Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

August 2012

Europe

France

On June 6, the new government announced a measure that will allow a limited number of eligible workers to retire at age 60 rather than age 62. The change, which was made by decree and will come into force on November 1, partially modifies provisions of the pension reforms adopted by the previous government that raised the earliest age to access pension benefits from age 60 to 62 and the qualifying age for claiming full benefits from age 65 to 67. According to the new government, the aim of the measure is to increase flexibility for people who began working at an early age (prior to age 20, up from age 17 under the previous rules) and who have contributed for the required number of quarters.

While employer representatives and other French commentators have expressed concern about the financial impact of the new early retirement measures, the government argues that the change does not affect either the age at which most workers can qualify for early retirement (age 62) or the age at which insured persons are eligible for a full retirement benefit (age 67). An estimated 100,000 workers will be eligible for retirement benefits under the new rules, with the projected cost to the public pension programs covered by the new decree of 1 billion euros in 2013 (US$1.2 billion) rising to 3 billion euros (US$3.7 billion) in 2017. To offset the higher costs, contributions will increase by 0.1 percent, divided equally between employees and employers. (Currently, employees contribute 6.65 percent of covered earnings for old-age benefits, and employers contribute 8.3 percent of covered payroll.)

The new decree will also allow mothers and individuals who have experienced periods of unemployment to be credited with an additional two quarters of coverage toward fulfilling the contribution requirements for early retirement at age 60. Currently, both mothers and fathers are eligible for a specified number of credited periods for the purpose of qualifying for pension benefits; additional credits are also granted for specified periods while receiving unemployment insurance benefits.

Sources: *Social Security Programs Throughout the World: Europe 2012*, US Social Security Administration; Ministere des Affaires Sociales et de la Sante, press release, June 6, 2012; “Mesure Gouvernementale: Élargissement du Dispositif de Retraite Anticipée,” Caisse National d’Assurance Veillesse, 7 août 2012.

Latvia

On June 14, the Latvian Parliament adopted a pension reform law that gradually raises the retirement age and the minimum contribution period for a pension under the country’s two-pillar pension system. The retirement age will gradually increase from age 62 to age 65 by 3 months a year from 2014 to 2025. The minimum contribution period will increase in two steps: from 10 years to 15 years in 2014, and to 20 years in 2025. According to the government, the changes are necessary to address Latvia’s shrinking and rapidly aging population; recent figures by Eurostat, the European Union’s statistical office, show Latvia’s fertility rate at only 1.3 births per woman, well below the replacement level of around 2.1. Partially because of that relatively low fertility rate, Eurostat projects an increase in the old-age dependency ratio—the projected number of persons aged 65 or older expressed as a percentage of the projected number of persons aged 15 to 64—from 25.19 percent in 2010 to 67.99 percent in 2060.

Latvia’s pension system consists of first-pillar notional defined contribution (NDC) accounts and second-pillar individual accounts. The second pillar is mandatory for workers who were younger than age 30 when the system was implemented on July 1, 2001, and for all new entrants to the labor force since then. Participation is voluntary for workers who were aged 30 to 49 on July 1, 2001. Combined employer/employee contributions are 35.09 percent of covered earnings, of which 18 percent finances the NDC account and 2 percent is directed to the individual account; the remaining 15 percent finances other social insurance benefits.

Sources: *Social Security Programs Throughout the World: Europe 2012*, US Social Security Administration; “Retirement Age in Latvia to Be Increased From 2014 by Three Months Every

Year," *Baltic Course*, June 14, 2012; "Saeima Pienem Grozijumus Likuma Par Valsts Pensijam," Ministry of Welfare, June 14, 2012; "Saeima in the Final Reading Adopts Amendments to the Pension Law," *Saeima Press Service*, June 15, 2012; "International Headlines," *Mercer*, June 20, 2012; Eurostat statistics database, European Commission, http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/themes), accessed August 6, 2012.

The Americas

Peru

On July 19, a new pension reform law was enacted that makes major changes to the country's nearly 20-year-old system of individual accounts. The new law includes measures to extend coverage to a larger portion of the population, encourage greater competition in the pension fund industry, and broaden the types of investment funds available to account holders. The following measures address some of the system's current issues:

- Less than 30 percent of the economically active population (EAP) is covered by a pension system. Participation is voluntary for self-employed workers who make up the majority of the country's EAP.
- Administrative fees charged to account holders (an average of 1.91 percent of monthly gross earnings) are high by international standards, in part, because it is presumed that there is not enough competition among the four existing pension fund management companies (AFPs).

The new law will gradually require self-employed workers with income over 1.5 times the minimum wage (1,125 soles or US$421 a month) to enroll in the system. In addition, a new social pension will cover microenterprise (companies with 1 to 10 employees) workers who are aged 40 or younger and earn less than this threshold and are not covered by any other pension system. The social pension will be financed by worker contributions and a government subsidy.

Another reform measure will encourage more competition among AFPs by assigning new labor force entrants to the AFP with the lowest administrative fee. A selection will be made through a bidding process (to be held every 2 years) open to any existing AFP and qualified company that plans to enter the market. The fee offered must be lower than the lowest one charged by all AFPs in the past 12 months. The winning AFP must maintain this fee for all account holders for 24 months. The government expects the first competition to be held by December 2012.

Other provisions of the pension reform law include the following:

- A gradual change (over 10 years) from administrative fees based on contributions to fees based on the account balance.
- An expansion of investment choices for affiliates that will add a "protection of capital" fund for account holders from age 65 until retirement. AFPs will also be permitted to offer life-cycle funds.
- A review of the contribution rate (currently 10 percent of gross earnings) will be held every 7 years by the finance ministry and pension regulator to make sure the rate provides an adequate replacement rate, on average, taking certain factors into consideration such as life expectancy and pension funds' long-term rates of returns.
- The creation of a publicly or privately run agency to centralize certain processes such as contribution collection, accreditation, and calculation and payment of benefits.
- Establishment of a financial education fund, financed by contributions from AFPs and insurance companies.
- New disclosure rules for AFPs.

A constitutional challenge is anticipated before the law is scheduled to be implemented (120 days after the regulations have been approved).

Sources: "Next Generation of Individual Account Pension Reforms in Latin America," *Social Security Bulletin*, vol. 71, no. 1, 2011; "Reforma Del SPP Busca Eficiencia y Mayor Rentabilidad a Favor de los Afiliados," Superintendencia de Banca, Seguros y AFP, el 2 de julio de 2012; Ley Número 29903, el 19 de julio de 2012; "Peru Enacts Pension Law That Aims to Widely Broaden Participation in System," *Pension and Benefits Daily*, July 20, 2012; "Factbox—Peru's Private Pension Fund Reform," Reuters News, July 24, 2012; *International Headlines*, Mercer, July 25, 2012; "Comisiones y Primas de Seguro por AFP," Superintendencia de Banca, Seguros y AFP, agosto 2012.

Asia and the Pacific

India

On July 12, the Pension Fund Regulatory and Development Authority (PFRDA) issued final guidelines to allow more pension fund managers to operate under India's National Pension System (NPS). The government expects the rule changes to encourage a higher level of participation in the system. The new rules are based on recommendations from the Bajpai

Committee, set up by the PFRDA in March 2010 to examine reasons for the slow take-up rate of NPS in the corporate and unorganized sectors (nongovernment). Established in 2004 as a low-cost mandatory defined contribution pension system for government employees, the NPS was extended on a voluntary basis in May 2009 to nongovernment workers aged 18 to 60. In 2010, a government subsidy was introduced for employees in the unorganized sector (estimated unofficially at more than 90 percent of roughly 490 million workers). For nongovernment NPS subscribers, the government initially selected six pension fund managers through a bidding process and required them to charge relatively low uniform management fees. (At the same time, three pension fund managers administer NPS accounts of public-sector employees.)

The new guidelines place no limit on the number of licensed fund managers provided they satisfy the eligibility criteria (subject to an annual review), which include demonstrating financial integrity and competency. Fund managers who receive a certificate of registration from PFRDA may—

- manage individual accounts under the NPS system;
- enroll subscribers from the nongovernment sector only;
- establish their own marketing and distribution networks; and
- set a fee schedule, such as brokerage and transaction costs, subject to an overall ceiling established by the PFRDA.

According to the PFRDA, as of January 2012, the NPS had nearly 2.8 million subscribers (1.9 million government employees and 0.9 million nongovernment workers) with over 126.8 billion rupees (nearly US$2.5 billion) in total assets under management.

Sources: "India," *International Update*, September 2010; *Annual Report 2011–12*, Ministry of Finance, 2012; Ministry of Finance, press release, July 12, 2012; "NPS Boost: All Fund Houses Can Now Manage the Scheme," Firstpost.com, July 13, 2012; "Investment Norms for National Pension System Should Be Made More Liberal to Boost Returns for Investors," *Economic Times*, July 26, 2012.

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