Global Experience In Pension Reform

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This document on developments in the pension sector in the period ending 31 May 2014 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 relevant articles in full.
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Rules introduced in the 2014 Budget allow individuals more choice in accessing pension savings from defined contribution (DC) pension accounts. Another, more extensive set of rules is proposed in the Budget is expected to be finalized by April 2015. These would eliminate all withdrawal restrictions and allow retirees to access their total pension savings, subject to their marginal rate of income tax.

The recent set of implemented rule changes includes the following:

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

From April, 2015 it is proposed to allow individuals aged 55 or older access to all their DC pension savings, subject to their marginal rate of income tax. The rules proposed include:

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

The retirement income system in the United Kingdom consists of the basic state pension (a near-universal, flat-rate benefit) and the earnings-related state second pension. Supplementary programs include voluntary employer-sponsored (DB and DC) pensions and personal pensions, in addition to a low-cost, (eventually) Mandatory Accumulation Scheme.

Kazakhstan

From January 1, 2014 employers are paying mandatory professional pension contributions for those employees who work in hazardous conditions into the Unified Accumulation Fund. The requirement to pay these contributions arises from the “Law on Amendments to Some Laws of the Republic of Kazakhstan Relating to Social Welfare”.

For companies with employees covered by this law, the contribution rate is 5% of wages.

Source: Republic of Kazakhstan Act No 156-V of 10 January 2014

Dominican Republic

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

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

The Dominican Republic provides first-pillar individual accounts that are mandatory for private-sector workers who entered the labor force after 2003. (The pay-as-you-go social insurance system for private-sector workers was closed to new entrants in 2003 and is being phased out.)

Five pension fund management companies administer the individual accounts and contract with insurance companies for disability and survivors insurance. A retirement benefit—a choice of an annuity or programmed withdrawals—is paid at age 60 with 30 years of contributions. A guaranteed minimum pension is paid at age 65 with at least 25 years of contributions, when the individual account balance is insufficient to finance the minimum old-age pension.

A separate program—subsidized individual accounts for self-employed persons and other vulnerable groups—was included in the 2001 law that created the system of individual accounts, but has not yet been implemented. Regulations for the subsidized program were approved by the CNSS in July 2013; the government expects to begin implementation by 2016.


Norway

Effective January 1, 2014 new rules for occupational pension plans allow employers greater flexibility in designing and funding pension plans. Those rules include (1) an option for new tax-favored hybrid plans that combine features of defined benefit (DB) and defined contribution (DC) plan designs, and (2) higher maximum contribution limits for tax-favored DC plans. Until now, employers were required to provide either a DB or DC plan, and most...
employers chose to offer a less expensive DC plan. Under the amended law, companies may offer a benefit more comparable to a DB plan through a DC or hybrid plan. Industry sources expect the changes to encourage the recent trend away from employer-sponsored DB pension plans.

Tax-favored occupational pensions, introduced in 2001, have been mandatory since 2006, with employers deciding the type of pension plan for their employees. (The reform was intended to address demographic pressures and slow the growth of public pension expenditures.) Plan sponsors offering DC plans must contribute a minimum 2 percent of annual earnings up to 12 times the public pension base amount (known as “G”), set at 85,245 kroner (US$14,229) in 2013. (Pension contributions are tax-deductible for earnings above 12G.)

Under the new rules, a major change to DC plans increases the limit on contributions to 7 percent of employee earnings from 1G to 7.1G, and to 25.1 percent of earnings from 7.1G to 12G. (The previous limits were 5 percent of earnings from 1G to 6G and 8 percent of earnings from 6G to 12G.) DC plan sponsors have a 3-year transition period to adapt to the new rates. Also, although there were no changes mandated for DB plans, existing DB-plan members who are transferred by their employers to a hybrid or DC plan must immediately have their DB benefit converted to an individual annuity arrangement with an insurer.

The new rules also allow employers to offer a hybrid plan with guarantee features similar to a DB plan, which include the following:

- Limits on contributions to employee accounts are the same as those for DC plans.
- Life insurance companies in a collective trust generally manage the fund.
- Employers can choose the overall investment portfolio for all of their employees or determine an investment portfolio from which employees may select.
- Employers may guarantee a minimum rate of return that prevents the nominal loss of contributions in accounts; a higher guaranteed rate (established by the Financial Supervisory Authority) may apply when employees are allowed investment choice.
- Pension indexation costs must meet national insurance regulations and are the employer’s responsibility; investment returns above the guaranteed rate may help finance such costs.
- Administrative expenses during the accumulation (preretirement) and decumulation (postretirement) investment phases for employees are the responsibility of the employer.

Other new requirements for occupational pension plans include establishing a flexible retirement age, from age 62 to 75, and providing a partial retirement pension, ranging from 20 to 80 percent of the full retirement benefit. Both of those measures are in accordance with the 2011 major reform of the public pension system, which introduced a guaranteed minimum benefit and an earnings-related benefit based on lifetime earnings and calculated according to life expectancy at retirement.


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On February 1, 2014 a new pension reform law took effect that (1) makes Pillar II individual accounts voluntary for all new entrants to the workforce; (2) allows current participants to opt out of Pillar II and transfer their account balances to the Pillar I notional defined contribution (NDC) program; and (3) transfers all government bond investments held by Pillar II OFE’s to Pillar I which is managed by Poland’s social insurance institution (ZUS).

The government says these changes which were first proposed in a June 2013 report by the Ministries of Labor and Social Policy and Finance—will ensure that workers have a stable
source of income in retirement, whilst reducing Poland’s public debt. The government estimates that the transfer of all government bond investments which were about 51.5% of all OFE assets will reduce public debt by about 9.3 percent of gross domestic product in 2014.

Key changes under the new law include—

- **Making participation in the second pillar voluntary.** All new entrants to the workforce will have to opt in to Pillar II; those who fail to do so will participate in the NDC program only. Previously, Pillar II participation was mandatory for all economically active workers born after December 31, 1968.

- **Allowing current participants to opt out of Pillar II.** Current participants have from April 1 through July 31 to submit a written request to remain in Pillar II. Those who fail to do so will automatically have their Pillar II account balance transferred to Pillar I. A decision to opt out of Pillar II cannot be reversed and persons in pillar II must opt again in 2016 and every 4 years thereafter.

- **Transferring all government bond investments from OFEs to ZUS and changing investment options for OFEs.** On February 3, the government transferred around 153 billion zloty (US$50.71 billion) of government bonds from OFEs to ZUS to be credited to individual’s pillar I accounts. OFEs can no longer invest in Polish treasury bonds, although they can invest in other types of bonds including those of EU governments.

- **Gradually transferring the remaining second-pillar assets to the first pillar as workers near retirement.** During the 10 years prior to reaching normal retirement age, individual account balances will be gradually transferred to subaccounts managed by ZUS, with the assets treated in the same way as those in OFEs. As a result, ZUS is now responsible for paying both first-pillar NDC pensions and pensions from the individual accounts.

In 1999, Poland introduced a multi-pillar pension system consisting of a Pillar I NDC program, a mandatory Pillar II system and voluntary Pillar III accounts. A law implemented in May 2011 created new Pillar I subaccounts funded through contributions that had previously been diverted to the second pillar. Workers in Pillar II in Pillar II contribute 6.84% to the NDC program and 2.92% to individual accounts. Employers contribute 9.76% to the NDC program. Employees who opt out of the second pillar contribute the full 9.76 percent to the NDC program. The normal retirement age is 65 and 4 months for men (gradually rising to age 67 in 2020) and 60 and 4 months for women (gradually rising to age 67 in 2040).


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Portugal

A new law was implemented on January 1, 2014 raising the full retirement age for a public pension, increasing the special contribution levy on higher pensions and abolishing the sustainability factor (introduced in 2008), which links initial benefits to average life expectancy at retirement. The new measures, which replace a series of measures passed in the 2014 budget that were declared unconstitutional, aim to reduce the 2014 fiscal deficit target to under 4% of GDP as called for under the 2011 bailout agreement with the EU, IMF and European Central Bank.

Changes under the new law include—

- The retirement age rose to 66 on January 1, 2014. Workers may retire at age 65 with a full pension if they are “legally prevented” from working beyond that age. Early retirement was suspended in May 2012 until the end of the bailout agreement which
expires at the end of June 2014. The only exception is for long-term unemployed individuals who may continue to retire at age 57. The government plans to link future increases in the retirement age to life expectancy.

- Increasing the special contribution levy (introduced in 2011) for persons with high pension income. The government has lowered the threshold for total pension income that is subject to this levy, from 1,350 euros (US$1,860) to 1,000 euros (US$1,381) a month and introduced higher levy rates for higher income levels; the levy ranges from 3.5 to 10.0% of total pension income, depending upon income. Currently, the levy for pensions greater than 4,611 euros (US$6,370) a month is 15% for up to 7,125 euros (US$9,850) and 40% for those greater than 7,125 euros. The government says about 13% percent of pensioners pay this levy.
- Eliminating the sustainability factor used to determine the initial pension (average life expectancy at retirement), beginning in 2015. Transitionally, the sustainability factor still applies in 2014. As a result, a 65-year-old individual who retires in 2014 has to work another year in order to receive a pension equal to one he or she would have received under the old rules.

Portugal's pay-as-you-go public pension system provides a retirement benefit to workers with at least 15 years of contributions. Since 2008, pensions are adjusted annually to a social support index, which is based on changes in the consumer price index plus growth in the country's GDP. Every 5 years, the index is reviewed to assess whether it is meeting its goal: maintaining the purchasing power of pensions and the financial sustainability of the social security system.


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**Costa Rica**

Effective January 1, 2014, the ceiling on administrative fees that pension fund management companies (OPCs) may charge accountholders was lowered to 0.70% of the account balance. This measure is part of a 2010 ruling by the National Council for the Supervision of the Financial System, which changed the calculation of administrative fees from a mixed percentage of the account holder’s salary plus the fund’s performance to a percentage of the account balance. The ceiling was set at 1.10% for 2011–2013 with a gradual decrease in the ceiling on fees every 3 years until reaching 0.35% in January 2020.

The Superintendent of Pensions estimates this change in the method of calculating fees and the decreased rate could increase an old-age pension by at least 21% (assuming the accountholder has made all required contributions over a 30-year period and received a 3 percent real rate of return). Prior to the change, funds could OPCs charge fees of up to 4% of salary and 8% of fund performance.

At January 1, 2014, five of the six funds charged 0.70% of the account balance and the other 0.68%. Total assets under management for the six funds were about $US5.5 billion at the end of November 2013; most assets are invested in government bonds.

An individual account is mandatory for new entrants to the labor force after 2005. Employees contribute 1% of salary and employers contribute 3.25% to an individual account. Employees may choose the fund and can move from one fund to another at any time. Those who do not choose are automatically enrolled in the Banco Popular fund, part of the government-run Banco Popular. Individual accounts supplement the Pillar I pay-as-you-go public pension program. A full retirement benefit from either pillar is paid at age 65 with 25 years of
On April 29, 2014, President Bachelet introduced a new pension advisory commission to evaluate the country’s current system of individual accounts, after more than 30 years of operation. The commission of 25 national and international pension experts will also assess the impact of the 2008 reform that made some fundamental changes to the rules regarding individual accounts, including providing benefits to previously uncovered groups. A preliminary report is due by October 2014 and a final report with proposed changes in January 2015. According to the president, a detailed analysis of the pension system is needed because of concerns surrounding the functioning of Administradoras de Fondos de Pensiones (AFPs)—pension fund management companies—and the adequacy of benefits (particularly for workers who have contributed to the system their entire working lives).

In addition to the issues outlined by the president, the commission will study the effect of demographic challenges facing the national retirement system, including a rapidly aging population. In 2010, the World Bank estimated 10% of the population was 60 or older, and that figure would reach 16% by 2015 and 21% by 2030. The United Nations estimated in 2012 that life expectancy at age 60 was 25 years for women and 21 years for men compared with 22 and 19, respectively in 2005.

The commission will also analyze the proportion of months that a worker makes contributions compared with the maximum number of months the worker could have contributed. A low figure means lower benefits and lower replacement rates. The Superintendent of Pensions indicates that on average, workers contribute to an individual account during 52% of their working lives; men 56% and women 48%.

Chile’s system of individual accounts is made up of six privately managed AFPs, with a total of 91 trillion pesos (US$16.2 billion) in assets under management at the end of April. In addition to the monthly contribution of 10% of covered earnings, an account-holder must pay an administrative fee to their AFP. Starting in August 2014 this will range from 0.47% to 1.54% of covered earnings.

Australia
1. On May 13, 2014 the government presented the 2014–15 budget to Parliament. It impacts the pension system. The government wants to lower the 2013-14 deficit of 2.8% of GDP to a 0.4% deficit in 2016–2017 and have a 1% surplus by FY2017–2018. It is estimated if no changes are made, pension expenditures will increase from the current A$40 billion (US$37 billion) a year to over A$72 billion (US$67 billion) in FY2023–2024. About 40% of this increase can be attributed to the cost of indexing benefits and the rest on a growing number of beneficiaries. (The population aged 65 to 84 is expected to double by 2050.)

Proposals in the budget related to pensions and the aging workforce include:
Increasing retirement age to 70. Retirement age is already scheduled to rise to 67 by 2023. Starting in 2025, the age would rise by 6 months every 2 years to reach age 70 by 2035. Persons born before July 1, 1958, would be exempt from the rise to age 70. Those born before July 1, 1952, are exempt from the rise to age 67.

Changing the indexation method. Currently, twice a year, the Pillar I pension is adjusted to changes in the consumer price index (CPI), the beneficiary living cost index; and the male total average weekly earnings. Beginning in September 2017 it will be adjusted to the CPI only, twice a year.

Delay the increase in the superannuation guarantee contribution rate. Currently, employers are required to contribute 9.25 percent of an employee's wages to his or her superannuation (retirement) account (Pillar II). That rate is now scheduled to rise to 9.50 percent in July 2014 and reach 12 percent by 2019. The proposal changes the schedule: the rate would remain at 9.50 percent until June 30, 2018, and then gradually increase to 12 percent by 2022.

Tighten the asset test. Currently, the asset-test thresholds for the Pillar I pension are A$46,600 (US$43,230) for a single person and A$77,400 (US$71,803) for a couple and are indexed annually to changes in the CPI. Beginning in September 2017, the budget proposal lowers those thresholds to A$30,000 (US$27,830) and A$50,000 (US$46,385), respectively, and it maintains the same value (no adjustment) for 3 years.

Change incentives to keep older workers in the labor force. Current tax incentives for workers aged 50 or older who remain in the labor force would be abolished on July 1, 2014, and replaced with wage subsidies paid to employers. Employers who hire workers aged 50 or older would receive up to A$10,000 (US$9,277), paid in installments every 6 months in which the older worker is employed for up to 24 months.

Australia’s retirement income system has (1) an Old Age Pension (Pillar I)—an asset- and income-tested benefit funded by general revenues; and (2) the Superannuation Guarantee (Pillar II) which consists of mandatory personal accounts that are funded primarily by employer contributions. The employee may choose between a private pension plan—either occupational or personal—and a retirement savings account. Total assets under management for pillar II are A$1.3 trillion (US$1.21 trillion).

2. In addition on November 22, 2013 the Australian government’s Productivity Commission released “An Ageing Australia: Preparing for the Future”, a report that describes the growing financial burden of a rapidly aging population on the national budget. From 2012 through 2060, the proportion of the population aged 65 or older is expected to nearly double (from 14 percent to 25 percent), and the population aged 75 or older is projected to rise from about 6.4 percent to 14.4 percent of the total population. If no changes are made, the Commission expects the cost of public pensions to increase from 2.7% to 3.7% of GDP during this period.

According to the Commission, even though people are living longer, the time spent in the labor force has not increased proportionately over the past 100 years. For example, since the early 1900s, life expectancy at birth increased by about 33 years for men, but the time spent in the labor force (for those born in 2012) will only increase by 7 years. Also, although men born before 1925 spent about 75 percent of their lives after age 15 in the labor force, those born from 1946 through 1965 are projected to work about 60 percent of that time, and those born from 1986 through 2060, about half. The Commission warns that the government will not be able to afford to pay for these lengthy retirements.

The Commission states that the current retirement income system discourages older workers from remaining in the labor force. The Age Pension, the asset- and income-tested public pension funded by general revenues, encourages a worker who qualifies for the benefit to leave the work force at the retirement age (currently 65, rising to age 67 from 2017 through 2023); if that person continues working beyond the retirement age, he or she may no longer...
qualify for the Age Pension based on the income test. A worker who does not meet either the asset or income test relies more on his or her pillar II fund. The preservation age (currently 55, rising to age 60 from 2015 to 2024) is the age at which a worker may withdraw his or her pillar II fund. This also encourages a relatively early exit from the labor force.

The Commission suggests that the retirement age be linked to life expectancy beginning in 2023. Based on current projections, that age would be gradually increased to 70 by 2035. The savings are estimated at between 0.1% and 0.15% of GDP per year. Linking the preservation age to life expectancy as well would encourage older workers to remain in the labor force longer.

Sources:

Effective April 1, 2014 a new law changes the rules for Employee Pension Funds (EPFs) to address the increasing number of underperforming funds. The new law prohibits the establishment of any new EPFs; encourages currently underperforming EPFs to dissolve and/or convert to another type of pension plan by April 2019 (and allows the government thereafter to order EPFs that fail to satisfy adequate funding standards to dissolve); and imposes stricter funding rules for the remaining EPFs. Since 1966, employers have been allowed to contract employees out of the earnings-related tier of social security and set up an EPF, which can be a single- or multi-employer defined benefit (DB) plan, in the hope that private-sector asset management would yield higher returns. However, the deteriorating funding status of EPFs in recent years has increased the financial burdens on participating employers who are ultimately bear the cost of pensions. Many industry experts predict the new law will lead to the elimination of all EPFs in the next 10 years since 210 out of the current 562 EPFs are considered underperforming).

Under the new law, EPFs with managed assets of less than 150 percent of the “minimum reserve,” or the amount needed to pay benefits that replace the public earnings-related tier, must dissolve. EPFs that satisfy the 150 percent funding requirement may continue operation, but are required to pass an annual performance test to assure adequate funding levels. Employer sponsors of EPFs that are being wound up are obligated to return to the government an amount equal to the minimum reserve and make up any funding shortfall. To make it easier for plan sponsors to dissolve EPFs, employers are allowed to pay any shortfall in installments over a period as long as 30 years, provided they begin the wind-up process by April 2019. The interest charged to the employer for amortizing the shortfall is set at the rate of the 10-year government bond when the plan sponsor begins the wind-up process. At the same time, employees whose EPFs are being dissolved will be switched to the earnings-related public program, or Employees’ Pension Insurance (EPI). The EPI will also assume the remaining losses of the EPFs that go bankrupt before completing the wind-up process.

EPFs not only provide a substitute benefit (equivalent to the earnings-related portion of the social security pension) but a supplemental benefit as well. Any assets that remain from a dissolved EPF after an employer returns the contracted-out portion owed must be transferred to another retirement plan on behalf of employees that includes (1) an existing or newly established employer-sponsored DB pension plan; (2) a new or existing employer-sponsored DC plan; or (3) the government-sponsored Smaller Enterprise Retirement Allowance Mutual Aid plan, for small to midsize companies. (Asset transfer from an EPF to
Japan’s social security system includes the following two programs: (1) the National Pension (NP), a partially funded flat-rate program for self-employed persons, farmers, and nonworking spouses and students; and (2) EPI for full-time, private-sector employees. The EPI includes a flat-rate first tier (with contribution and benefit features identical to the NP program) and an earnings-related second tier. Voluntary private pension plans supplement the public pension system.


As part of the 2014 budget, new tax rules for retirement funds (including occupational and personal pension plans) went into effect on March 1, 2014. These increase the amount of lump-sum benefits that are tax exempt. The new rules will help workers with low levels of retirement savings reduce their tax burden. According to the government, further reforms to promote retirement savings in the country are anticipated in the next few years, based on the recommendations from a series of technical discussion papers released in 2012 and 2013.

Lump-sum benefits are taxed as follows: (1) preretirement withdrawals, which occur primarily following separation from a job; and (2) retirement withdrawals, which occur at retirement, upon the death of plan member, or (3) following a company closure. Under the new tax rules, the first 25,000 rand (US$2,367) of preretirement lump-sum withdrawals are now tax-exempt, up from 22,500 rand (US$2,130) previously. Withdrawals exceeding 25,000 rand will continue to be taxed at a rate ranging from 18 to 36%, depending on the size of the withdrawal; the highest rate applies to withdrawals exceeding 900,000 rand (US$85,206). For retirement lump-sum withdrawals, the first 500,000 rand (US$47,337) is now tax-exempt, up from 315,000 rand (US$29,822) previously. Withdrawals above this threshold are taxed at a rate between 18 and 36%.

In addition, the 2014 budget notes that further reforms related to the taxation of retirement funds will be implemented in the coming years. This includes a plan to make employer and employee contributions to pension plans tax deductible (up to a certain limit) to be available to employees. (The legislation for this reform was passed in 2013, but it requires regulations to be drawn up and which are expected to be effective in March 2015.)

The South African pension system consists of a noncontributory, means-tested old-age grant, financed by general revenues and supplemented by voluntary, employer-sponsored and personal pension plans. The old-age grant provides up to 1,350 rand (US$128) a month—up from 1,265 rand (US$120) a month prior to the 2014 budget—to individuals meeting certain asset and income tests. Occupational pension plans are established on a voluntary basis by an employer or group of employers.


On January 1, the Armenian government introduced a mandatory second pillar of individual accounts for workers born on or after January 1, 1974, and voluntary for those born before 1974. (A worker who has chosen to participate cannot reverse their decision.) The reform is part of a 2010 law that also created third-pillar, voluntary individual accounts (introduced in January 2011) to supplement the first-pillar, pay-as-you-go (PAYG) public program. According to the government, the new pillar II should spur economic development, improve the public pension system’s long-term financial sustainability and improve the relatively low level of retirement savings in the country.

The government estimates that the 2014 average pillar I monthly pension will be 36,000 drams (US$88.94), with many retirees below the poverty line.

Key provisions of pillar II include—

- **Contribution rates:** The overall contribution rate is 10% of an employee's monthly earnings. For employees with earnings up to 500,000 drams (US$1,235.26), 5% is paid by the government and 5% by the employee. For employees with earnings exceeding 500,000 drams, the government will contribute 25,000 drams (US$62.76), and the employee will contribute the remainder in order to reach 10% of his or her monthly earnings. Workers may continue to contribute to their individual accounts upon reaching normal retirement age, but the government contribution will cease. Workers born prior to 1974 who voluntarily join the second pillar contribute 5% of monthly earnings but will receive no government contribution.

- **Selection of a pension fund management company and pension fund:** Participants have until March 2014 to choose both a pension fund management company (there are currently two licensed companies in the country) to manage their individual accounts and the specific pension fund where their assets will be invested. Participants may choose from one of three pension funds with varying levels of risk: (1) a fixed-income fund, with no equity exposure; (2) a conservative fund, with up to 25% invested in equities; and (3) a balanced fund, with up to 50% in equities. (The Central Bank will issue regulations on specific investment rules for each fund.) Workers who do not make an active choice will default to the conservative fund of a randomly selected pension fund management company.

- **Management fees:** Pension fund management companies may charge the accountholder up to 1.5 percent of assets under management.

- **Payment of retirement benefits:** Upon reaching normal retirement age of 63, participants may convert their account balances into an annuity, programmed withdrawal, and/or a lump sum.

- **Guarantees.** The form of payment depends on the amount of assets held in the individual account. The law also guarantees that participants will receive at least the total amount of contributions (adjusted for inflation), minus management costs. The guarantee fund pays out 20% of the accumulated amount, and the government pays out 80% of the benefit.

In addition to pillar II, the Armenian pension system includes a pillar I PAYG program and pillar III individual accounts. Pillar I covers all employed and self-employed persons and is financed by an employee contribution of 3% of monthly after-tax earnings and (2) an employer contribution of 7,000 drams (US$17.29) a month in addition to an amount based on the employees' income levels. To receive a pension, a worker must be aged 63 with at least 25 years of covered employment. (The qualifying conditions are reduced for those employed in arduous or hazardous work.) A social assistance pension is paid at age 65 to workers with less than 5 years of covered employment.

In December 2013, dozens of MPs from the four non-ruling parties in parliament filed an application with the Constitutional Court, arguing that several provisions of the new law were unconstitutional. In particular, individuals drawing minimal wages should not pay mandatory contributions to the accumulation pension system. The plaintiffs asked the Court to revoke the mandatory component of the law.

On April 2, 2014 the Constitutional Court ruled that the mandatory component was unconstitutional, and the Armenian government and parliament were given until September 30 this year to revise the law to comply with the requirements of the ruling.

On May 15, 2014 the Parliament adopted in the second reading a law to comply with the Constitutional court ruling. The amended law allows for employees to opt out of the mandatory component of the funded pension system by submitting a written request to their employers. The Law on Funded Pension, which came into effect on January 1 this year,
initially required all employed citizens in Armenia born after 1973 to pay 5% their monthly gross wages to private pension funds, with the government contribution another 5%.


On December 18, the National Assembly approved a public pension reform that gradually increases both the contribution rates and the required number of contribution years for a retirement benefit. The reform changes when benefits are adjusted. According to the government, those measures will help keep the system on a more sustainable path.

Without any changes, the pension deficit was projected to double by 2040 from its current 14 billion euros (US$19 billion). A major reason for the deficit is population aging. The old-age dependency ratio is expected to fall from 1.7 in 2011 to 1.4 in 2040. During the same time frame, life expectancy at birth for both men and women is projected to increase by about 4 years to age 88.4 for women and 81.5 for men.

Reform measures helping reduce the public pension deficit include:

- The old-age contribution rates for employees and employers are gradually increasing by 0.15% in 2014 and by 0.05% a year from 2015 through 2017. In 2017 the contribution rates will be 7.05% percent of earnings for employees and 8.7% for employers.
- The number of required contribution years for a full benefit will rise gradually from 41.5 to 43 years in the 2020–2035 period. (A 2003 law raised the contribution requirement from 40 to 41.5 years by 2020.)
- Retirees who receive a 10% supplement for having raised 3 or more children will have to pay taxes on that benefit, beginning in 2014, for the benefit received in 2013. Previously, these benefits were tax-exempt. (Retirement pensions are already taxed.)
- Starting in 2014, most benefits will be indexed to changes in the cost of living in October of every year; the minimum retirement benefit will be adjusted twice yearly—in April and October. Previously benefits were adjusted once a year—in April.

In addition, the reform sets up a point system for employees who are exposed to one of the ten “hardship” criteria identified in the labor code (such as extreme temperatures, mechanical vibrations, repetitive or night-shift work).

As of January 2015, workers with exposure to each of the criteria will earn a point (2 points for workers aged 59 or older) that can be used toward training for less arduous work and full-time pay while transitioning to part-time work at the end of their working lives. Workers aged 55 or older may convert these points into quarters of coverage in order to retire early, beginning at age 58.

Other features of the new reform include—

- Changing the rules for crediting quarters of coverage toward a retirement benefit under certain conditions such as maternity leave, training, unemployment, apprenticeship, and part-time work.
- Simplifying access to retirement. Beginning in 2016, each insured person will have one electronic account that provides all of his or her relevant information regarding retirement, such as contribution history and projected benefits from different programs (public pay-as-you-go pensions and mandatory supplementary occupational pensions).
Creating a new committee to evaluate the pension system: A new committee composed of four pension experts will monitor the system, highlight any issues facing the public pension system, and propose corrective measures.


Spain

On December 23, 2013 a new law entered into force that (1) introduces a sustainability factor linking initial pensions to changes in life expectancy and (2) changes the way public pensions are indexed. Those two measures are based on a June 52013 report by the Committee of Experts appointed by the Prime Minister. According to the government, these measures will enable the public pension system to ensure a balance between contributions and benefits in the near and long term.

The principle of a sustainability factor was introduced in the 2011 reform of the country's pay-as-you-go public pension system. This, coupled with what the government called an intense economic crisis, sought to address the country's growing deficit due to the rapid aging of the population, the retirement of the baby boom generation, the system's relatively generous benefits, and increasing life expectancy. (Main provisions of the law included a gradual increase in both the retirement age, from 65 to 67, and the number of contribution years required for a full pension, from 15 to 25 years.) However, the 2011 law did not provide any specific details on the sustainability factor.

Beginning in 2019, the sustainability factor will be based on life expectancy at the normal retirement age during a 5-year period. That factor will be applied only once, when the initial pension is determined, and will be revised every 5 years. Analysts have concluded that as a result, the value of initial pensions could be reduced by 5%, on average, every 10 years.

In addition, the new law creates a new indexation method whereby benefits will be adjusted based on the ratio of the social security system’s income (that is, contributions) to expenses (that is, benefits) over the past 5 years and projected for the next 5 years (every January starting in 2014). The law also establishes minimum and maximum levels of adjustment. According to National Social Security Institute estimates, the new adjustment method will save some 33 billion euros (US$45.5 billion) between 2014 and 2022. For 2014, benefits have been increased by 0.25%. Previously, benefits were adjusted annually to changes in the consumer price index. (In 2013, benefits were increased by 1% even though the inflation rate at the end of 2012 was 2.9%.)

In addition, every 5 years, the government will be required to provide Congress and the social partners with a study of these new measures that evaluates their efficacy. One of the responsibilities of the Independent Authority for Fiscal Responsibility—a new public agency created by a November 2013 law—will be to provide appraisals of the government’s proposed annual adjustments of benefits and changes in the sustainability factor.


China

On January 1, the Chinese government introduced tax incentives to promote voluntary occupational pensions, known as Enterprise Annuity (EA) plans. The new rules were adopted in an effort to make these EA plans more attractive and help develop the country's evolving employment structure and reduce the dependency ratio.
multi-pillar retirement system. EA plans are the only approved occupational retirement plans however the participation rate is low. In mid-2013, 19.6 million employees (out of an urban labor force of over 280 million) were enrolled in EA plans, with total assets under management of 530 billion yuan (US$87 billion)—roughly 0.1 percent of China's gross domestic product. Industry observers suggest that this low take-up rate is the result of insufficient tax incentives and restrictive portfolio guidelines that typically yield lower returns on investments. According to industry estimates, the new policy could boost EA assets under management by as much as 200 billion yuan (US$33 billion) annually, which would help channel more funds into the country's capital markets.

Employers sponsoring an EA plan must contribute to an employee's account (most plan sponsors contribute from 5 to 8 percent of employee earnings up to a legal maximum of one-twelfth of the previous year's payroll); employees' contributions are voluntary. At retirement (age 60 for men and professional women, age 55 for nonprofessional salaried women, and age 50 for other categories of female workers), employees can withdraw the funds accumulated as a lump sum or annuity.

Under the new tax rules—

- Monthly employer contributions are not taxable. Previously, employer contributions were considered a separate category of taxable monthly payroll.
- Employee monthly contributions on income up to 4 percent of salary (based on their previous year's annual earnings) are now tax deductible; monthly contributions that exceed 4 percent are taxed as income.
- Earnings on investments in the account portfolio remain tax exempt.
- Accumulated contributions and earnings withdrawn at retirement are now taxed as income.

China's pension system consists of basic pension insurance and mandatory individual accounts for urban workers (in enterprises and certain institutions) and the urban self-employed, in addition to two voluntary pension programs—one for rural workers and another for non-employed urban residents.


On October 31, the Finnish Pension Panel issued “Adjusting the Finnish Pension System to the Increase in Life Expectancy”, a report that finds recent pension reforms insufficient to achieve national fiscal and retirement-age goals. According to the Panel, the rate at which life expectancy is increasing, together with the growing concern for the sustainability of public finances, emphasizes the need for further reforms. (Finland's population is aging faster than any other member country in the OECD).

The Panel, a working group of pension experts appointed by the central labor market organizations, suggests that a variety of measures need consideration to address population aging. The central labor market organizations are expected to propose a package of pension reforms by autumn 2014 in order to have legislation passed by 2017. The Panel's findings are largely illustrative rather than specific recommendations for reform, which will be negotiated by the social partners.

The Panel discusses how recent reform measures have addressed the country's demographic challenges. Pension reform since 2005 included provisions to encourage older workers to remain in the labor force and limit the growth of pension expenditure by—

- Changing the normal retirement age for the earnings-related pension from 65 to a
flexible range (63 to 68), abolishing the early old-age pension, and restricting access to early retirement (the retirement age for the universal pension remains at age 65);
- Introducing a life expectancy coefficient to the pension calculation, which will reduce pension payments as individuals live longer and promote an increase in the effective retirement age;
- Changing the benefit formula to cover lifetime earnings (instead of the final 10 years);
- Increasing pension contributions by 0.4% each year to 23.6% in 2014, 24% in 2015 and 24.4% in 2016.

According to the Panel, previous pension reform measures are only a partial success. Recent reforms have led to a slower than expected increase in pension expenditures in the past two decades, a trend which should continue. However, it appears that the targeted effective retirement age of 62.4 years by 2025 will not be reached unless further reform measures are taken. (Finns currently retire at 60.9 years on average.) Achieving that target would help lower incentives to raise pension contributions and reduce the considerable pressures on public finances, which are expected to increase without reform.

The report highlights three measures particularly relevant for examination by the social partners in future pension reform negotiations: (1) pension contributions, (2) benefit amounts, and (3) retirement age. According to the report, a more flexible approach could be adopting some combination of those measures. In addition, the report recommends reviewing the existing early retirement systems, the financial incentives that encourage workers to postpone retirement, and the limits on the flexible retirement age. Another important aspect discussed is social fairness and better adapting the pension.

REPORTS AND STUDIES

a. Organisation for Economic Co-operation and Development (OECD)

On November 26, 2013, the OECD released *Pensions at a Glance 2013*, a biennial report that examines public and private pension systems in 34 OECD member countries and 8 nonmember G-20 countries. This year’s report provides an in-depth analysis of the impact of recent pension reforms and of the role of housing, financial wealth, and public services in providing adequate living standards in retirement. According to the report, many of the countries surveyed have implemented reforms in recent years to improve the financial sustainability of their pension systems in the face of rapid population aging and increasing life expectancy. However, the report argues that by reducing future spending, those reforms may also increase the challenge to governments of ensuring that citizens have adequate income in retirement.

The report highlights trends in pension reforms across the aforementioned 34 OECD member countries: (1) reforms of pay-as-you-go public pension systems aimed at postponing retirement, such as higher retirement ages, automatic adjustment mechanisms, and changes in indexation rules; and (2) reforms of second-pillar defined contribution programs, with some countries (the Czech Republic and the United Kingdom) introducing new programs and others reducing (Poland) or eliminating (Hungary) their second-pillar programs. The report notes that the most common reform during the past 5 years has been increasing the normal retirement age; the majority of OECD countries will have a retirement age of at least 67 years by 2050, with some (Denmark, Greece, Hungary, Italy, Korea, and Turkey) going further by also linking the retirement age to changes in life expectancy. Because of these reforms, the report states that workers who enter the labor force today will have lower benefits at retirement than previous generations.

The report analyzes the adequacy of retirement incomes from a broad perspective, including not only pension benefits but also the role of housing, financial wealth and the value of publicly provided services. While noting a lack of reliable internationally comparative data, the report finds that—

- Homeownership can contribute substantially to pensioners’ living standards by allowing them to live in their own homes and, when necessary, convert their property into cash through sale, rent, or reverse mortgages. Across OECD member countries, approximately 77% of workers aged 55 or older are homeowners; the percentage still repaying their mortgage varies from country to country, from around 60% in Switzerland to around 10% in Hungary and the Slovak Republic.
- Financial wealth of older workers aged 65 older is very unequally distributed, with women faring particularly poorly. While upper income workers can draw on their resources at retirement, most workers are unable to rely on financial wealth to improve their retirement income.
- Publicly provided services—particularly healthcare and long-term care—significantly improve pensioners' household income, especially among the poorest households. The share of in-kind public services in the disposable income of the elderly is around 40% across OECD countries exceeding 70% in Sweden and Norway.

The report also provides a variety of comparative indicators e.g. replacement rates and pension wealth and detailed profiles on the surveyed countries’ public and private pension systems.

b. World Bank Reports

(i) Europe and Central Asia

On February 21, 2014, the World Bank released *The Inverting Pyramid: Pension Systems Facing Demographic Challenges in Europe and Central Asia*, which examines the demographic challenges facing pension systems in Europe and Central Asia. According to the report, when pension systems in these regions were first developed, a growing number of workers were financing old-age benefits for a relatively small number of pensioners. As a result, governments could provide generous benefits to pensioners. However, ongoing demographic changes—(such as rising life expectancy and lower fertility rates) combined
with the general provisions in many of those pension systems (such as relatively low retirement ages and generous benefits)—led to a much smaller group of workers financing benefits for a growing number of pensioners. The result is an increase in pension expenditures that, in many countries, are now the single biggest budget expense.

The report notes that a number of countries have implemented pension reforms over the past 20 years to reduce these expenditures. The reforms include structural changes (such as individual accounts and notional defined contribution systems) and parametric changes (such as increasing the contribution rate, retirement age, and number of years of required contributions, and lowering the benefit levels). However, some of these countries reversed course during a period of high economic growth in the mid-2000s by increasing benefit levels, while others reversed the reforms entirely following the financial crisis to help meet short-term deficits.

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

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

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

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


(ii) Latin America and the Caribbean

On March 13, 2014 the World Bank launched *Beyond Contributory Pensions in Latin America and the Caribbean (in Spanish)*, which examines the trends in pension coverage of older adults (over age 65) in the region during the past decade. From 2000 through 2013, at least 18 countries introduced some type of non-contributory program that incorporated about one-third of the older population not previously covered. This is a paradigm shift from the 1980s and 1990s when the focus of pension reform in the region was to put contributory systems on a more sustainable path.

Because coverage in the contributory system has not increased significantly, the shift has been toward inclusion: either through expanding non-contributory programs or making the requirements for the contributory system more flexible.

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

1. *Universal access*. Bolivia and Trinidad and Tobago introduced a universal benefit where access is possible for all citizens that meet minimum general requirements, such as age.
2. *Inclusion of the excluded*. Argentina, Brazil, Chile, Mexico, Panama, and Uruguay target older adults who are not covered by the contributory program, with the goal of universal social protection.
3. *Targeting the most vulnerable*. Colombia, Costa Rica, Ecuador, El Salvador, Panama, Paraguay, and Peru use means testing to target older adults who are poor and at risk.
The report also compares the level of benefits among the 14 countries. Argentina, Costa Rica, Trinidad and Tobago, and Uruguay provide non-contributory benefits that are, on average, more than 50 percent of the contributory benefits. Benefits in the other 10 countries range from 4 percent to 40 percent, on average, of contributory benefits.

The report concludes that the design of new programs and expansion of others must take into account the rapid aging of the population in the region. Life expectancy at birth has increased from age 52 in 1950 to age 74 in 2010, and it is expected to reach age 85 by 2100.

In addition, in 1950, there were 6 adults over age 65 for every group of 100 working-age persons (aged 15 to 65); in 2010, there were 10 adults over age 65, and projections for 2100 exceed 50 older adults for every group of 100 working-age persons. As the number of older adults significantly increases, so will the financial needs of the programs.

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

(iii) Africa

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

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

Other findings of the report include the following:

- Coverage of safety net programs for the poor and vulnerable is generally very low, but growing. Some countries, such as Ghana, Kenya, and Rwanda, have begun expanding some of their programs on a national scale. In several southern African countries, social pension programs provide significant benefits to the elderly; however, these programs do not specifically target the most vulnerable populations.

- Lack of data collection in addition to monitoring and evaluating safety net programs make it difficult to evaluate the effectiveness of those programs. The report recommends a greater emphasis on collecting basic data on the number and types of beneficiaries covered under these programs and on the impact of that coverage.

- With the exception of middle-income countries in southern Africa, spending on safety net programs is very low, but increasing.

- The report finds that spending is currently concentrated on scattered emergency and food-based programs, and it recommends a shift to focusing on funding sustainable safety nets that aim to reduce long-term chronic poverty.