure on the publicly financed pillar I.

"Poland, even more than many other countries, was relying on the change from a publicly funded system to a privately funded one," Leppälä said. "The building up of funded pension provision is a key element of European pensions policy, which has been adopted for more than a decade, because we know pillar I will not be adequate or sustainable, while purely private pensions savings are too costly and fail to cover enough of the population."

He was also highly critical of the government's proposal to remove the pension funds' Polish sovereign bond assets, effectively restricting them largely to equity investment. "A good pension fund needs a well-diversified portfolio in various asset classes," he said. "Forcing pension funds to take too much risk will lead to sub-optimal returns, or at least very high hedging costs."

PensionsEurope wrote to the European Commission just before the Polish government announced its reforms to express its concerns. It now intends to use its voice to lobby the Commission, the European Parliament and other bodies. "European pensions policy and strategy over the decade, culminating in the White Paper adopted last year, has been based on funded occupational and supplementary pensions," he said.

"Following Poland's changes and Hungary's earlier and more drastic measures, the future would look like we don't have funded occupational pensions for millions of European citizens. "The outlook for providing sustainable public pensions looks very bad. We are then risking the sustainability of public finances and introducing massive old-age poverty, which would be destabilising for many of these countries."

Poland, in Leppälä's belief, is unlikely to have broken any EU laws, as social policy is part of the competence of individual member states. However, employment and economic policies are both subject to EU legislation. "The EU

[14] http://www.ipe.com/polish-government-aims-to-shrink-second-pillar-pension-assets/56673.article

can recommend what is good or best practice," he said. "What Poland is proposing looks like bad practice."

In addition, the Commission's own strict economic governance criteria – such as keeping the general government deficit to within 3% of GDP – have not generally taken account of the budgetary costs for countries introducing second pillars funded from social taxes. In one notable exception in May (2013), the Commission abrogated its excessive deficit procedure for Lithuania after correcting for the net costs of its systemic pensions reform. This exercise cut the country's 2012 deficit by 0.2 percentage points to 3%. The same leeway was not extended to Poland[15].

The Polish government's proposed reform of its second-pillar pensions system, resulting in the transfer of all state and state-guaranteed bonds in pension fund (OFE) portfolios to the ZUS and making the mandatory system voluntary, unnerved the markets amid widespread criticism from home and abroad.

On 4 September, following the government's announcement, the Warsaw Stock Exchange's WIG20 index experienced one of its worst sell-offs since September 2011. The worst affected were companies with a large OFE shareholding and banks because of their heavy investments in government bonds.

"Market unfriendly" is how Benoît Anne, head of global emerging markets strategy at Société Générale, described the reforms. "The government's decision is disappointing for the market and has undermined investor confidence," he wrote. "It will negatively affect liquidity on the bond market and make it even more dependent on foreign investors, whose share on the debt market will rise in line with the cancellation of domestic-held bonds. It may have an adverse effect on the equity market as well, as a significant share of citizens may be willing to leave the OFE system."

While the government's bond transfer proposals aimed to reduce the country's debt and budget deficit, the credit rating agencies have remained neutral. Fitch Ratings, which in August revised the outlook on Poland's A rating from 'positive' to 'stable', said: "The initial favourable impact on the headline public debt ratio may be offset by the reduction in the stock of assets to meet future pension provisions and a consequent increase in long-term state liabilities."

Moody's wrote that, under EU accounting rules, the bond transfers would reduce the general government gross debt by approximately 7.9% of GDP to 49.9% in 2013, against its earlier forecast of 57.3%, while the general government financial balance would move from a forecast deficit of 4.4% of GDP to a surplus of 3%.

In its subsequent Credit Outlook, it described the changes as 'credit negative' for Poland's insurers – the bulk of pension fund companies accumulating pension assets– with a reduction in assets resulting in lower management fees and profitability, while freezing the contribution rate at 2.92% would significantly limit their ability to generate new business. Moody's expects the insurers to offset this loss by directing their customers to voluntary savings accounts and life insurance.

Wiesław Rozłucki, chairman of the Warsaw Stock Exchange's supervisory board, told IPE that the impact of the pension changes would be detrimental to the exchange and other Warsaw markets. "Future inflows of investible funds will be reduced, which will affect primary markets such as IPOs, and secondary markets," He stressed that OFEs, as buy-and-hold investors, engage

[15] http://www.ipe.com/pensionseurope-warns-of-contagion-after-polish-raid/56876.article

in less trading activity than mutual funds, retail and foreign institutional investors, and that their stock market role should not be exaggerated. Nevertheless, their investment activity does influence that of other investors. "Pension funds will be more volatile, which will discourage investors," he says. In the longer term, he adds, another financial crisis will temporarily push down the value of the pension funds' largely equity holdings. "Their clients will demand a return to the state pension fund," he warns. Rozłucki stresses that, although he is a supporter of the present government, this is not one of its best policies, and could have been better handled, while previous governments did nothing to reduce what he describes as the "excessive" charges levied by the funds, and which subsequently contributed to the OFEs' demonisation by the government and sections of the press.

With the possibility of Pillar II system being voluntary, the OFEs will have an uphill struggle convincing existing members to remain in the second pillar and future workers to join. For existing members, 85% of their pension contribution already goes to ZUS – whose future payments will be conditioned by the declining ratio of workers to pensioners – so the decision centres on whether the remainder can gain a better return invested in largely equity-weighted OFEs.

The government, by making ZUS the default option, has skewed the choice to push workers out of OFEs. As Rozłucki notes, most people, when confronted with such complex questions, will avoid having to make a decision. "My personal opinion is that the status quo should be the default position. The government thinks 50% will opt for ZUS. My guess is that 90% will not respond, and their future contributions will be automatically transferred to ZUS."[16]

14 October 2013. The Polish government has finally published the draft bill radically changing the pillar II pension system. The bill, issued late on 10 October, puts in place essentially all the proposals announced in September, alongside punitive restrictions on advertising by OFEs and some proposed changes to the third pillar.

The bill is now out for a 30-day public consultation.

Its publication marks a U-turn from 1999, when establishing pillar II was seen as a way to provide higher retirement income while eventually reducing the pension and public deficit, to a position where the system has ostensibly done the opposite.

The draft bill states that the costs associated with the OFEs had, according to the Finance Ministry, ballooned to PLN279.4bn (€66.7bn) by the end of 2012 equivalent to 17.5% of GDP and more than 30% of the country's public debt.

The Finance Ministry estimated that the change will in 2014 reduce public debt by 8.4% of GDP according to national accounting standards and by 9.2% by EU methodology. As expected, ZUS will handle the OFE retirement payouts, with the accumulated funds transferred incrementally 10 years before retirement.

Controversial investment changes are also in place. All Polish sovereign and state guaranteed bond holdings, including central bank issues, will be transferred from the OFEs on 3 February 2014. The draft law actually stipulates 51.5% of portfolio value on 3 September 2013 – the day before the government officially announced the changes – so the funds that cannot satisfy this quota with state bonds will have to make up the difference with other non-equity assets such as cash and bank deposits, road and municipal bonds.

[16] http://www.ipe.com/analysis/analysis/polish-reform-bid-upsets-markets/10000129.article

Earlier, the Polish Chamber of Pension Funds which disputed the legality of both the asset transfer to ZUS before retirement and the removal of government securities, sought the European Commission's opinion.

Małgorzata Rusewicz, IGTE acting president, told IPE: "We still emphasise that proposed changes raise serious legal doubts. "In accordance with legal regulations valid in Poland, the OFEs have the right to invest the assets of their members until the insured retire. Therefore, the transfer of assets from an OFE to ZUS, even if it concerns only a part of them, as in the case of bonds, constitutes appropriation of the assets that are the property of the OFE and its members by a public institution without compensation. The assets accumulated on behalf of the insured will cease to be private property – they will become public property and will be consumed by the state."

It is expected that in future, OFEs will be banned from investing in any state securities, not just Polish ones, as well as state-guaranteed loans, deposits and related instruments. As part of what the government has consistently called "real economy" investment, they will be allowed to invest, for instance, in Polish road and other infrastructure bonds, corporate and municipal issues.

As of 4 February 2014, the OFEs will have to invest a minimum 75% in equity, irrespective of their members' age and risk appetite. "Forcing a pension fund to invest a minimum 75% exclusively in shares will significantly increase the risk of such transactions and make it impossible to manage in a manner beneficial for the insured," said IGTE. "It will make it impossible to protect the real value of those assets in periods of a slump in the economy. Until now, such solution has never been used in pension funds anywhere." Other investment restrictions will be lifted as of 1 July 2014, including abolishing the minimum investment return benchmark.

The foreign investment cap of 5% will be raised to 10%, then 20% in 2015 and 30% in 2016.

The OFEs will be able to lend stock, a practice previously prohibited, while a separate law will specify in what circumstance they will be able to use derivatives, also banned up till now. Contribution fees will be halved, to 1.75% for the OFEs and 0.4% for ZUS, and the contributions to the OFEs capped at 2.92% of gross wages.

New entrants to the labour market and existing OFE members will have a three-month window from 1 April to declare their intention to remain in pillar II or have future contributions transferred to ZUS. They can make this choice in person, by post or online. Those who do not will by default have their future contributions moved to ZUS. Workers will be able to change their decision, with the April-June window open in the first instance after two years, then every four years.

This is effectively the only concession the government has made since its proposals were announced in September. Previously, the freedom to change one's mind was to be restricted to those workers who had opted to remain in the second pillar. OFE members will be able to change their fund every three months, although it is not clear how they will make their decision, as the government also dropped a bombshell by making the publication and distribution of OFE advertising a criminal offence subject to a penalty of PLN1m or up to two years in prison.

"We are surprised with additional change, according to which there will be no possibility to advertise OFEs in any way," said IGTE.   "We honestly don't know at the moment how to interpret these rules. We don't know, for example, if the IGTE would be able to organise any informational campaign regarding

OFEs. "It would be a phenomenon for the whole EU if such a rule would be adopted by the Polish Parliament."

The draft also covers changes in the third-pillar IKZE retirement accounts introduced in 2011 to improve the take-up, including increasing the limit on tax-free contributions and reducing the tax on payouts to 10%.[17]

29 October 2013. The list of Polish state institutions criticising the government's proposed pillar II overhaul gets longer by the day.

The Attorney General's Office has described the plan to transfer all sovereign, state guaranteed and central bank assets from OFEs to ZUS as a "classic expropriation" and unconstitutional.

The Office, while representing the State Treasury's legal interests, is an independent body. It believes the OFEs, as legal persons, are the owners of the accumulated contributions, with that ownership guaranteed by the Polish Constitution. To date, the pensions industry has claimed the monies belong to the members, while the government insists they are state property.

The Office also highlighted an inconsistency in the non-governmental securities the funds would be allowed to buy. These include bonds issued by Bank Gospodarstwa Krajowego (BGK), which channels most of the EU funding granted to Poland and finances large infrastructure projects. The OFEs have in the past been the biggest purchasers of BGK road bonds. As the Office points out, BGK is a state-owned bank and thus part of the Polish Treasury.

The Polish Statistics Office (GUS) has noted that, under new Eurostat accounting methodology (ESA 2010), which comes into effect in on 1 September 2014, the state bond transfer would not affect the ratios of government deficit and public debt to GDP undermining the Finance Ministry's argument that the main purpose of the reform is to improve public finances.

The Justice Ministry has warned that the timetable envisaged in the draft bill between the publication of the law and its enactment is too short, while both the central bank and the Insurance Ombudsman have concerns about the impact of a ban on state bond investment on future pension returns.

The prime minister's Chancellery has questioned why the penalties envisaged under the proposed OFE advertising ban – a fine of PLN1m (€234,000) and up to two years' imprisonment – are so much more punitive than those imposed on other banned advertisements, notably tobacco.

Given the proposed ban on investment objects, the Polish Chamber of Pension Funds and the Polish private sector employers' confederation, plan a joint mass media campaign between November and mid-December 2013.

They have some ground to make up. According to a recent study by the Kronenberg Foundation and Citi Handlowy bank, only 13% wanted OFEs to continue investing their social security contributions (Pillar II), while 51% want to hand the full amount of their contributions to ZUS.

Poland's decision to appropriate its second-pillar pension assets to fix its public finances has inevitably started to raise questions in the region.[18]

In a further article in October 2013,IPE staff analysed the current system in Poland and provided the following assessment. The concluded:-

Managers of Polish pension funds (OFEs) can at least be grateful that their industry has not been entirely nationalised following the proposals in early

[17] http://www.ipe.com/poland-places-further-restrictions-on-second-pillar-pension-funds/10000170.article
[18] http://www.ipe.com/polands-second-pillar-pensions-overhaul-classic-form-of-expropriation-attorney-general/10000288.article

September to end mandatory participation in the second-pillar system and to transfer domestic government bond holdings to the government. Of the OFEs' total €66.5bn investment portfolios, around half is invested in fixed income of all types.

The World Bank's three-pillar pension model was adopted by Poland and some of its Central and Eastern European neighbours in the 1990s and 2000s. But since the financial crisis there has been a fundamental tension between the WB model and EU accounting rules. Pension assets in countries that built up a funded second pillar have not sat on the government balance sheet since they are formally in private hands. Recent budgetary pressures have made a partial or wholesale dismantling of the pillar II systems almost inevitable. At a stroke, the aforementioned proposals of Poland's government will reduce public debt and improve the fiscal deficit.

But there are several areas of concern. First is the liquidity effect OFE's withdrawing as private holders and traders of Polish government debt. While there is an inescapable rationale in favour of using OFEs government debt assets to reduce overall debt levels and the fiscal deficit, it would have been preferable to use the assets to create one (or more) buffer funds to finance long-term pension liabilities.

A wholesale liquidation of government debt portfolios of private pension funds would have had a much more serious effect on the liquidity of Polish equity markets, even if a wind-down were carefully managed over a long period, not to mention on Polish corporates' ability to raise long-term capital.

But an IMF report of July still predicts liquidity issues in the domestic equity and government debt markets, even without a wholesale withdrawal of pension fund capital.

The second concern is the effect on Polish citizens in the short and long term. Anyone remaining in the old system will be a holder of an equity growth portfolio and it is untenable that they should not be permitted to diversify into government debt.

Third, is the business rationale for the existence of the OFEs, many of them owned by foreign insurers, who moved into the market in good faith early in the last decade. They have endured much uncertainty, and further consolidation is inevitable.

Fourth, is the effect such proposals by Poland will have on other countries in the region. The partial dismantlement of the largest funded pillar II system in the CEE region sets a precedent for the fate of other similar systems.

Regardless of the politics and the incompatibility of the World Bank system with European norms, the World Bank model was, in itself, prudent in that it enabled the gradual build-up of significant assets to fund long-term pension liabilities.

The OFEs, until now among the region's foremost institutional investors, smoothed Poland's path through the recent economic turmoil as providers of liquidity to government and private enterprises. As long-term shareholders, the OFEs have also influenced corporate governance for the better and for the wider benefit of all shareholders.

Unfortunately, Poland's proposal is merely the latest in a series of attacks on pillar II systems in CEE, and should be set in the context of nationalisations of pension assets and the drawdown of buffer funds in countries across the European Union. Poland's government would now do well to promote its (currently little used) workplace saving vehicle. International bodies, not least the EU, should continue to promote supplementary pension saving and long-term investment.[19]

Poland's Pension System is composed of three pillars.– For older people a PAYG pillar I benefit. For younger people a notional defined contribution pillar I benefit plus a compulsory pillar II benefit based on contributions remitted to private pension funds (OFE's). Pillar III a system of contributions (mainly) by individuals to private pension funds

PILLAR II

Lithuania

In early October, Stasys Jakeliūnas, financial affairs adviser to the Lithuanian prime minister Algirdas Butkevičius, called for a suspension of contributions to the voluntary pillar II as of January 2014. He argued that the system was making the financial position of SoDra, the social insurance fund responsible for the first pillar and other benefits, increasingly unstable.

He has been backed by some other members of the Social Democratic Party – the largest in the ruling four-party centre-left coalition that took power following the October 2012 election – including Algirdas Sysas, deputy speaker of the Seimas (Parliament), who has also hinted at nationalising pillar II.

In November 2012, the new Parliament voted in the previous government's pension reform. This raised the members' second-pillar contribution from 1.5% to 2.5% in 2013. In 2014, members can make an additional contribution of 1%, matched by a state contribution of 1% of the national average wage. In 2016-19, the additional member and state contributions rise to 2%.

In line with Jakeliūnas' proposal, workers who joined the voluntary second pillar in 2013 have to make the additional contribution, while existing members have until 30 November to decide whether to pay extra, leave the system altogether or continue paying only the base contribution, which falls to 2% in 2014-19. Those who fail to declare their intention remain in the second pillar under the old terms.

Given the November deadline, Jakeliūnas's timing was unfortunate. Marijus Kalesinskas, chairman of the board of the Lithuanian Pension Fund Members' Association, said: "I guess his intention was good to stimulate a debate on how to further improve the pension system, but it came out at a wrong time and in a wrong context. Some long-term critics of pillar II were quick to support his proposal and to further suggest nationalisation of the assets. That increases the confusion among those pension savers who need to make up their mind at the moment and among quite a few of those who already have. People are left with a sense of insecurity, not knowing what further to expect from the government and the politicians."

Fortunately for pillar II supporters, the prime minister has not opened up a debate on the subject, and neither SoDra's nor the state draft 2014 budgets currently before Parliament assume any changes.

Lithuania's public finances are in somewhat better shape than in Poland, which used the size of its deficit and public debt to shrink the second pillar drastically. In Lithuania's case, the key policy objective has been to get this year's budget deficit to within 3% of GDP to qualify for euro membership in 2015.

According to Kalesinskas, suspending pillar II contributions in 2013 would have decreased the budget deficit by only LTL500m (€145m) and by LTL500m-600m

[19] http://www.ipe.com/analysis/analysis/polish-reform-a-lot-not-to-like/10000125.article

the following year. "That would hardly be decisive for the 3% Maastricht criteria," he said.[20]

Lithuania's pension system – pillar I is a PAYG scheme based on a flat amount plus a further amount related to years of service, actual wage and national income. Pillar II is a voluntary scheme of contributions directed to private pension funds whilst pillar III is a system of voluntary employer and/or employee contributions to private pension funds.

PILLAR I

France

On 15 October 2013, French MPs voted on October 15 on the country's new pension reform, which seeks to further extend the length of contributions, increase social contributions and introduce special accounts for "hardship conditions" at work.

The new reform – part of president François Hollande's plan to tackle the budget deficit, which could reach up to €20.7bn by 2020, is to be adopted by the Chamber of Deputies today before the pension act is sent to the Senate for final approval.

Last week, a minority of deputies already pre-approved the measures announced by the government.

Among the measures agreed, one aims to extend the length of contributions from the current 41.5 years to 43 years by 2035. Additionally, employers and employees will see their social contributions increase over the next four years – by 0.15 percentage points in 2014 and 0.05 percentage points in 2015, 2016 and 2017 – to reach an overall increase of 0.3 percentage points by 2017.

The government will also ask companies to finance special accounts for "hardship conditions" at work.

Hollande's government announced a new set of measures to reform the French first-pillar pension system at the end of August, after it received a report from a pensions advisory panel. It convened the panel after a report from the pension steering committee, the Conseil d'Orientation des Retraites (COR), argued in December last year that the previous pension reform introduced in 2010 would fail to tackle France's deficit by 2018, as previously expected.

In its final report sent to the government in June, the pensions advisory panel recommended a further increase in the period of contributions, tax rises for pensioners and an increase in the level of contributions. Additionally, it recommended a limit on the indexation of pensions, which would lead the most wealthy retirees, already paying as much as 6.8% of general social contribution (CSG) in tax, see their pensions fall by 1% compared with inflation. The CSG, introduced in 1990, aims to fund health insurance family benefits and the Retirement Solidarity Fund (FSV).

In May, the European Commission called on France to introduce pension reform after granting the country a further reprieve in correcting its "excessive" budget deficit. At the time, it said: "New policy measures are urgently needed to remedy this situation while preserving the adequacy of the system."

According to Brussels, such measures could include a further increase in the minimum and the full-pension retirement ages, as well as the contribution period, to obtain a full pension. Additionally, France could adapt indexation rules and review the currently "numerous exemptions" to the general scheme for specific categories of workers. However, the Commission warned against

[20] http://www.ipe.com/polish-actions-embolden-second-pillar-pension-critics-in-lithuania/10000194.article

increasing the level of social security contributions, given its negative impact on the cost of labour.

After further consideration, the French government decided to ignore all the recommendations made by Brussels.[21]

October 16, 2013. France's lower house of parliament narrowly passed a reform intended by President Francois Hollande to bolster the finances of the country's indebted pension system on under pressure from the European Union.

The bill is one of the flagship pieces of legislation of Hollande's presidency and has been criticized by some for not being ambitious enough and by others for unfairly hitting low-income workers. It must still be examined by the upper house but is unlikely to be modified before it enters law books.

Hollande took a careful approach to the reform, opting to adapt the current system by raising the level and duration of pension contributions rather than attempt a politically risky increase in the current statutory retirement age of 60.

His softly-softly approach has staved off a repeat of huge street protests against earlier reforms by his predecessor Nicolas Sarkozy in 2010. Rallies on Tuesday gathered only hundreds in major cities - an even smaller turnout than for a previous round of protests on September 10.

But the modest overhaul has yet to convince the European Union's executive arm, which is pressing France to cut its overall public deficit and to overhaul its economy, that he has gone far enough to fix the system durably.

The reform aims to fill a hole in pension coffers due to reach 20 billion euros ($27 billion) in 2020 if nothing is done. It will raise contributions slightly for both firms and workers.

The EU's Economic and Monetary Affairs Commissioner asked France last month to prove the reform would not add to already high French labor costs. The government said it would offset the increase in employer contributions by lowering the amount they pay for family benefits.

Thierry Lepaon, head of the CGT union, called the reform "unfair" because it penalizes younger workers. "Not only are they going to work for longer, not only are they going to pay for years and years, but in general this means 5 to 6 years of additional contributions from one generation to the next," Lepaon told a Paris rally.[22]

France's pension system – Pillar I – a compulsory contribution based PAYG scheme. Pillar II a near to compulsory system of employer and employee contributions to occupational pension funds. Pillar III a system of voluntary contributions to private pension funds by individuals

PILLAR II

Russia

9 October 2013. Russian ministries have finally unveiled a range of changes to the accumulation portion of the retirement pension. The contribution rate is expected to be slashed once again.

Until now, workers born on or after 1 January 1967 have had 6% their of gross salary paid to either a non-state pension fund (NSPF), the fund run by the state-owned Vnesheconombank (VEB) (PFR) but administered by private asset managers.

[21] http://www.ipe.com/frances-chamber-of-deputies-set-to-embrace-pensions-reform/10000195.article
[22] http://www.reuters.com/article/2013/10/15/us-france-pensions-idUSBRE99E0L420131015

The VEB fund is also the default option for those failing to choose an NSPF or asset manager themselves.

As of the end of June, the VEB managed RUB1.7trn (€39.2bn), the NSPFs RUB887.6bn and the asset managers 34.3bn.

A law in December 2012[23], due to take effect at the start of 2014, cut the default contributions to 2%, with the remaining 4% moving to the insurance component. This law is now to be scrapped, with the default contribution in favor of such workers proposed to reduce to 0% based on passive investors having no interest in a funded system – although the decision deadline has been extended from the end of 2013 to 2015.

It has also been proposed to restrict the opportunity for workers to change their retirement fund from once every year to every five years. More controversially, it is proposed that all pillar II contributions in 2014 – some RUB244bn – will be frozen.

Vladimir Potapov, chief executive and global head of portfolio management at VTB Capital Investment Management, said: "The money will be retained by the state pension fund, and, judging by the finance minister's recent statement, is supposed to become a sort of an air bag that will be activated in case an emergency in the national economy occurs. But it is not certain at the moment. The retained saving can also be spent for social projects or can reduce the state transfer to the state pension fund budget in 2014."

Russia's economy, heavily dependent on oil and gas revenues, has slowed alarmingly. According to the World Bank, this year's GDP growth is expected to fall to 1.8%, the slowest rate since the 2009 recession. This, in turn, has put pressure on government revenues, with the consolidated budget set to fall to a deficit.

PILLAR III

Meanwhile, all the NSPFs will have to convert from their existing status as non-profit organisations to joint-stock companies. The non-profit status lacked ownership transparency and was prone to many abuses including a major mis-selling scandal, and clients transferred on the basis of falsified documentation some 18 months ago. In May, Russia's Audit Chamber launched an audit into the performance of the NSPFs over the previous 10 years to calculate the profits they generated for their clients in relation to inflation, as well as uncover any illegal activities.

For some NSPFs, the conversion will be complicated. "For aggregated reporting of holdings, which will incorporate pension funds, it's quite probable that, instead of a big non-state pension fund specialised both in work with pension reserves and pension savings, we will see two funds," Potapov said. "One of them will be a joint-stock company, and the other one will stay as a non-commercial organisation and resume its work with pension reserves."

He sees the 100-odd private pesion funds shrinking in number to 40-80, with the larger ones acquiring the weaker ones, along with their clients.

The converted NSPFs, along with the VEB fund, will switch to IFRS accounting standards and require licensing by Russia's central bank, which, as of the start of September, took over pensions and other financial market regulations from the Federal Financial Markets Service.

While many NSPFs will have to leave the market, in principle, the change in their legal status is welcomed. Alexander Lorenz, chairman of the council at

[23] The Federal law 243-FZ of 12/3/2012 "On amendments to certain legislative acts of the Russian Federation on mandatory pension insurance"

Raiffeisen Pension Fund in Moscow, said: “We have been advocating for some time that this will be a good development. But do we need a freeze in contributions with all the negative repercussions for the local capital market?”

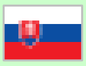
While president Vladimir Putin, who has the final say on these laws, has explicitly ruled out any ultimate confiscation of contributions, this freeze – alongside the uncertainty about whether they will be returned, and, if so, with any interest – will create untold headaches for the pension funds’ business models.

As Lorenz told IPE, in the case of pensions contracts signed in 2013 for next year, the funds will for now not receive any assets for the distribution costs they have already incurred, and no-one knows as yet whether the funds, pending central bank licensing, will be able to sign new contracts in 2014.

Under another new law, the newly licensed companies would be expected to sign up to a new guarantee scheme similar to Russia’s bank deposit insurance programme. “It would alleviate some issues that have been hampering us for some time, such as having to provide long-term principal guarantees, that would allow us to invest long term,” said Lorenz. The flip side is that the scheme would inevitably create additional bureaucracy and costs. Lorenz was hoping for a general overhaul of the current pillar II fee structure – 15% of investment income – to one that also factors in contribution levels and assets under management.[24]

Russia’s pension provision system “Retirement pension” consists of three parts: the first part is a fixed base pension benefit; the second part is an insurance component with nominal accumulation individual accounts, and the third part is a mandatory defined contribution accumulation portion of the retirement pension. The mandatory accumulation scheme portion of the retirement pension is where employers pay contributions in favor of their employees and its participants are free to choose one of several options: (1) permit the State to accumulate their pension savings under the control of the public pension fund (the Russian Federation (RF) Pension Fund), with pension assets being managed by Vnesheconombank (VEB) as a State-owned asset manager; (2) transfer mandatory contributions from the RF Pension Fund to a private pension fund; or become a participant of the voluntary accumulation pension system where employer and/or employee contribute to private pension funds, the largest of which are corporate pension funds.

PILLAR III



Slovakia

Slovakia is aiming to boost its third-pillar pension system by reinstating part of the annual tax relief abolished at the start of 2011 as part of the government’s austerity drive.

On 13 September 2013, Parliament approved a series of amendments to the system, including the introduction of an annual tax relief of €180. Although the tax relief is small – in 2010, it was close to €400 – Juraj Dlhopolček, executive director for pensions at ING Slovakia, believes it will have an impact on retirement savings in the long run, as the third pillar would be the only private savings vehicle attracting tax relief.

According to data from the Association of Supplementary Pension Companies, the third-pillar industry association, assets as of 6 September totalled €1.3bn.

The earlier removal of the tax concession, according to ING, reduced the interest of younger workers – the average age of pillar III members is a relatively high 48 years.

[24] http://www.ipe.com/confusion-reigns-as-russia-shakes-up-second-pillar-system/10000115.article

The new law also removes the minimum 10 years' saving period but toughens the conditions for early withdrawal. Under the existing regime, savers could withdraw both theirs and their employers' contributions at any time, with a 20% penalty. As of January 2014, new plan members will only be able to withdraw their own contributions prior to retirement, and only once every 10 years, while the age at which members can draw on third-pillar pensions has been raised from 55 years to the state pension retirement age of 62.

"People are not using pillar III as something exclusively for retirement but to finance, say, travel or Christmas presents," said Dlhopolček, adding that both the pensions industry and government needed to educate the members.

Management fees, which were reduced incrementally as of 2010 down to 2.34% in 2013, face another sharp cut – to 1.8% as of start of 2014, with annual cuts of 10 basis points to 1.2%.

"It's a massive shock therapy for us," Dlhopolček said. "We need assets to grow but don't expect it in the short to medium term because members in the old system will still be withdrawing."

The industry will now have to look at campaigns to attract members, and at reducing expenses by, for instance, by replacing paper statements with electronic ones, although only 10% of members have so far consented to this.

PILLAR II

While prime minister Robert Fico's centre-left government is now trying to boost voluntary savings, it has been less well disposed to the mandatory accumulation second pillar. This sector is still recovering from a large loss of members from the third opening – allowing members to return exclusively towards the state system – that ended this January. Asset inflows have slowed after last year's cut in the contribution rate – from 9% to 4% – and while members could make additional contributions, few have done so.

Another change in the law concerned the risk profile of the funds offered by the pension companies. Alongside an obligatory guaranteed return fund, the companies could offer plans with investments in higher-risk instruments such as equities and indexed-linked products. By the end of March (2013), all members had to confirm their intention of remaining in a higher-risk fund or be automatically transferred to a mandatory guaranteed one, where, by default, most have ended up.

At of the end of 2012, balanced, equity and indexed funds accounted for more than 85% of the net asset value of second-pillar funds. As of 6 September 2013, according to data from the Association of Pension Fund Management Companies (ADSS), the total net asset value of the guaranteed funds stood at €5bn, compared with €538m in non-guaranteed structures, even though the latter are generating far better returns.

The current legislative thrust centres on a payout system in time for the first main block of retirees, in 2015. The problem for these retirees, who have only been in pillar II for 10 years is that their savings will generate minimal annuity payments. "What's dangerous for us is the type of discussion this will generate," Dlhopolček said. "The government could use this to open up the second pillar again, and we will have a massive outflow."[25]

Slovakia's pension system – pillar I is a PAYG system of compulsory contributions. Pillar II is a voluntary system of pension accumulation system in private pension funds whilst pillar III is a system of voluntary contributions made by employers and/or employees into private pension funds.

[25] http://www.ipe.com/slovakia-reintroduces-tax-advantages-for-third-pillar/10000009.article

PILLAR II

PILLAR III

Estonia

KredEx, Estonia's state-owned credit and export guarantee agency, has said it hopes to create greater opportunities for local pillar II and pillar III pension funds to invest in the domestic economy through the launch of several venture capital fund of funds aimed at start-up companies.

The €80m fund of funds would invest into four separate sub-funds, each targeting companies at different stages of development, KredEx said. It explained that the funds would consist of a seed capital fund for start-ups and early stage companies, an angel fund, and two venture capital funds for later stage early growth companies.

It added that the vehicles would seek investment from local pension funds, but also offer what it hoped would be seen as attractive investment opportunities for foreign investors.

Andrus Treier, chief executive, KredEx told IPE: "Estonian pension funds haven't been actively investing in their local economy. Only 6% of their total assets are invested in Estonia. So the hope is to create more opportunities for them to do so. But we won't exclude big international investors, although we don't expect much interest, because the amounts involved will not be very big."

Most of the €55m in capital will be provided by European Union structural funds, but the Estonian state would also make a contributions. Matching investment would then be sought from institutional investors, directly into each sub-fund, to bring the total investment to around €80m.

"In Estonia, we already have a private equity fund of funds investing in more mature later stage companies," Treier said, noting the existing Baltic Innovation Fund, a joint fund with Latvia, Lithuania and the European Investment Fund (EIF) managed by EIF. "However, there is no fund to help start-ups and other early-stage companies."

The seed capital fund is expected to be the smallest, at around €15m. It will be 90% funded by the state, with private investors contributing 10%. The two venture capital funds would have €20-€30m each to invest, and along with the angel fund, would be 30% privately funded.

However, Treier said that if there is interest from investors, the private component could be bigger.

The two venture capital funds had been planned to compete with other, giving better investment opportunities for target companies.

The new fund would invest primarily in Estonian companies. But if such an approach offered too restricted a universe, the fund could seek out investments in neighbouring countries[26].

Estonia's pension system – Pillar I is a universal he PAYG defined benefit scheme with a flat rate national pension and an earnings-related full pension scheme. Pillar II is a mandatory accumulation scheme with contributions invested by private asset management companies. Pillar III is a system of voluntary contributions by employers and/or employees to corporate or open pension funds.

[26] http://www.ipe.com/estonian-schemes-offered-domestic-opportunities-through-venture-capital-fund/56186.article

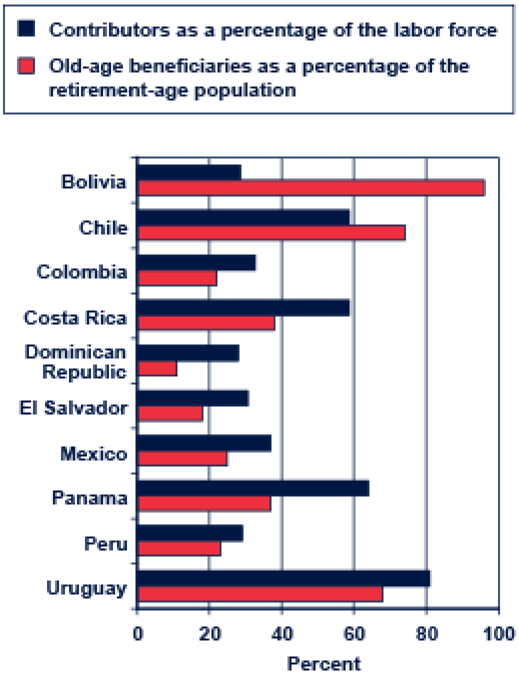
A CASE STUDY - SOCIAL PENSIONS AND SUBSIDIZED BENEFITS IN LATIN AMERICA

Improving pension coverage remains a major challenge for most Latin American countries, regardless of what type of pension program they have. A major reason for the low rate of coverage in the region is the size of the informal labor force; in general, workers in the informal sector do not contribute to social security. In addition, workers who switch between the formal and informal sectors may have some contributions, but not enough to qualify for a minimum benefit. Because of low rates of coverage, countries in the region have introduced social pensions for the most vulnerable groups of people who do not qualify for any other type of benefit and have added subsidies (often called guaranteed minimum benefits) for workers whose self-financed pension is below a certain threshold. This article focuses on the 10 Latin American countries with some form of individual account program: Bolivia, Chile, Colombia, Costa Rica, the Dominican Republic, El Salvador, Mexico, Panama, Peru, and Uruguay. Among the 10 countries—

- Bolivia, Chile, El Salvador, and Mexico have first-pillar individual accounts as well;
- Colombia and Peru offer a choice between individual accounts and the public pay-as-you-go (PAYG) pension program;
- Costa Rica, Panama, and Uruguay have mixed systems—a first-pillar PAYG program and second-pillar individual accounts. In Panama and Uruguay, individual accounts are mandatory only for higher earners.

Pension experts divide coverage into two phases: (1) the period of time an active worker contributes to social security acquiring a right to receive a benefit in the future and (2) the period of time that receiving benefits. The accompanying chart presents ILO data on the rates of coverage, both in terms of contributors as a percentage of the labor force and old-age beneficiaries as a percentage of the retirement-age population for the 2009–2012 period. In the chart, the percentage of the labor force that is covered by social security includes workers that regularly contribute to either the individual account or the public program, depending on the type of system present in the country. Benefits for retirement-age adults are either contributory or noncontributory.

Pension coverage in selected Latin American countries, 2009–2012



SOURCE: "El Rol de los Pisos de Protección Social en los Sistemas Integrales de Seguridad Social en América Latina y el Caribe (Documento Borrador para su Discusión)," Organización Internacional del Trabajo, Seminario Regional, el 26 y 27 de agosto de 2013.

The labor force coverage rate ranges from 28% in the Dominican Republic to 81% in Uruguay, and the rate for the retirement-age population ranges from more than 10% in the Dominican Republic to about 96% in

Bolivia. In addition, the difference between the two phases of coverage in each of the countries in the region with some form of individual account system is the largest in Bolivia and the smallest in Peru.

All 10 countries provide some type of noncontributory or social pension (the terms are often used interchangeably) to needy adults who do not qualify for any other type of retirement benefit (Table 1). All of the noncontributory programs provide old-age benefits, of which three provide old-age and disability benefits (Chile, Costa Rica, and Uruguay), and one (El Salvador) provides old-age, disability, and survivors benefits. From July 2013 the Dominican Republic is also offering all three types of benefits. Recently, the Mexican president introduced a pension reform bill to Congress that would set up a universal noncontributory old-age benefit.

Table 1. Characteristics of noncontributory (or social pension) programs in selected Latin American countries

Country (year started) [a]	Name of program	Age of eligibility	Source of funding			
			General revenue	Earmarked taxes	Separate fund	Other
Bolivia (1996, 2008)	Dignified Income	60	X	X	X	X
Chile (1991, 2008)	Solidarity Pensions	65			X	X
Colombia (2003)	Older Colombia	57 (men), 52 (women) [b]	X		X	
Costa Rica (1974)	RNC -noncontributory pension scheme with a basic amount	65	X	X		X
Dominican Republic [c]	Solidarity Pension	60	X			X
El Salvador (2009)	Social assistance pensions	70	X			
Mexico (2007, 2013)	65 and Older	65	X			
Panama (2009)	100 for the 70 year olds	70	X			
Peru (2011)	Pensions for the 65 year olds	65	X			
Uruguay (1919, 1995)	PNC -Noncontributory old-age and disability pension program	70	X			

SOURCES: “Programas de Pensiones No Contributivas en Países FIAP, Parte 1: América Latina,” FIAP, mayo 2011; “Pension Watch,” HelpAge International Social Protection Database, September 17, 2012; “Pensiones No Contributivas en América Latina,” Transferencias Sociales, Banco Interamericano de Desarrollo, 2013; “El Rol de los Pisos de Protección Social en los Sistemas Integrales de Seguridad Social en América Latina y el Caribe (Documento Borrador para su Discusión),” Organización Internacional del Trabajo, Seminario Regional, el 26 y 27 de agosto de 2013.

a. When there are 2 years listed, the current program replaced another similar one.

b. The age of eligibility is rising to 62 (men) and 57 (women) in 2014.

c. Not yet implemented. The regulations were approved In July 2013.

Currently, Bolivia has the only universal social pension among these countries. The full benefit is paid to workers without any other type of pension, while pensioners receive 75 percent of the full benefit. The noncontributory pensions in the other countries with individual accounts target the neediest adults. However, in El Salvador and Colombia, the programs are gradually being extended by geographic area; the poorest regions or urban areas are covered first. Funding in most of these countries is from general revenues. Funding also may come from earmarked taxes (Bolivia and Costa Rica) and a separate fund (Bolivia, Chile, and Colombia).

Subsidized benefits are paid to workers who have made some contributions to an individual account, but not enough to qualify for a minimum benefit. Table 2 describes characteristics of the subsidy programs. Those with mixed systems (Costa Rica, Panama, and Uruguay) do not provide this type of subsidy and Peru's guaranteed minimum pension is only for retirees born before January 1, 1946.

Table 2. Subsidized benefits in selected Latin American countries

Type of benefit	Qualifying conditions				Financing
	Age of eligibility	Contributions	Benefit or earnings level	Other	
Bolivia					
Old-age top up	58 (lower ages for women with children, miners, and workers in metallurgical industries)	10 years	Minimum and maximum thresholds vary according to number of years of contributions (from 10 to 35); benefit increases with more years of contributions	NA	Insured person and employer contributions; higher earners pay a higher percentage of earnings
Chile					
Old-age top up	65 (men), 60 (women)	NA	Self-financed pension below threshold set by the government; family among poorest 60 percent of population	Resident for 20 years including 4 of last 5 years	Government
Disability top up	18 to 64	NA	Self-financed pension below threshold set by the government; family among poorest 60 percent of population	Assessed as disabled; resident for 5 of last 6 years	Government
Colombia					
Old-age top up	62 (men), 57 (women)	1,275 weeks (rising to 1,325 by 2015)	Self-financed pension below minimum pension	Resident for past 10 years	Higher-earner contributions
Old-age contribution subsidy (paid for 500 to 750 weeks)	Formal-sector workers, 58; informal-sector workers, 35 (men) and 30 (women)—both up to 65	500 weeks (have to contribute between 5 percent and 30 percent of full contribution)	Earns below minimum wage	NA	Higher-earner contributions; certain fines paid by pension fund management companies and employers
Disability top up	20 up to 65	26 weeks before disability began	Self-financed pension below minimum wage	Assessed as disabled	Insurance premiums paid by account holders
Survivors top up	Insured was an old-age or disability pensioner at time of death	26 weeks immediately before or in the year before death	Pension below minimum wage	Beneficiary must be a member of deceased's family	Insurance premiums paid by account holders
Dominican Republic					
Old-age top up	Older than 65	300 months	Low income; pension below minimum pension	NA	Employer contributions

Type of benefit	Qualifying conditions				Financing
	Age of eligibility	Contributions	Benefit or earnings level	Other	
El Salvador					
Old-age top up	60 (men), 55 (women)	25 years	Income, including pension, below minimum wage	NA	Government
Disability top up	NA	10 years or 3 of last 5 years of contributions before disability began; for nonwork-related accident, 6 of last 12 months before accident	Income, including pension, below minimum wage	Assessed as disabled	Government
Survivors top up	NA	10 years before insured's death or 3 of last 5 years before insured's death; for an accident, 6 of last 12 months before insured's death, who was contributing at time of death	Income, including survivor pension, below minimum wage		Government
Mexico					
Old-age top up	65	1,250 weeks or 24 years	Self-financed pension below minimum wage (in Mexico City)	NA	Government
Old-age contribution subsidy (a flat-rate that varies according to salary)	NA	Government subsidy paid only when account holder makes contributions	NA	NA	Government
SOURCES: *Programas de Pensiones No Contributivas en Paises FIAP, Parte 1: América Latina, FIAP*, mayo 2011; *Social Security Programs Throughout the World: The Americas, 2011*, US Social Security Administration, 2012.					

Other subsidy programs enacted into law, but have not yet been implemented include:

- the subsidized contributory old-age, disability, and survivors program for the self-employed (part of the 2001 law that introduced individual accounts) in the Dominican Republic; and
- special subsidized programs for certain categories of low-income workers in Colombia.

This top-up subsidy is paid on a sliding scale; eligible workers with the lowest pension entitlement receive the highest amount, and those with the highest pension entitlement receive the lowest amount. The characteristics of the subsidies that are similar in some countries and differ in others include:

- In many countries, the minimum benefit is equal to the minimum wage.
- Workers must be at or close to the normal retirement age and, except for in Chile, have a minimum number of contributions.
- Chile and Colombia have a residency requirement.
- Bolivia and Mexico only provide old-age subsidies.

Both Colombia and Mexico also have subsidies to supplement the contributions paid by low-income workers for old-age protection.

Introducing individual accounts (funded old-age savings) in Latin American pension systems did not accomplish one of its major goals—closing the pension coverage gap. Even though guaranteed minimum benefits were usually a part of the reform, a large proportion of contributors do not, or will not, have enough contributions to qualify for the minimum pension based on their contribution patterns. To address this problem, many countries introduced noncontributory pensions and subsidized benefits to provide protection to those workers. To date, the success of these programs is mixed. For example, because Bolivia's program is universal, coverage is very high. Also, Chile has reached its goal of providing these benefits to the poorest 60 percent of the population. For most of the countries one of the greatest challenges for the future is how to extend coverage successfully to a larger portion of the retirement-age population.

SOURCES: "Ampliando la Proteccion: El Papel de Las Pensiones Minimas y de La Asistencia Social," Organización Internacional del Trabajo, 2002; *La Cobertura de los Sistemas Previsionales en América Latina: Conceptos e Indicadores*, World Bank, 2011; *International Update* (various issues), US Social Security Administration, 2011 through 2013; "Programas de Pensiones No Contributivas en Países FIAP, Parte 1: América Latina," FIAP, mayo 2011; *Social Security Programs Throughout the World: The Americas, 2011*, US Social Security Administration, 2012; "Pension Watch," HelpAge International Social Protection Database, September 17, 2012; "Colombia Mayor," Colombia Mayor Consorcio, 2013; "Programa 100 a los 70," Proyecto Cohesíon Social, Panama, Ministerio de Desarrollo Social, 2013; "Pensiones No Contributivas en América Latina," Transferencias Sociales, Banco Interamericano de Desarrollo, 2013; "El Rol de los Pisos de Protección Social en los Sistemas Integrales de Seguridad Social en América Latina y el Caribe (Documento Borrador para su Discusión)," Organización Internacional del Trabajo, Seminario Regional, el 26 y 27 de agosto de 2013; "Mexico: President Outlines Social Security Reform," Mercer *International Headlines,* September 18, 2013.