



January 2007

Europe

Cyprus

In November 2006, Cyprus' parliament passed legislation requiring pension funds to obtain professional investment advice and diversify their assets. The measure brings Cyprus in compliance with the 2003 European Union Pension Funds Directive, which provides guidance on pension fund regulation, sets standards for investment operations, and requires information dissemination to pension fund members. The law will help increase the flow of pension fund money into domestic equities. Today, the majority of fund investments are in time deposits with banks, earning reliable but low rates of return. Private pension plan assets in Cyprus total over CY£2 billion (US\$4.5 billion).

The private pension funds supplement the public pay-as-you-go social insurance system that covers both public- and private-sector employees. Employers and employees each contribute 6.3 percent of payroll, the self-employed contribute 11.6 percent of earnings, and the government contributes 4 percent of payroll. These contributions also finance other social insurance programs: sickness and maternity, work injury, and unemployment benefits.

Under the public pension system, old-age benefits are available to individuals aged 65 with at least 3 years of contributions. Individuals who do not qualify for a public pension old-age benefit may qualify for a social assistance pension.

Sources: *International Update*, July 2005; *Social Security Programs Throughout the World: Europe, 2006*; Reuters, November 6, 2006; *Investment & Pensions Europe*, November 20, 2006; Thomson Online Benefits, December 29, 2006; Cyprus Stock Exchange, January 8, 2007; *International Financial Law Review*, January 8, 2007.

Italy

On January 1, 2007, the Italian government advanced by 6 months (from January 1, 2008, to June 30, 2007) the required date for companies to transfer severance funds, known as *Trattamento di fine rapporto* (TFR), into private pension funds. TFRs are mandatory end-of-employment accounts that employers must maintain for employees. The law, passed on December 12, 2006, as a

part of broader pension reform in Italy, requires companies with at least 50 workers to transfer their TFR funds to a pension fund by the new date.

Employees of companies with more than 50 employees, who have already joined either an employer-sponsored or private pension fund, will have their TFR transferred into that pension fund. Employees who have not joined a pension fund may:

- Select their employer's pension fund for their TFR;
- Select a private pension fund not sponsored by their employer for their TFR; or
- Transfer their TFR to the state-run National Social Insurance Institute (Istituto Nazionale Previdenza Sociale, or INPS) fund. Employees who do not make a selection will automatically have their TFR transferred to the INPS.

The former law allowed companies to access TFR funds (often as low-interest, medium-term loans) as long as the company could pay the TFR to employees when they terminated employment. (See also the December 2005 issue of *International Update*.) The new law curtails this practice.

Under the old rules, employers contributed 7 percent of an employee's annual wages into a TFR account, plus 1.5 percent annual interest on the employee's TFR account balance. Each year the employer added to the employee's TFR account an additional 75 percent of the annual inflation rate multiplied by the employee's account balance. Employees did not contribute to the TFR. When employees terminated employment for any reason, they received a lump-sum payment equal to the balance in their TFR account.

Beginning July 1, 2007, TFRs will no longer exist for firms with 50 or more employees. These larger employers will be required to contribute 7 percent of the employee's annual wages to employee-selected pension funds.

The new TFR law generally exempts employers with fewer than 50 workers from the requirement to transfer TFR funds to an employee pension account. Smaller companies may voluntarily deposit TFR funds into the employee's company-sponsored pension account, unless

an employee explicitly decides not to join the company's pension fund. If an employee decides not to join the company's pension fund, the company will continue to hold an employee's TFR in a separate interest-bearing account or transfer the money to an employee-selected private pension account.

According to government estimates, the €18.9 billion (US\$24.2 billion) that would have gone into TFR accounts in 2007 is likely to be deposited as follows:

- 36.6 percent (€6.91 billion, US\$8.85 billion) into employer-sponsored or private pension funds;
- 31.7 percent (€5.99 billion, US\$7.67 billion) into INPS; and
- 31.7 percent (€5.99 billion, US\$7.67 billion) retained by the companies exempted under the special provisions for companies with fewer than 50 workers.
- In 2005, TFR reserves totaled about €125 billion (US\$160 billion), or about 10 percent of Italy's gross domestic product.

Sources: *Social Security Programs Throughout the World: Europe, 2006*; Reuters, October 19, 2006; AFX News limited, October 24, 2006; *Pension & Benefits Daily*, November 14, 2006; *The Law Decree on TFR now in force*, Istituto per la Promozione Industriale, November 15, 2006.

United Kingdom

On December 12, the United Kingdom's Department for Work and Pensions released a White Paper proposing the automatic enrollment of private-sector workers into a new, low-cost defined contribution personal account system by 2012. This system, known as the National Pensions Savings Scheme (NPSS), is part of a broader series of pension reforms proposed by the government in the Pensions Bill submitted to parliament in November 2006. The NPSS would target the estimated 7 million persons not currently saving enough for retirement, especially employees with annual income below £15,000 (US\$29,100), people in their 20s and 30s, and women.

The White Paper provides details about the NPSS, including:

- Automatic enrollment of employees between age 22 and the state pension age of 65, unless they already participate in a workplace retirement plan with benefits equal to or greater than those proposed in the NPSS. Individuals may opt out of the NPSS, but the government would automatically re-enroll them every

3 years. Individuals may opt out of the NPSS with each re-enrollment.

- Contributions of at least 4 percent of earnings from employees and 3 percent from employers phased in over 3 years. Employees participating would also benefit from a tax credit equal to 1 percent of their salary. Contributions would be based on earnings between £5,000 (US\$9,830) and £33,500 (US\$68,808) per year, up to an annual contribution ceiling of £5,000 (US\$9,830).
- Self-employed and unemployed individuals voluntarily participating in the NPSS. No minimum contribution would be required, although the annual maximum contribution of £5,000 (US\$9,830) would apply.
- Several investment choices: a default fund, a limited number of low fee "bulk-bought" funds, and a wide range of other funds. Private-sector fund managers would compete to invest NPSS funds.
- No transfers into or out of NPSS accounts, either from or to existing pension plans, allowed after 2012—the first year of NPSS operation.
- Benefits may begin as early as age 55 and must begin by age 75.
- A tax-free lump-sum distribution up to 25 percent of the NPSS account balance.

The White Paper included the Pension Commission's recommendation for a single NPSS body to collect contributions via a central clearinghouse, to contract with private-sector service providers for the operation of low-cost personal accounts, and to carry out the placement and review of contracts for fund management.

The government projects that annual administrative charges for the NPSS, as a proportion of an individual's NPSS account size, would be about 0.5 percent of assets initially and eventually decline to less than 0.3 percent. The government would establish a Personal Accounts Delivery Authority to design NPSS policy and develop a "commercial and procurement" strategy. By 2012, this delivery authority would turn over the supervision and operation of personal accounts to an independent Personal Accounts Board, a corporate body similar to a pension fund board of trustees.

The government expects the NPSS to promote long-term retirement savings especially in low-income households. It estimates that by 2050, 9 out of 10 households will benefit from these private accounts, adding

between £4 billion (US\$7.86 billion) and £5 billion (US\$9.83 billion) in pension savings each year.

The White Paper and other pension reform information is available at <http://www.dwp.gov.uk/pensionsreform>. The consultation period began on December 12, 2006, and will run until March 20, 2007.

Sources: *Are Personal Accounts Suitable for All?* Pensions Policy Institute, November 2006; *Personal Accounts: A New Way to Save*, UK Department of Work and Pensions, December 2006; Watson Wyatt, December 2006; *Professional Pensions* (London), December 12, 2006; Reuters (London), December 11, 2006; *The Sunday Times* (London), December 17, 2006; BBC News, December 18, 2006; *Money Marketing* (London), December 21, 2006; and Fool.co.uk (London), December 26, 2006.

The Americas

Chile

On December 19, 2006, Chilean President Michelle Bachelet sent Congress a pension reform bill to increase coverage and benefits provided by Chile's 25-year-old individual retirement accounts system. The government expects Congress to approve the bill this year and implement the reforms in 2008. The proposed changes are based largely on the Pension Advisory Commission's July report. (See also the July 2006 issue of *International Update*.)

The proposed reform adds a new pillar, known as *Sistema de Pensiones Solidarias* (SPS), to the existing mandatory individual retirement accounts system. The SPS would replace the current means-tested pensions and the guaranteed minimum pension (see also the May 2006 issue of *International Update*.) with two types of pension benefits to the country's low-income population aged 65 or older who have lived in Chile for at least 20 years. The SPS would offer a pension of 60,000 pesos (US\$111) a month beginning July 1, 2008, to individuals who are not eligible for any other pension. SPS would also provide a top-up benefit of up to 60,000 pesos (US\$111) a month to a retiree whose pension from an individual retirement account is lower than 200,000 pesos (US\$369).

A number of other proposed reforms address gender equity:

- As an incentive to work beyond age 60, a woman would be allowed to contribute to her individual retirement account until age 65. Currently, workers may contribute to their individual retirement account only until age 65 (men) and 60 (women). The President's bill did not include the Pension Advisory

Commission's proposal to raise the retirement age for women from age 60 to 65.

- Beginning July 1, 2009, all women retiring at age 65 would receive a bonus for each child she had, another incentive for women to work longer. The bonus would be equal to 12 monthly contributions based on the minimum wage at the time each child was born, plus 4 percent annual interest for each year after the child was born until the woman reaches age 65.
- Widowers would receive a survivor pension. Currently, only widows receive this benefit.
- In case of divorce or marriage annulment, the assets in an individual retirement account would be divided evenly between the spouses.

Another reform provision mandates that the self-employed, about 27 percent of the labor force, join the individual retirement account system within 7 years after the reform has been implemented. Currently, the self-employed are not required to establish an individual account, and less than 5 percent of them are enrolled in the system.

In order to promote youth participation in the individual retirement account system, the reform proposes a monthly subsidy to low-income workers (those who earn less than 1.5 times the minimum wage) between ages 18 and 35 for the first 24 months of employment after they first enter the labor force. The subsidy has two parts: up to 5 percent of the minimum wage would be paid directly to the worker, and up to 5 percent of the minimum wage would be deposited into a worker's individual retirement account.

The reform bill also includes a provision for employer-sponsored voluntary pension plans, known as *Ahorro Previsional Voluntario Colectivo* (APVC). Even though other types of voluntary retirement savings plans already exist in Chile, the government wants to encourage more workers to supplement their mandatory individual accounts. Under the proposed plan, an employer would be permitted to set up more than one APVC plan as long as a majority of workers in the company approved each plan. Both employers and employees would contribute to the AVPCs. Workers would choose to receive a tax break on either their contributions or their retirement benefit.

Finally, provisions of the bill to increase competition among the pension fund management companies (AFPs) and lower individual account holder fees include:

- Eliminating the monthly fixed administrative fees that most AFPs charge their account holders, which are in addition to the monthly percentage-of-earnings fees

workers pay. Fixed fees are proportionately higher for low-wage earners than for high-wage earners.

- Allowing banks to establish an AFP as a subsidiary with restrictions that ensure fair competition for all AFPs. Under current law, banks are specifically prohibited from setting up an AFP.
- Gradually raising the AFPs' foreign investment limit from 30 percent to 80 percent 3 years after the reform has been implemented.
- Assigning new labor force entrants to an AFP with the lowest fees. The AFP would have to maintain that fee for 18 months and offer the same low-rate fee structure to all its account holders.

Sources: "Reforma Previsional: Protección para la vejez en el nuevo milenio," diciembre 2006; "Mensaje de S.E. La Presidenta de la República con el que Inicia un Proyecto de Ley que Perfecciona el Sistema Previsional, el 15 de diciembre de 2006; US Fed News, December 15, 2006; Fund Pro Latin America, December 19, 2006; *El Mercurio*, 20 y 26 de diciembre de 2006; *Business News Americas*, December 21, 2006.

Asia and the Pacific

China

On November 29, China's public pension reserve fund, the National Social Security Fund (NSSF), selected 10 foreign pension asset management companies to invest its assets outside the country. The government expects greater portfolio risk diversification and higher rates of return on reserve fund assets from this new investment policy. China's public pension reserve fund initially awarded the 10 asset management companies approximately US\$1 billion to invest, but that amount will grow because current guidelines allow the reserve fund to invest up to 20 percent of its 230 billion yuan (US\$29 billion) in assets overseas.

The National Social Security Fund was established in 2000 to supplement anticipated shortfalls in China's provincial pension systems. Funding for the NSSF comes from the central government budget, the national lottery, investment income, and the privatization proceeds of state-owned enterprises. (See also the April 2004 issue of *International Update*.) From 2001 to 2003, the NSSF held most of its assets in cash and low-yielding government bonds. In 2003, the NSSF began investing in domestic equities and corporate bonds, which accounted for 73 billion yuan (US\$9 billion) at the end of 2005.

In 2004, the NSSF was one of the first financial institutions in China to receive Qualified Domestic Institutional Investor (QDII) status, which allowed investments over-

seas. After regulations were issued, the NSSF began the process of selecting global fund managers in May 2006. The 10 financial firms chosen will manage NSSF investments in the following areas: the Hong Kong stock market; global equities, excluding the United States; foreign exchange cash products; United States equities; and international bonds.

Until recently, capital controls limited Chinese financial institutions to investing only in domestic equities and government bonds. These restrictions were relaxed in 2006, allowing banks, insurance companies, and other domestic financial institutions to invest in foreign financial markets. For example, Chinese insurance companies have US\$3.5 billion invested in foreign assets, and regulators have given Chinese commercial banks permission to market international investment products worth US\$11 billion to individual investors.

In a December 2006 cabinet-level White Paper, the government acknowledged the impact that rising life expectancy (71.5 years at birth in 2000 to 78.7 years at birth in 2050) and declining fertility (2.55 in 1980 to 1.7 in 2000) will have on future pension expenditures. The United Nations (UN) projects that the share of China's population aged 15 or younger will decline from 24.8 percent in 2000 to 15.7 percent in 2050, and the share of persons aged 65 or older will more than triple, from 6.8 percent to 23.6 percent. With fewer children entering the work force, the UN estimates a decline in the working-age population (ages 15–64) from 68.4 percent to 60.7 percent during the same 50-year period.

Sources: *World Population Prospects: The 2004 Revisions*, United Nations, 2004; *The Globe and Mail* (Toronto), October 11, 2006; PR Newswire, October 12, 2006; *Financial Times*, October 24, 2006, and November 30, 2006; Dow Jones News Service, November 29, 2006; *Market News International*, November 29, 2006; *Shanghai Daily*, November 30, 2006; *Wall Street Journal*, November 30, 2006; *SinoCast China Financial Watch*, December 1, 2006; *Wall Street Journal Asia*, December 5, 2006; and *Taipei Times*, December 22, 2006.

International Update is a monthly publication of the Social Security Administration's Office of Policy. It reports on the latest developments in public and private pensions worldwide. The news summaries presented do not necessarily reflect the views of the Social Security Administration.

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SSA Publication No. 13-11712