Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

June 2009

Europe

Germany

The German parliament approved an increase in public pensions effective July 1, which overrides, for the second consecutive year, legislation implemented in 2005 to control future pension expenditures. The 2005 law set up a "sustainability index"—an automatic adjustment mechanism that aims to achieve long-term solvency of the pension system by limiting the growth rate of benefits and contributions to changes over time in the system dependency ratio (the ratio of contributors to pensioners) and wages. In announcing the increase, the Cabinet cited the economic stimulus effect as well as the healthier assessment of social security reserves, which reached an amount equal to about one year of benefit payments at the end of 2008.

The recent increase in pension benefits—by 2.41 percent in the western part of Germany and 3.38 percent in the east—is the largest since the 1990s. The geographic disparity stems from significantly higher increases in salaries and wages in eastern Germany. Despite the benefit increase, the government pledged to honor the 2005 legislative requirement that any future increases would be cut by half until 2011 to compensate for maintaining pension amounts, and it would postpone any contribution rate decrease triggered by the sustainability index until 2012.

The effort to slow down projected increases in both benefits and contribution rates has resulted in a series of significant reforms adopted over the course of the past decade. In addition to the introduction of the sustainability index in 2005, the government passed a law in 2007 that will increase the retirement age from 65 to 67 between 2012 and 2029. A contribution rate of 19.9 percent of gross wages, divided equally between worker and employer, currently finances Germany's public pension system, with the government subsidizing the cost of benefits not covered by contributions.

Sources: "Germany," *International Update,* U.S. Social Security Administration, May 2008; *Social Security Financing: Automatic Adjustments to Restore Solvency,* AARP Public Policy Institute, February 2009; "German Cabinet Won't Cut Public Pensions When Wages Go Down, Labor Secretary Says," *Pension and Benefits Daily,* May 20, 2009.

Hungary

The Hungarian parliament on May 11 passed a public pension reform package that includes measures increasing the retirement age, changing the calculation of pension bonuses, and changing the way retirement benefits are indexed. The measures are intended to reduce the financial burden of the state-run pay-as-you-go (PAYG) pillar of the pension system in the face of a deep recession. According to recent government estimates, the Hungarian economy may contract as much as 6 percent this year, with modest growth not expected until 2011.

Specifically, the key measures included in the reform package—

- Increase the retirement age from 62 to 65, by 6 months each year, from 2012 through 2017. The change affects workers born in 1957 or later.
- Eliminate the so-called "13th month pension"—equal to a full month's pension—and replace it with a pension bonus linked to economic growth. The bonus, which ranges from 20,000 forints (US$101.13) to 80,000 forints (US$404.66) depending on the level of economic growth, will be paid after gross domestic product (GDP) growth reaches 3.5 percent.
- Change the way PAYG retirement benefits are indexed. When GDP growth is 3 percent or less, indexation will reflect increases in prices. When GDP growth exceeds 3 percent, indexation will be based on increases in both prices and wages, respectively, in the following proportions: 80 percent to 20 percent for growth between 3 and 4 percent; 60 percent to 40 percent for growth between 4 and 5 percent; and equal proportions of 50 percent for growth exceeding 5 percent. Previously, indexation was based on increases in prices and wages in equal proportions, irrespective of GDP growth.

In 1998, Hungary introduced a new pension system consisting of a first-pillar earnings-related PAYG

benefit, second-pillar individual accounts that have been mandatory for new entrants to the labor force since 1998 and voluntary for all others, and third-pillar voluntary individual accounts.

Sources: "Hungary Passes New Tax, Pension Rules in Final Vote," Reuters News, May 11, 2009; "Parliament Approves Pension Changes," MTI—EcoNews, May 11, 2009; *IBIS Compliance Alert, Hungary*, May 27, 2009.

Ireland

Several measures in the Social Welfare and Pensions Act of 2009, enacted in April, provide increased protection for workers covered by defined benefit (DB) pension plans. The Irish government forecasts that more than 90 percent of DB plans may be insolvent by the end of 2009 because of the recent turmoil in financial markets. Official estimates of the accumulated deficit of these plans range from €20 billion (US$28 billion) to €30 billion (US$42 billion).

The new law changes the way funds are distributed if a DB plan is terminated with a deficit. Pensioners will continue to get first priority for their pensions, but future pension increases (such as adjustments for inflation) will not be granted until the pension entitlements of workers and former employees not yet retired, who have contributed to the plan, are satisfied. Formerly, if an insolvent DB plan was terminated, pensioners were entitled to scheduled pension increases before current and former employees received consideration for benefits under the plan. Under the new law, the distribution of plan assets for postretirement increases may be applied only after the basic pension entitlements of all plan members are addressed.

In addition, the law establishes a Pensions Insolvency Payment Scheme (PIPS) to assist current and former employees of companies where the employer becomes insolvent and the DB plan is in deficit. Under PIPS, plan trustees will be able to purchase annuities from the government rather than from an insurance company in the private sector. PIPS will offer government annuities, which could be 20 percent less expensive than private-sector annuities, leaving more assets for pensions of those yet to retire and reducing the potential for future pension shortfalls. The National Treasury Management Agency is authorized to actuarially assess each DB plan under PIPS. The cost of the annuity will vary according to the age profile of the plan and other relevant factors. The Department of Finance is currently developing detailed regulations to enable PIPS to begin operating on a pilot basis for 3 years.

Finally, new government regulations make it easier to penalize employers who do not pass on employees' pension contributions to the pension plan. Employers are now required to remit all deductions from employees' salaries to a pension plan within 21 days following the end of the month in which the deduction is made. In Ireland, most DB plans require employees to contribute.

Sources: Department of Social and Family Affairs press release, April 27, 2009; "Government to Change Rules on Insolvent Pensions," *Irish Times*, April 27, 2009; "Hanafin Criticised for 'Rushing' DB Changes," IPE.com, April 29, 2009; "Ireland—Government Changes to Defined Benefit Schemes," mercer.com, May 14, 2009; "Building an Effective Pension Framework," *Global Pensions*, May 29, 2009.

Asia and the Pacific

Australia

In a May 12 budget speech, Australia's Treasurer introduced the government's plans to reform the public pension system, which address the rapid aging of the population and fiscal sustainability of the system. "Secure and Sustainable Pension Reform" raises the retirement age, improves benefits especially for single pensioners, tightens the income-test rules for the non-contributory age pension, and changes the disability assessment process.

According to current population projections, by 2047, the ratio of workers to retirees will decrease from 5.0:1 to 2.4:1, and the proportion of Australians aged 65 or older will increase from 13 percent of the population to 25 percent. As a result, the government plans to gradually raise the retirement age from 65 to 67, by 6 months every 2 years between July 1, 2017, and July 1, 2024. Currently the retirement age is 65 for men; it is 63 for women, but is rising gradually to age 65 by July 1, 2013.

The reform also includes a number of changes to the age pension, the country's noncontributory income-tested benefit, funded by general revenues. Provisions effective September 20 include—

- Increasing benefits for single pensioners by about 11 percent—to A$336.68 (US$271.95) per week and for couples by about 2 percent—to A$507.50 (US$409.92).

- Introducing a new index for pensions called the Pensioner and Beneficiary Living Cost Index based on price changes that affect pensioner households. Currently most pensions are adjusted twice a year according to changes in the consumer price index.
- Tightening the rules for the age pension income test to better target the neediest pensioners.
- Creating a pensioner work bonus of up to A$125 (US$100.96) every 2 weeks to encourage pensioners to work part time.

The government will also modify the disability assessment procedures. On July 1, 2010, a fast-track process will be introduced for those who are clearly eligible for disability benefits, such as those with congenital disabilities, cancer, or other life-threatening conditions. For other persons, new guidelines for work capacity will be established. In addition, a pilot program, which is part of the National Mental Health and Disability Employment Strategy, will begin on March 1, 2010, to identify, recruit, and prepare 1,000 disability beneficiaries to find work.

To help fund these reforms, the government plans to modify the rules for the country's mandatory private pension system, called superannuation guarantee, which is funded by mandatory employer contributions of 9 percent of payroll. Tax benefits for voluntary employee retirement contributions to a superannuation account will be cut in half, from an annual cap on income of A$50,000 (US$40,387) to A$25,000 (US$20,193). In addition, the government will temporarily reduce the matching co-contribution rate it provides to low- to middle-income workers from 150 percent to 100 percent of the employee's contribution until 2012, and then it will raise the rate to 125 percent until 2014. Beyond 2014, the co-contribution rate will return to 150 percent.

Sources: "Secure and Sustainable Pensions," Commonwealth of Australia**,** May 2009; Minister for Families, Housing, Community Services and Indigenous Affairs media release, May 12, 2009.

New Zealand

To help stem the country's rising budget deficit, New Zealand's Finance Minister announced on May 28 that the government would suspend its regular annual payments to the New Zealand Superannuation Fund (NZSF, or the Fund) until there is a budget surplus to fund the contribution. NZSF is an investment fund created in 2001 to partially finance the projected rise in the cost of public retirement (called superannuation) benefits as the country's population ages. The ratio of workers to retirees is expected to decrease from 5:1 today to 2:1 by 2050. At the same time, the number of retirees is projected to double to more than one million. The cost of benefits is also expected to double.

According to government projections, the suspension of full payments to the NZSF of close to NZ$2 billion (US$1.3 billion) per year could last up to 11 years. A partial payment of NZ $250 million (US$163 million) will be made for the current fiscal year and any future partial payments will be determined annually according to the country's finances. The budget deficit forecast for the current fiscal year is NZ$12 billion (US$7.8 billion) or 6.8 percent of gross domestic product.

Until now, the government's plan was to fund NZSF with an average annual contribution of NZ$1.95 billion (US$1.27 billion) from general revenues until about 2027, when NZSF assets were expected to cover about 20 percent of the cost of pensions. Without the automatic payment, Treasury estimates that in 2030 the Fund will have a NZ$37 billion (US$24 billion) shortfall when the government will need additional funds to cover a portion of benefits.

New Zealand Superannuation is the country's flat-rate public pension system funded by general revenues. Benefit amounts depend on marital status and living arrangements and are taxed as income. NZSF assets under management at the end of April 2009 were NZ$12.5 billion (US$8.1 billion).

Sources: "Fund Highlights," New Zealand Superannuation Fund, May 21, 2009; "Instant View 5-NZ Government 2009/10 Budget," Reuters News, May 27, 2009; "New Zealand Super Fund—Fact Sheet," scoop.co.nz, May 27, 2009; "Pension Age Row Looms," *The Southland Times,* May 30, 2009.

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