Social Security

# International Update:

## Recent Developments in Foreign Public and Private Pensions

September 2005

## Europe

### *Poland*

**On August 19, President Kwasniewski signed into law a controversial bill that permits miners with at least 25 years of contributions to retire when they choose, instead of having to wait until the age of 65.** The legislature approved the bill on July 27, and implementation is set for January 1, 2008.

In late July, some 5,000 miners held demonstrations and rioted, demanding their right to an early retirement, because of higher mortality rates of most miners before the normal retirement age of 65. Critics of the measure, including the Prime Minister and the Economy Minister, worry that the 15-year cost of about 90 billion zlotys (US$27.3 billion) will further strain the federal budget, which is currently running an annual deficit of 35 billion zlotys (US$10.6 billion), and delay Poland's eligibility for adopting the Euro as its currency. Former Economy Minister Jerzy Hausner has warned that the government may have to raise taxes to fund this provision, which covers about 140,000 miners.

Since 1999, Poland's retirement system consists of notional accounts plus mandatory individual accounts with retirement at the age of 65. Men must have contributed for 25 years and women for 20 years. Under the old pay-as-you-go system, which covers all workers born before January 1, 1949, and those born between that date and December 31, 1968, who chose to remain in the old system, miners and certain other categories of workers are able to retire at earlier ages. Analysts fear that this new provision affecting miners will encourage other groups that are also entitled to earlier retirement under the old system to demand the same treatment under the new system.

**Sources:** PAP Market Insider, August 19, 2005; Polish News Bulletin, August 3, 4, 9, and 19, 2005; PAP News Agency, July 27, 2005; *Social Security Programs Throughout the World: Europe, 2004*.

## The Americas

### *Peru*

**Peru's asset management companies (AFPs) have become more competitive with the introduction in August of Prima, the first new AFP since individual retirement accounts became available in 1993.** Prima's low introductory administrative fee of 1.5 percent of a worker's earnings, compared with 2.27 percent for the average fee charged by the others in July, has caused all of its competitors to announce reduced fees beginning in October—some as low as 1.45 percent for workers who sign up for 3 years.

Although the Superintendent of Banking, Insurance, and Pension Fund Management Companies must approve these new fee structures, it estimates that the lower fees could save Peru's 3.5 million accountholders some NS$190 million (US$58.4 million) per year. Prima estimates that it will incur first-year operating losses of at least US$10 million but expects to break even by 2007, provided it enrolls 30 percent of Peru's accountholders.

Prima AFP is owned by Credicorp, Peru's largest financial holding company, which also owns the country's largest bank, Banco de Crédito. Credicorp, which is not a new player in Peru's pension market, sold its 40 percent ownership in another AFP in 1999 and then agreed not to reenter the market for 5 years.

Prima's competitors, which include major shareholders such as ING and Citibank, have launched an aggressive advertising campaign to at least maintain and hopefully expand their account holder base. Since earlier this year, transfers from one AFP to another are permitted at any time without penalty. (See also the March 2005 issue of *International Update*.)

The government originally licensed eight AFPs when it launched its system of individual accounts in 1993, but that number has declined over the years and stood at four until last month. Some analysts predict that this new round of competition will cause further consolidation

among the AFPs. Before Prima entered the marketplace, Integra held the largest share (31.5 percent) of the system's US$8.67 billion assets under management, while Horizonte had the largest share (26 percent) of account holders.

Account holders are required to contribute 8 percent of their earnings to an individual retirement account each month. They also pay about 1 percent of earnings per month for survivors and disability insurance.

**Sources:** Business News Americas, July 20 and 22, August 16 and 24, and September 6, 2005; Dow Jones International News, August 3, 9, 12, 18, and 25, 2005; Superintendencia de Banca y Seguros del Peru, "Noticias Diarias," August 22, 2005; *El Comercio* (Peru), August 22, 2005; Superintendencia de Banca y Seguros del Peru, "Series Históricas del Sistema Privado de Pensiones"; Reuters Noticias Latinoamericanas, August 12, 2005; Superintendencia de Banca y Seguros del Peru, "Información Diaria de las Principales Variables del SPP," August 11, 2005.

## Asia and the Pacific

### *China*

**The Ministry of Labor and Social Security (MOLSS) has given approval for 37 financial institutions to manage voluntary occupational pension funds under China's new Enterprise Annuity (EA) program.** The first operating licenses were awarded on August 2 to 15 Chinese investment managers, 4 of which are joint ventures with foreign companies. An additional 22 licenses were awarded to companies providing administrative services, such as custodians, trustees, and administrators.

MOLSS issued regulations in 2004 to establish a framework for China's new system of voluntary corporate retirement plans to safeguard the investment of occupational pension fund assets. (See also the June 2004 issue of *International Update*.) These regulations replaced 1995 rules that permitted companies to establish retirement plans for their employees but did not provide sufficient safeguards against underfunding.

By comparison, retirement plans under the EA program will be fully funded, defined contribution individual accounts and subject to stringent oversight. The governance structure requires a plan trustee to oversee the pension fund and appoint a plan administrator, a custodian, and an investment manager. A separate license is required for each of these functions. Guidelines for EA service providers to obtain operating licenses were issued this year in early February.

Under the new EA program, employee contributions will be allowed (but not required), and employee (but not employer) contributions will be fully vested immediately. While employers will be permitted to contribute a maximum of one-twelfth of the prior year's gross payroll, combined employer-employee contributions cannot exceed one-sixth of gross payroll from the previous year. Benefits will be paid as an annuity or as a lump sum at the legal retirement age of 60 for men and 55 for women. The individual accounts will be transferable with a job change if the new employer offers an EA plan; otherwise, an employee's account will remain with the previous employer's fund manager.

Fund managers will oversee the portfolio selection (there is no employee choice). Investment restrictions will require a share of at least 20 percent in liquid investments (money market funds, for example); a maximum of 50 percent in fixed-income products and convertible bonds, including a minimum of 20 percent in government bonds; and a maximum of 30 percent in equities (stocks, mutual funds, and investment-linked insurance products). In addition, investment managers will be required to put 20 percent of administrative fees into a separate trust fund as a contingency against possible investment losses.

Administrative fees for EA plans will be limited and proportioned as follows: trustee (0.2 percent of assets); administrator (RMB5 or US$0.62) per month for each employee); investment management (1.2 percent of assets); and custodian (0.2 percent of assets).

Although the issue of tax treatment of contributions was not addressed, MOLSS is working with the Ministry of Finance and other agencies on a national policy of tax relief for pensions. Meanwhile, several provinces have issued their own tax policies on employer contributions, but they have been silent on the treatment of employee contributions.

It is expected that the new EA plans will increase the number of workers covered by a retirement plan beyond the current 169 million, which is less than 25 percent of the national labor force. The EA program is also expected to promote China's capital market development. Although the World Bank has projected that China's pension fund market could grow to as much as US$1.8 trillion by 2030, many industry professionals predict that managed corporate pension funds could reach that level much earlier. China's voluntary pension plan assets currently stand at about RMB50 billion (US$6.19 billion), but once the EA program is implemented, managed assets are expected to increase by as much as RMB100 billion per year (US$12.37 billion).

Pension reform is a high priority in China where the ratio of workers to the elderly is expected to drop from 9 to 1 to 2.6 to 1 over the next 40 years. (See also the October 2004 issue of *International Update*.)

**Sources:** *Pensions* 10(1) 2004; Stan Feng, "China Pension Update," presentation at OECD/IOPS Conference on Private Pensions in Asia (Bangkok, Thailand), April 27, 2005; Yan Hu, "Regulatory Framework: China's Pension System," and Raymond Tam, "Role of Insurance Companies in Pension Business—China Experience," presentations at the International Actuarial Association International Pension Seminar (Taipei, Taiwan), May 30–31, 2005; Watson Wyatt, Global News Briefs, August 2005; *Financial Times*, August 2, 2005; AFX Asia, August 3, 2005; *China Industry Daily News*, August 3, 2005; *Industry Updates*, August 3, 2005; *NewTrak Daily*, August 4, 2005; Bloomberg News, August 23, 2005; PRNewswire, September 2, 2005.

# Africa

## *Kenya*

**A new law promotes greater old-age security for workers by restricting the early withdrawal of retirement savings.** Through June 9, workers routinely withdrew their retirement savings from their employer's pension plan, including their employer's contributions, as a lump sum when they changed or left their jobs.

Now, with the exception of those in ill health or those who have been part of an occupational plan for less than 3 years, workers who leave their jobs before the normal retirement age of 55 may no longer withdraw all of their retirement savings at that time. Workers will, however, be allowed to withdraw their own contributions before reaching the age of 55. They will also be allowed to use their retirement savings, including their employer's contributions, as collateral when buying a home.

This action has sparked debate over the likelihood of workers actually collecting their retirement benefits, given that the prevalence of HIV/AIDS has caused life expectancy in Kenya to decline by more than a decade since 1990. According to the World Health Organization, a male born in Kenya in 2003 can expect to live to age 50, a female to age 49. Some estimates, however, place life expectancy at birth in Kenya as low as age 45 for both men and women.

Kenya's pension system comprises voluntary employer-sponsored pension plans; a civil service pension program; and a 2.9 million member provident fund for private-sector workers, which the government is in the process of converting to a mandatory defined benefit social insurance program. Kenya's labor force in 2004 is estimated at 11.4 million. (See also the March 2004 issue of *International Update*.)

**Sources:** Hewitt Global Retirement and Financial Management (RFM) Update, August 2005; Hon. David Mwiraria, Minister for Finance, budget presentation to the Kenya National Assembly for fiscal year 2005–2006, June 8, 2005; Library of Congress Federal Research Division, Country Profile: Kenya, March 2005; World Health Organization, Kenya, August 2005; *The World Fact Book*, Kenya.

# Reports and Publications

## *The World Bank*

**On August 23, the World Bank released a report, *Pensions in the Middle East and North Africa: Time for Change*, indicating that pension systems in the Middle East and North Africa (MENA) are urgently in need of reform.** This is the Bank's first regional review of 13 MENA countries covering more than 30 pension systems. The report presents recommendations for these governments to gradually reform their currently unsustainable pension systems.

Aging is not yet an issue in the MENA region where populations are still relatively young. In fact, 36 percent of the region's current population is under the age of 15. The lowest median ages are found in Yemen: 16.5 years, the West Bank and Gaza: 17.1 years, and Iraq: 19.1 years; the highest are found in Lebanon: 26.8 years, Kuwait: 29.5 years, and Bahrain: 29.8 years. Instead, the World Bank report found that the pension systems in these countries face structural problems which include

- limited coverage—only a third of the labor force are covered, primarily workers in the public and formal private sectors;
- lack of plan uniformity and portability—multiple plans limit labor force mobility across sectors and fail to take advantage of economies of scale from managing a single pension plan;
- eligibility conditions that encourage early retirement;
- benefit formulas that disfavor lower income workers by basing pension entitlement on final salary, which is open to abuse, rather than on average lifetime earnings;
- unsustainable benefit promises, given current retirement rules and contribution rates; and
- weak governance and administrative capacity as reflected by the generally poor management of pension reserves.

The report highlights the uneven progress across the region to address these problems and ranks the countries by sorting them into three groups, exploring certain socioeconomic factors that might explain the differences.

- The first group of countries, which includes Algeria, Libya, and Syria, are at the earliest stage of the pension reform process or have not even begun to discuss reform.

- The second group of countries, Iran, Iraq, Tunisia, and the Republic of Yemen, are further along in policy discussions but still lack a coherent strategy for reform.
- The third group of countries, Djibouti, Egypt, Jordan, Lebanon, Morocco, and the West Bank and Gaza, have either developed detailed reform proposals or have begun to implement their pension reforms.

The report urges countries in the first group to develop the baseline data that is necessary to conduct a proper financial assessment of their systems before considering alternative reform packages. For countries in which policy discussions have advanced but a coherent strategy has not yet emerged, the Bank recommends moving from strategic guidelines to a detailed reform. Those MENA countries with reform experience are advised to consolidate their policies into an integrated strategy and move toward implementation.

**Sources:** *World Population Prospects: The 2004 Revision*; World Bank, press release, August 23, 2005; *Pensions in the Middle East and North Africa: Time for Change*; *Daily Star* (Beirut), August 24, 2005.

## *Social Security Administration*

**The Social Security Administration has released *Social Security Programs Throughout the World: Africa, 2005***, part of a four-volume series that provides a cross-national comparison of the social security systems in 44 African countries. It summarizes the five main social insurance programs in those countries: old-age, disability, and survivors; sickness and maternity; work injury; unemployment; and family allowances. The other regional volumes in the series focus on the social security systems of countries in Europe, Asia and the Pacific, and the Americas. The report is available online at: http://www.socialsecurity.gov/policy/docs/progdesc/ssptw/2004-2005/africa/index.html.

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Editor: Susan A. Carleson.

Writers/researchers: Denise Lamaute, Barbara E. Kritzer, David Rajnes, and Craig Romm.

**Social Security Administration**
Office of Policy
Office of Research, Evaluation, and Statistics
500 E Street, SW, 8th Floor
Washington, DC 20254

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