Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

August 2007

The Americas

Canada

A newly published Statistics Canada report, *Portrait of the Canadian Population in 2006, by Age and Sex*, released in July 2007, reveals that Canada's population is growing older at a steadily increasing pace. According to the report, within 10 years, more Canadians will enter retirement than will enter the workforce. Statistics Canada, the nation's central statistics agency, produced the report using 2006 Canadian census data.

The report notes that in 2006, the median age of Canada's 31.6 million people is 39.5 years, up from 37.6 years and a population of 30 million in 2001. The median age is expected to reach 44 years by 2031. Life expectancy at birth in Canada is up to 82.5 years, from 77.7 years in 2004.

The ratio of the population aged 15 to 24 to those aged 55 to 64 has decreased from 2.3:1.0 in 1976 to 1.4:1.0 in 2001 and 1.1:1.0 in 2006. One in seven Canadians is aged 65 or older, and the number of Canadians aged 80 or older reached 1.2 million in 2006. Government experts warn that Canada's aging population—and pending baby-boom retirements—may lead to declines in the rate of growth, and lower productivity could spark inflation. Further, many experts contend that the growing number of older Canadians may weaken the nation's publicly funded universal health care system.

Today, all Canadians older than age 65 with at least 10 years of residence after attaining age 18 are eligible for a universal old-age pension. Additionally, most working Canadians are covered by either the Canada Pension Plan or the Quebec Pension Plan, both of which are mandatory earnings-related pension programs. Workers aged 60 or older who have made at least one contribution are eligible to receive benefits from one of the mandatory pension programs. Employers and employees each contribute 4.95 percent of earnings, and the self-employed contribute 9.9 percent of earnings. Finally, 60 percent of Canadian workers participate in voluntary occupational pension plans.

A copy of the report is available at http://www12.statcan.ca/english/census06/analysis/agesex/index.cfm.

Sources: Statistics Canada, July 31, 2007; *Canada Today*, July 23, 2007; *Global Pensions*, July 16, 2007; *The Globe and Mail*, July 16, 2007.

Chile

Chilean pension fund management companies (AFPs) can increase their foreign investments from 30 percent to 45 percent of their assets. Within the next year, the Central Bank will oversee a gradual increase in the AFPs foreign investment limit to 35 percent of assets and then eventually to 45 percent. The AFP Association estimates that this increase will permit US$12.5 billion n AFP assets to be invested in foreign securities.

The goal of this measure is to allow the AFPs to diversify their portfolios. The gradual implementation aims to lessen impacts on the local market that may accompany a reduced concentration in domestic instruments. Some analysts express their concern that current AFP investments inflate domestic stock and bond prices and reduce liquidity. As AFPs increase their exposure to foreign assets, they are most likely to reduce the allocation of their domestic fixed-income assets. AFPs expect a higher yield from their foreign securities than they earn from their domestic fixed-income assets.

Over time, the government has increased the AFPs' limit on foreign investment incrementally. For the first 10 years of operation, AFPs were not allowed to invest overseas. In 1992, international investments represented less than 1 percent of AFP assets, and by 2002, that amount had reached about 15 percent.

Raising the AFPs foreign investment limit is part of the social security reform package currently before the Chilean Congress (see also the January 2007 issue of *International Update*). The provisions of this proposed reform include an increase in allowable foreign investments to 80 percent of assets. Because many expect the social security reform to be approved by the Chilean Congress by 2008, the overseas invest-

ment bill passed in July is largely viewed as an interim measure.

AFPs have more than US$100 billion in assets under management, over 60 percent of the country's gross domestic product. The AFPs' combined portfolio at the end of June 2007 included about 30 percent in foreign investments, 30 percent in the domestic financial sector, 10 percent in government debt, and 7 percent in domestic equities.

Separately, a new regulation announced on May 7, 2007, requires AFPs for the first time to submit a statement of their investment policies to the pension regulator (Superintendent of AFPs, or SAFP) for each of the funds they offer. Each AFP's board must approve this statement and assume responsibility for its policies. The SAFP must receive these policy statements by early September 2007 and will make them available to the public 30 days later.

Since 2002 each AFP must offer four (and is permitted to offer five) different types of funds with varying degrees of risk. From September 2002 through the end of June 2007, the average annual real rate of return for each type of fund among all the AFPs ranged from 3.34 percent to 18.02 percent. For the one fund that has been in existence since 1981, the average historical real rate of return is 10.35 percent per year.

Sources: *Social Security Bulletin* 65(1), 2003/2004; "Reforma Previsional: Protección para la vejez en el nuevo milenio," diciembre de 2006; Business News America, May 8, 2007; *El Mercurio*, May 8, 2007; *Pension and Benefits Daily*, June 1, 2007; Asociación AFP, Estudios (17), junio de 2007; Dow Jones International News, July 4 and August 1, 2007; SAFP, Comunicado de prensa, 7 de mayo de 2007 and 10 de julio de 2007; SAFP, Panorama Previsional, julio de 2007; Banco Central de Chile, Comunicado, 31 de julio de 2007.

Asia and the Pacific

Japan

Concerns over the mishandling of public pension records have rocked Japan this summer. At issue is the more than 50 million unmatched public pension records managed by the Social Insurance Agency (SIA), raising questions about the accuracy of the agency's computerized record system. A variety of corrective measures, including legislation to overhaul the SIA and steps to resolve undocumented claims for pension benefits, have yet to ease public anxiety over the agency's management of pension records. On July 2, 2007, an independent government panel began investigating public pension record-keeping practices and establishing pension payout criteria for undocumented pension claims related to the unmatched pension records.

Until 1997, it was common for workers to receive a new pension identification number every time they switched jobs. That year, the SIA introduced an integrated computer database and initiated steps to combine an individual's multiple pension accounts into a single account with a unique pension identification number. However, the conversion faltered and many pension records could not be linked to the proper contributor. According to the SIA, about 50 million pension records still remain unmatched.

The volume of complaints and inquiries to the SIA about missing payment records increased dramatically as details about the mismanagement of pension records began circulating in the media last October. To restore public confidence in the public pension system, the Japanese government introduced the following two pieces of legislation, both enacted in July 2007:

- One law abolishes the SIA by 2010 and transfers its responsibilities to a new institution that will regulate and supervise private-sector firms. The private-sector firms will collect public pension contributions and perform record-keeping and other pension system tasks.
- A second law will allow pensioners to claim, retroactively, benefits they did not receive because of the SIA's record-keeping errors. This law eliminates the previous 5-year statute of limitations on claiming benefits. According to the government, about 250,000 pensioners have not received an estimated 95 billion yen (US$801 million) in benefits, or about 380,000 yen (US$3,202) per beneficiary.

The independent panel investigating the SIA's record-keeping errors submitted a draft of its interim report to the government on July 10. The panel established the following three working groups to continue exploring the issues raised in that report:

- One working group will analyze problems with the SIA's record-keeping system.
- A second group will investigate the agency's compliance system by examining the possible misappropriation of pension contributions by SIA employees.
- A third group will study the agency's management of the pension system, including how working conditions based on labor–management

agreements may have negatively affected daily operations.

The independent panel also established the basic criteria for determining pension benefits for individuals whose contribution payment records cannot be located by the SIA. This new criteria will be used by 50 local panels created to screen individual cases that have incomplete pension payment histories. Screeners will accept as evidence of contribution payments such records as salary statements, tax returns, or documentation from a contributor's employer.

The government aims to reconcile the 50 million unmatched public pension records and send the results of the verification process to program participants and pensioners by October 2008. Approximately 100 million individuals, including all pensioners and those currently paying into the public pension program, will receive a detailed contribution payment history upon completion of the records' reconciliation process.

Sources: *Daily Yomiuri*, May 18 and July 9, 2007; *International Herald Tribune*, May 24, 2007; *Kyodo News*, May 29 and June 4, 2007; *Mainichi Daily News*, June 5, 2007; *Nikkei Report*, June 5 and July 6, 2007; *Yomiuri Shimbun*, July 6 and 11, 2007; *Japan Times*, July 13 and 18, 2007.

Reports and Studies

World Bank

The World Bank released a report that assesses the implications of aging populations in Eastern Europe and the former Soviet Union for pension systems, health care, labor markets, savings, and capital markets. The 2007 report, *From Red to Gray: The "Third Transition" of Aging Populations in Eastern Europe and the Former Soviet Union*, concludes that policy reform can substantially mitigate the potentially negative economic consequences of rapid demographic change, even in the face of these countries' unique combination of rapid aging, low percapita income, and weak institutional development. In particular, the report argues that an aging population does not necessarily imply slower economic growth or lead to an increase in public spending.

For a majority of the nations in the study, the average age is projected to increase by 2025, while the populations of many of these nations are projected to decline over the same period. The extent of these changes varies considerably from country to country. Kazakhstan's population, for example, will decline by 2 percent (approximately 0.3 million people), and the proportion of its population aged 65 or older will increase from just over 5 percent to just over 10 percent. Ukraine's population, on the other hand, will decline by 24 percent, or approximately 11.8 million people, and the proportion of its population aged 65 or older will increase from around 15 percent to over 20 percent. Other nations, however, notably the Central Asian countries and Turkey, will experience significant population increases over this period as well as an aging population.

The report estimates that countries in the region must undertake pension reform if they are to avoid a rapid increase in pension expenditures. If pension spending rises in proportion to the growth of the portion of the population aged 65 or older, by 2025 pension spending could rise from around 15 percent of gross domestic product (GDP) to 22 percent of GDP in Poland and from approximately 15 percent to 19 percent of GDP in Ukraine.

The report classifies countries in the region into several groups. One group, termed "aging early reformers," has already taken steps to ensure that pension expenditures do not rise in line with demographic changes. Poland and Latvia, for example, expect decreases in their pension expenditures by 2025 because of the reforms they enacted beginning in the mid- to late 1990s.

The report recommends the following two critical reforms in addition to reforms that countries may have already implemented on their own:

- First, the report suggests raising the normal retirement age for women so that it equals that for men and reducing the number of early retirement provisions.
- Second, the report advocates indexing pension benefits to prices instead of wages. Because wages typically increase faster than prices, this reform would lower pension costs.

Another group, termed "aging late reformers" in the report, has not undertaken reforms. Countries in this group include the western Balkans and former Soviet nations such as Ukraine. The report recommends that these countries implement the reforms mentioned above, as well as other reforms, in order to ensure the solvency of their pension systems.

In addition to rising expenditures and population decline, the unfunded pay-as-you-go (PAYG) systems in the region also face a decrease in the number of contributors across age groups, which will further

weaken the solvency of these pension systems. With the expected contraction of the contributing labor force, the report advises these countries to enact policies that foster greater labor force participation among the elderly, women, and youth by increasing opportunities for flexible, part-time work.

The report further suggests that the region's countries should undertake a more basic assessment of their public pension systems. This assessment would evaluate whether these countries will adequately meet the two major objectives of such systems in the future: preventing poverty in old age and consumption smoothing across a lifetime. Given the weak financial status of many of the region's PAYG systems because of the shrinking number of contributors, the report suggests that the region's countries adopt a flat noncontributory social pension to meet the first goal of preventing old-age poverty.

The full text of the report can be found at http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/0,,contentMDK:21378474~pagePK:146736~piPK:146830~theSitePK:258599,00.html.

Social Security Administration News

Totalization Agreement

The United States and Denmark signed an agreement to exempt U.S. and Danish employers and workers from double payroll taxation. The agreement, concluded on June 13, 2007, must now be ratified by the United States Congress and the Danish Parliament before it becomes effective. The agreement will exempt U.S. citizens sent by U.S.-owned companies to work in Denmark for 5 years or less from paying social security taxes to both countries. Similar arrangements will apply to Danish citizens sent to work temporarily in the United States.

Currently, U.S. workers sent to work in Denmark, and their U.S. employers, must contribute to both countries' social security systems. Once the agreement is ratified, U.S. workers stationed temporarily (5 years or less) in Denmark will be exempted from Danish social security taxes. Danish workers will be similarly exempted from U.S. social security taxes. Additionally, individuals who have worked in both countries but currently do not meet the minimum benefit eligibility requirements for either system may qualify for a benefit based on combined coverage credits from both countries. Combined coverage periods may be used to calculate retirement, disability, and survivor benefits.

The agreement will also significantly reduce costs for employers in both countries by decreasing their overall tax liability in their host country. Currently, many U.S. and Danish employers reimburse employees for social security taxes incurred as a result of foreign placement. Host countries, however, often consider these reimbursements to be taxable income, and employers then reimburse their overseas employees for the additional income tax on the taxable reimbursements. Under this new agreement, employers will no longer have to pay these overseas tax reimbursements.

The U.S. has totalization agreements with 21 other countries. The full text of the United States–Denmark agreement can be found at http://www.socialsecurity.gov/international/Agreement_Texts/denmark.html.

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