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# THE OPERATIONS OF PENSION SYSTEMS AROUND THE WORLD

## AUSTRALIAN INSTITUTE OF SUPERANNUATION TRUSTEES

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MARSH & McLENNAN COMPANIES

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# 1

## Executive Summary

A review of the operations of pension systems around the world has many aspects to it. Within this report, we have concentrated on the objectives of these systems, the metrics used to measure their success and some operational aspects.

However, before we begin, it is useful to highlight the role of each pillar in a three pillar system for the purpose of this report, as follows:

- The first pillar is a basic pension from public finances with a focus on poverty alleviation. It may be a universal pension, a means tested pension or a combination of the two. The Australian age pension is an example of the first pillar.
- The second pillar is a mandatory system which is earnings-related where the retirement benefit is determined, at least in part, by the period of service and career earnings. It may be provided by a public system or a fully funded private system as occurs through Australia's mandatory SG system.
- The third pillar is fully funded voluntary savings in the private sector which may be occupational pension schemes and/or individual arrangements.

There is an enormous variety of retirement income systems around the world yet many, if not most, of these systems do not have clearly stated objectives or goals. However, to the extent objectives or goals exist, it is evident the following two approaches are present:

1. A focus on the provision of a basic level of income through the first pillar. Denmark and Sweden could be considered examples of this approach.
2. A broader focus upon improving retirement income that encompasses more than one pillar, such as in Switzerland and potentially the UK. It is worth noting that the Swiss use subjective terms such as adequate or appropriate to go beyond the poverty alleviation concept.

None of the systems considered have an objective for pillar 2 (i.e. the SG in Australia) only. It is very difficult to have an objective for pillar 2 without an agreed objective for pillar 1 or the overall system. In this respect, a recent comment from the OECD is relevant:

> Funded private pension arrangements are complementary to public pensions and not a substitute. The growing importance of funded pension arrangements has been in general to complement PAYG-finance arrangements, becoming a component of overall retirement income.[1]

In countries with mandatory systems, employers are obligated to make contributions on behalf of their employees. Typically, the responsibility to enforce this action falls to a government agency although, in Sweden, this compulsion is provided by union involvement. The penalties for non-compliance are fines and compulsion to make contributions, even if this results in additional payments in some jurisdictions.

There is no general agreement on the measures used to assess the success of a pension system. Indeed, there is very limited evidence of countries measuring and monitoring the success of their retirement income system on a regular basis in either mandatory or compulsory systems. Of course, it should be recognised that governments may be reluctant to specify an objective metric for a compulsory system as any failure would be apparent for all to see. On the other hand, there appears to be some value in appointing an independent body to review the operations on a regular basis and report its findings to government. Such an approach could provide independent advice outside the political process.

Finally, there is a huge range of pension reform processes amongst the countries reviewed. With the possible exceptions of Finland and Singapore, none of these countries seem to have well-designed and well understood process of pension reform. Inevitably, financial and/or political pressures on governments can and do lead to short term decisions which may not always promote sustainable retirement income systems that provide adequate benefits for all. For example, neither the revised financial framework for pension funds in the Netherlands and the PBGC changes in the USA provided optimal results for funds members over the longer term. Similar outcomes have been seen in Australia as short term political decisions take priority!

**Dr David Knox**
**Senior Partner**

[1] OECD (2016), *OECD Pension Outlook 2016*, page 33.

# 2

## Introduction

In September 2016, it was agreed between Mercer and the Australian Institute of Superannuation Trustees (AIST) that global research would be conducted into different pension systems around the world that have some similarities to Australia to explore the objectives of each system, the metrics of success used in these countries and the processes used to develop pension reform.

The countries used in this study are Chile, Denmark, Finland, the Netherlands, Singapore, Sweden and Switzerland all of whom have compulsory or quasi-compulsory systems of private pension savings. In addition, we have included Canada, the United Kingdom and the United States as there are some parallels between their legislative and social backgrounds and that found in Australia. Section 2 of this report provides a brief description of the system in each country.

Section 3 reviews the objectives of each country's system as reported by our Mercer colleagues before Section 4 reviews the actual operations of mandatory systems.

In Section 5, the research focuses on measuring success and, in particular:

- What are key measures or metrics within the system (such as adequacy, fairness, sustainability, gender gap) that are used to measure success?
- How are the metrics or measures reviewed from time to time?

Finally Section 6 considers the process of pension reform by considering:

- The different processes and outcomes arising from the different legislative structures, including some advantages and disadvantages of various approaches
- Particular outcomes that may have arisen from a particular process, review or experience

# 3

## A description of each country's system

This section briefly describes the retirement income system in each country.

**Canada (8th in the 2016 MMGPI[2])**

Canada's retirement income system comprises a universal flat rate pension, supported by a means-rested supplement; an earnings-related pension based on revalued lifetime earnings (known as the Canada Pension Plan (CPP) or the Quebec Pension Plan); voluntary occupational pension plans (many of which are defined benefit schemes); and voluntary individual retirement savings plans.

The standard age to receive a CPP pension is age 65 although a reduced pension is available from age 60. Similarly an increased pension is available if the pension starts after age 65.

**Chile (9th in the 2016 MMGPI)**

Chile's retirement income system comprises means-tested social assistance; a mandatory privately managed defined contribution system based on employee contributions; and a framework for supplementary plans sponsored by employers.

The compulsory employee contribution is 10% of earnings. The resulting pension is available from the legal pension age - 60 for women and 65 for men. An individual can receive the pension and continue working. The exception is for public employees, who must cease work within 60 days after they decide to receive the pension.

**Denmark (1st in the 2016 MMGPI)**

Denmark's retirement income system comprises a public basic pension scheme, a means-tested supplementary pension benefit, a fully funded defined contribution scheme (ATP) and mandatory occupational schemes.

The occupational pension arrangements are mainly based on individual private savings and employer based pension schemes. The latter was made a part of all major Danish Collective Bargain Agreements (CBAs) from around 1991, starting with a contribution of approximately

[2] The 2016 Melbourne Mercer Global Pension Index covered 27 countries. Australia ranked 3rd.

0.9% of the employee's salary which has since evolved to a minimum of 12% of the salary for most Danish workers. This system is not compulsory in itself – only for the employers who have decided to (or have been "forced to") enrol in a CBA. Retirement savings through CBAs was initiated to mitigate inadequate social security due to a shrinking workforce, increased elderly burdens, and in order to obtain a higher degree of individually self-financed savings.

**Finland (4th in the 2016 MMGPI)**

Finland's retirement income system consists of a basic state pension, which is income tested, and a range of statutory earnings-related schemes.

Under Finnish legislation, private employers are under an obligation to arrange the pension provision (i.e. the statutory pension TyEL) for their employees, most of which is carried out through major pension insurance companies. The liability starts from the beginning of the month after the month the employee turns 18 and ends at the end of the month during which the employee turns 68.

**Netherlands (2nd in the 2016 MMGPI)**

The Dutch retirement income system comprises a flat-rate public pension and a quasi-mandatory earnings-related occupational pension linked to industrial agreements. Most employees belong to these occupational schemes which are industry-wide defined benefit plans with the earnings measure based on lifetime average earnings.

The occupational schemes can be compulsory if the social partners (i.e. employers and unions) request it to be compulsory with the government. If granted, the provision is compulsory for the whole sector represented by these social partners through a Collective Labour Agreement.

**Singapore (7th in the 2016 MMGPI)**

Singapore's retirement income system is based on the Central Provident Fund (CPF) which covers all employed Singaporean citizens and permanent residents. Employees and employers are required to make contributions towards retirement, healthcare and housing savings within the CPF. Some member benefits are available to be withdrawn at any time for specified housing and medical expenses with other benefits preserved for retirement.

A prescribed minimum amount is required to be drawn down at retirement age in the form of a lifetime income stream. This can commence at any time between ages 65 and 70.

**Sweden (5th in the 2016 MMGPI)**

Sweden's national retirement income system was reformed in 1999. The new system is a funded earnings-related system with notional accounts. There is also an income-tested top-up benefit which provides a minimum guaranteed pension. In addition, occupational pension plans have broad coverage.

Contributions to occupational pension plans are quasi-mandatory due to enforcement by collective agreements. It is estimated that 90% of the working population in Sweden are covered by a collective agreement. In this case, employers need to pay contributions into the relevant agreed occupational pension plan. The pension benefits depend on the collective agreement that the employer signs. The two large ones are ITP (for white collar workers) and SAF-LO (for blue collar workers). There are also other collective agreements for council workers, specific industries etc.

**Switzerland (6th in the 2016 MMGPI)**

Switzerland's retirement income system comprises an earnings-related State pension with a minimum pension; a mandatory occupational pension system where the contribution rates increase with age as well as voluntary pension plans.

Every employee with earnings above an annual threshold has to be covered by an occupational pension plan, which is registered with the supervisory authorities. The State Social Security authorities, which are providing the State pension for all employees and employers, have the additional duty to check and make sure that every employer covers its eligible employees in a registered pension plan.

**United Kingdom (11th in the 2016 MMGPI)**

The British retirement income system comprises a state pension supported by an income-tested pension credit, supplemented by voluntary occupational and personal pensions.

Auto-enrolment will cover nearly all employers by 1 April 2017, requiring employers to enrol employees (aged 22 and over who earn more than £10,000 p.a.) in qualifying pension schemes with minimum contribution rates. These are currently 1% for both employers and employees but increasing to a total of 8% from April 2019. Employees can opt out although the current opt out rate is less than 10%.

**United States of America (13th in the 2016 MMGPI)**

The American retirement income system comprises a social security system with a progressive benefit formula based on revalued lifetime earnings together with a means-tested top-up benefit; and voluntary pension plans, which may be occupational or personal.

# 4

# Objectives of the pension system

Mercer colleagues in the eight countries (including the UK where auto-enrolment is now in place) were asked whether there are any stated objectives for the private pension system or the broader retirement income system in their country. Here are their responses.

## Chile

There are no specific system objectives. There are only pension objectives for the solidarity pillar (1st pillar), as follows:

a) Basic Solidarity Pension for people who did not contribute to system
b) Guaranteed Minimum Pension / Solidarity Pension Contribution for those who contributed for a short time and with limited savings.

## Denmark

There are not any particular objectives as such, but naturally there are some general thoughts behind the current system.

The Danish retirement system is based on an intention of providing a minimum income for those in need. The original definitions (minimum income, need etc.) are not very detailed, and can be dated back to the first Danish legislation on the public pension in 1891. Several changes and new laws have altered the basic rules of the public pension since then but basically it – and its objective – originates back to 1891. ATP was added as a supplementary benefit saved by the individual employee themselves besides the savings through general taxes. A short answer to the question relating to objectives would be the Danish system was originally founded to provide a minimum income for those in need.

## Finland

No objective

## Netherlands

I am not aware of any particular objective. "What is the role of the various pillars?" is the subject of ongoing discussion in the Netherlands.

## Singapore

The main stated objective is to ensure that CPF can provide for basic retirement needs. In the event CPF does falls short of this (i.e. for the poor), top up payments and subsidies are provided by the government.

The main objective of the CPF is to be a comprehensive social security system that enables working Singapore Citizens and Permanent Residents to set aside funds for retirement. It also addresses healthcare, home ownership, family protection and asset enhancement. CPF savings are designed to provide a monthly income for basic living expenses in old age.

## Sweden

There is no objective for the whole system.

The DC section of the state pension, ITP1, promises to review fees to ensure that they are pushed down as far as possible.

The DB section of the occupational pension ITP2, naturally has the objective to pay the pension promises which is primarily achieved through insured DB plans.

## Switzerland

The pensions of the Federal Old-age, Survivors and Invalidity Insurance (i.e. 1st pillar) must be sufficient to cover basic living expenses adequately.

Article 113 of the Federal Constitution states the occupational pension scheme (2nd pillar), together with the Old-age, Survivors' and Invalidity Insurance, enables the insured person to maintain his or her previous lifestyle in an appropriate manner.

In article 111 it is stated: The Confederation shall take measures to ensure adequate financial provision for the elderly, surviving spouses and children, and persons with disabilities. These shall be based on three pillars, namely the Federal Old-age, Survivors' and Invalidity Insurance (1st pillar), the occupational pension scheme (2nd pillar) and private pension schemes (3rd pillar).

## United Kingdom

In a briefing paper prepared by the House of Commons library in May 2016, the following comments were made:

"The Government says that, based on a cautious set of assumptions about changes in future saving behaviour - its reforms (auto-enrolment, the introduction of the single-tier state pension in April 2016 and the bringing forward of increases in the State Pension age) will:

- Reduce the number of people facing inadequate retirement incomes by 1 million;
- Increase the incomes (and replacement rates) of 73% of those facing inadequate retirement income, bringing them closer to their target income; and
- Halve the proportion of future pensioners who will retire with no private income at all from 27% to 12% in 2050."

With the Government's reforms in place, over half of the people currently of working age considered in the Government's analysis are expected to build adequate retirement incomes and maintain their living standards during their retirement. However, this leaves an estimated 12.2 million people facing inadequate retirement incomes. Roughly half of these are within 20% of their target amount, with the remainder facing a more significant challenge. This is a particular issue for moderate and higher earners.

## Summary

It is apparent that many, if not most, retirement income systems do not have clearly stated objectives or goals. However, to the extent objectives or goals exist, it is evident there are two approaches that are present:

1. A focus on the provision of a basic level of income through pillar 1 (the Australian age pension equivalent) which could be summarised as poverty alleviation. Denmark and Sweden could be considered examples of this approach.
2. A broader focus upon improving retirement income that encompasses more than one pillar, such as in Switzerland and potentially the UK. It is worth noting that even in Switzerland they use subjective terms such as adequate and appropriate to go beyond the poverty alleviation concept.

None of these systems have an objective for pillar 2 (the SG in Australia) only. It is very difficult to have an objective for pillar 2 without an agreed objective for pillar 1 or the overall system.

# 5

## The operations of mandatory systems

In terms of the operations of the mandatory system in each country, Mercer colleagues were asked the following questions:

- How is compulsion enforced?
- What are the consequences for an employer or an individual who does not comply?

### Chile

Employees: The employer withholds the contribution from the employee's salary, and transfers it to the respective AFP. Workers who start work for the first time automatically join the system through the AFP with the lowest cost under the auction system.

The employer that does not pay the full contribution to the respective AFP is sanctioned with fines and an interest charge. A similar approach applies to employers that base the contribution on an amount less than real income.

Independent (self-employed) workers: From 2018, independent (self-employed) workers will be required to make contributions from their taxable income. The payment will be made from the annual tax return.

### Denmark

The only possible "non-compliance" with pension requirements is an employer not meeting the obligation to pay contributions to ATP. If an employer has not paid the full and correct amount to ATP, the employer is held liable for the full contribution (i.e. both the employer and employee part of the contribution).

### Finland

Employees have a statutory right to an earnings-related pension.  Employers are obliged to take out statutory pension insurance (TyEL) for all employees if the work is performed under an employment contract and the employee is between 18 and 67 years old and the monthly salary paid for the work is at least EUR 57.51.

Both the Customer Information Department and the Supervisory Department at the Finnish Centre for Pensions (FCP) ensure that employers arrange pension insurance for their employees.

If something is out of order, the supervision may lead to enforced insurance arranged at the expense of the employer. If an employer neglects its obligation to take out insurance, the FCP will urge that employer to correct the neglect.

Should an employer fail to heed the request for correction, the FCP will either take out insurance for the employee with one of the pension insurance companies at the expense and on behalf of the employer or provide the insurance company with the employer's insurance data. For the period of neglect, the pension contribution can be increased by as much as 100%.

If the individual is a self-employed person whose self-employment meets the criteria for coverage under the Self-employed Persons' Pensions Act, they will be reminded by the FCP if they have neglected to take out statutory pension insurance. If, despite the reminder, the individual neglects to take out insurance, the FCP will take out the insurance with a pension insurance company on the self-employed individual's behalf and at their expense

## Netherlands

If employers take out a pension provision other than the compulsory one, the employer can (and will likely be forced to) buy into the compulsory one as well. This means double retirement provision and double cost. On demand of Netherlands' legislator, advisors must perform a specific check before advising employers about pensions in order to ascertain if there is an Industrywide Fund applicable to the employer. That is, advisors have a certain duty of care to make sure the employer is free to make their own choice concerning pension provision. The advisor can be liable in case of double coverage but some employer clients are unwilling to pay for checks in advance, which makes executing the duty difficult.

## Singapore

Employers must make contributions to retain their business licence in Singapore.

This means that from an employer's standpoint, they may lose their business licence and/or be fined for not making the mandatory contributions. It is also the employer's responsibility to calculate the contribution amounts correctly and ensure the definition of pensionable earnings is correct. There is a grace period, and a period in which interest penalties apply for late contributions. Employee contributions are required through automatic deduction and also are the employer's responsibility.

## Sweden

The mandatory social security contributions are enforced through the normal tax collection payroll deduction process. So once the individual has completed their annual tax declaration, and it is approved by the local tax authority, they then pay the year's worth of contributions over to the pension authority as a lump sum contribution.

If the state sponsored contributions are not paid that means that tax has not been paid either, and therefore it will also be a case of tax evasion which will be pursued by the local tax authority.

For the occupational plans, compliance is enforced through the unions.

If it is found that employees have not been signed up to the collectively agreed pension plan, the employer will need to backdate all relevant contributions, otherwise risk union unrest.

## Switzerland

Every employee has to be covered by a pension plan, which is registered with the supervisory authorities. The State Social Security authorities, which are providing the State pension cover for all employees and employers, must ensure that every employer covers its eligible employees under a registered pension plan.

If an employer isn't affiliated with a registered pension plan, they will be automatically and retroactively affiliated by the State Social Security Authority with a central pension foundation, the Substitute Pension Plan. The Substitute Plan provides the legal coverage to all employees that have no other coverage available. As these are usually the "difficult" cases affiliated to the Substitute Plan, its premiums are comparatively high.

## United Kingdom

Any requirements are only relevant in respect of employers, as employees have the right to opt out.

Under auto-enrolment legislation, the employer has various reporting duties. The legislation also covers "anti-inducement" i.e. employers must not try to persuade employees or potential new hires to opt out. The Pensions Regulator is the supervisor and has a regulation and enforcement strategy. This covers both the approach and outlines potential fines on employers for non-compliance. The Regulator publishes monthly declaration of compliance reports and quarterly bulletins that provide information about enforcement action taken.

## Summary

In all these countries employers are obligated to make contributions on behalf of their employees. Typically, the responsibility to enforce this action falls to a government agency although, in Sweden, this compulsion is provided by union involvement. The penalties for non-compliance are fines and compulsion to make contributions, even if this results in additional payments in some jurisdictions.

Self-employed individuals face some responsibility to make contributions in Finland and, from 2018, will have responsibilities in Chile.

# 6

# How is success measured?

## What metrics are used to measure success?

Having considered the objectives and operations of mandatory systems, it is now appropriate to consider how success of retirement income programs around the world is determined.

There is no general agreement on the measures used to assess the success of a pension system. Indeed Denmark, the top performing country in the MMGPI, does not measure the success of their overall system at all!

Economists broadly agree that a conceptual benchmark measure for adequate retirement saving is an amount that will, along with other sources of retirement income, allow a household to maintain its pre-retirement standard of living into retirement. However, there is no consensus about how much income this standard requires. It should also be recognised that adequate retirement income often comes from a variety of sources. In that respect, it is interesting to note that the OECD recently commented as follows:

> Funded private pension arrangements are complementary to public pensions and not a substitute. The growing importance of funded pension arrangements has been in general to complement PAYG-finance arrangements, becoming a component of overall retirement income.[3]

Although this comment is general in nature and not focussed on a particular country, it is relevant for the current Australian debate on the role and objectives of our superannuation system. That is, both pillars have an important role to play.

Several studies (particularly in the US) have attempted to evaluate the adequacy of retirement income or project the likelihood of current workers having sufficient retirement income. Some of these studies attempt to judge the retirement readiness of workers by using data on income, wealth, gender and race for working-age households and projecting a replacement rate at retirement; they then compare this projection to a target replacement rate that they estimate to be enough to maintain a standard of living in retirement. Different studies use different replacement rates or other benchmarks for defining retirement income adequacy. Hence there is no consensus.

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[3] OECD (2016), *OECD Pension Outlook 2016*, page 33.

Notwithstanding this lack of agreement, it is suggested that the range of measures that are sometimes used can be grouped into several categories, as shown below. To begin, we will consider the measures used in countries that have mandatory or quasi-mandatory second pillar schemes, (i.e. similar to Australia). The metrics listed relate to the answers provided by our colleagues in each country. The first two groups are adequacy and sustainability measures which are consistent with both the MMGPI and the European Commission themes.

## *Adequacy, including poverty alleviation*

- The replacement rate, although the level is not agreed (Chile, Finland)
- Basic retirement needs only and not an income to maintain lifestyle post retirement (Singapore)
- Assist those who have nothing or very little (Denmark)
- Percentage of aged population with income below 60% of median income (Finland)
- The length of the working life (Finland)

## *Sustainability*

- Pension expenditure as a % of GDP (Finland)
- Profitability of the pension fund (Chile)
- Self sustainability for the majority (Denmark)

## *Efficiency*

- Level of fees on individual savings plans (Chile)

## *Equity*

- Gender differences (Sweden)

The lack of clearly established and well known metrics in mandatory systems is again evident by the relatively few items in the above list. However, it should be recognised that governments may be reluctant to specify an objective metric for a compulsory system as any failure would be apparent for all to see.

One exception to this lack of regular measurement is the Finnish Centre for Pensions which publishes an annual report showing 30 indicators related to three central goals: length of working life, pension level and pension financing. This collection of indicators was first introduced in 2013 for the monitoring and evaluation of pension provision. In broad terms they are consistent with many of the European Commission’s (EC) indicators, initially discussed in their 2012 White Paper.[4]

[4] European Commission (2012), WHITE PAPER *An Agenda for Adequate, Safe and Sustainable Pensions.*

It is interesting that the EC noted in its White Paper that the basic purpose of pension systems is

> to deliver adequate retirement incomes and to allow people to enjoy decent living standards and economic independence.[5]

This relatively simple statement introduces the concepts of both adequacy and independence or self-reliance, at least to some extent.

Let us now consider three Anglo-Saxon countries that do not have mandatory second pillar schemes (namely Canada, UK and the USA) in the private sector as well as suggestions from the EC.

These items have been shown separately from the previous list as metrics within a non-mandatory system cannot be applied to the whole working population and are therefore guidelines or desirable outcomes from those within the pension industry rather than government objectives for the overall system.

## *Adequacy, including poverty alleviation*

- The replacement rate, although the level is not agreed (UK, USA, EC)
- Percentage of workers covered by an employment-related plan (Canada, UK)
- Percentage of aged population with income below 60% of median income or at risk of poverty (Canada, EC)
- Level of contributions paid into pension savings (Canada)
- Projection of the percentage of families expected to meet target replacement ratio in the future (Canada)
- Average duration of working life (EC)

## *Sustainability*

- Projected change in gross public pension expenditure as a percentage of GDP (EC)
- Long term affordability from the Government’s perspective (Canada)

## *Efficiency*

- Level of fees on individual savings plans and/or group plans (Canada, UK)
- Need for some flexibility in the system, including a multi pillar system (Canada)

## *Equity*

- No transfer of costs to the next generation (Canada)
- Gender relativity (EC)

[5] Ibid, page 9.

*International comparisons*

- The ranking of the system in international benchmarks such as the MMGPI (Canada)

In summary, there is no internationally accepted approach to measuring the success of pension systems. Of course, the relative importance between the public pension (1st pillar) and the private pension (2nd and 3rd pillars) also varies greatly between countries which adds to the uncertainty of what is best to measure.

Notwithstanding these difficulties, it is reasonable to summarise that the major areas of focus include:

- The net pension provided, whether that be at the basic or replacement rate level
- The workforce experience, which inevitably affects the pension provided
- The present and future cost to government, expressed as a percentage of GDP

## Have any metrics or measures been reviewed?

Given the absence of any agreement relating to metrics, there is very little evidence that there are published objectives or metrics that are regularly reviewed or monitored by Governments or regulatory agencies. Finland appears to be a possible exception although it has probably based most of its data publications on the EU's approach.

In many countries there is no formal process to review the pension system but here are a few examples of some activities that are undertaken.

**Finland**

In Finland, the research statistics including data on the effective retirement age, the financing of earnings-related pensions (such pension assets, financial statements and earnings-related pension contributions), and the pension recipients forms the basis of a review. The Finnish Centre for Pensions (FCP) receives all the data from pension providers and the Social Insurance Institution of Finland (Kela).

The FCP also makes earnings-related pension expenditure forecasts including a projection of the statutory pension expenditure of the ongoing year and the number of pensioners receiving an earnings-related pension. Long-term projections spanning 60-70 years are published every two or three years.

The results and subsequent reviews are then used as the basis for negotiations.

### Netherlands

In 2009 an independent committee was installed, the committee Goudswaard, that looked at the sustainability of DB schemes. The result was that the DB system was deemed unsustainable over the long term as a result of the current market environment and economic indicators. As a result, the financial framework for pension funds has been slightly amended.

The Dutch government has a long term and continuing aim to have as many workers (including business owners) in a pension plan. Groups of workers that are not in a pension plan are labelled as so called ‘white spots’ and the purpose is to reduce these as much as possible. In addition, legislation in the Netherlands will be gender neutral and measures are and will be taken to reduce any gender gap.

In terms of proposed legislation, the Central Plan Bureau (CPB) is asked to perform calculations in respect of legislative proposals. That is, the CPB will calculate all the effects of proposed legislation including the administrative burdens and the economic and budgetary effects

### Singapore

In Singapore, the government’s primary and main focus is the Central Provident Fund (CPF). In terms of the adequacy of basic retirement needs, it is not widely known what metrics or measures the government uses in setting contribution rates and expected lifetime income.

The CPF appointed an independent advisory panel in 2014 to evaluate and monitor certain metrics of the performance of the CPF and respond to feedback from the public/employers. The advisory board comprises a group of academics, finance practitioners and community representatives. Interestingly, in arriving at a recent set of recommendations, the Panel was guided by the considerations of adequacy, flexibility and simplicity.

We believe the advisory panel relies heavily on data provided by the Department of Statistics, and reviews items such as household expenditure, life expectancy and healthcare costs. Note that the CPF is a holistic system that goes beyond retirement and includes a focus on housing and healthcare. We believe many of the advisory panel’s recommendations were formally adopted or put into a road map for future adoption. We also understand the advisory panel has set up focus groups and discussions with the general public to informally test some of their recommendations.

### Sweden

The Pensionsmyndigheten (which is the state agency) gets annual directives from the government to follow and report back on the Swedish pension system. One item that is high on the current agenda is the gender differences in pensions (as women in general have much lower pension entitlements at retirement than men). This agency would also conduct any reviews although typically it does not provide recommendations.

There is also a body named “Pensionsgruppen” which consists of members from the main political parties in Sweden. It is led by the minister of Social Security in Sweden. They have recently initiated a study on gender and equality. This group may provide questions for the Pensionsmyndigheten to investigate.

**United Kingdom**

In recent years, the UK has been rolling out auto-enrolment of pension fund membership. Hence the success of auto-enrolment has been a policy that has been subject to considerable scrutiny and measure since 2012. The Department of Work and Pensions (DWP) published an evaluation strategy and a baseline report in 2012 and since then annual reports have been published by the DWP setting out the increase in the number of individuals participating in workplace savings, increases in the level of savings, the level of opt outs and the overall employer awareness and understanding. However these reports have had a stronger focus on auto-enrolment rather than broader retirement income outcomes.

**Summary**

There is very limited evidence of countries measuring and monitoring the success of their retirement income system on a regular basis. On the other hand, there appears to be some value in appointing an independent body to review the operations on a regular basis and report its findings to government.

# 7

# Processes for pension reform

To provide insights into how countries conduct pension reform around the world, we asked Mercer colleagues in each country the following questions:

a. Briefly describe the process and/or legislative structures used for pension reform in your country?
b. What are the advantages and disadvantages of the current processes? What changes (if any) would you recommend?
c. Can you provide an example or case study of how a particular process or review in the last five years has led to a particular outcome?
d. Have any new agencies or processes been established recently to oversee pension policies? If so, what are they?
e. What tensions or lack of cohesion (political, legal or otherwise) exist in your country that lead to fragmented or less desirable outcomes in the pension industry?

The following paragraphs provide a summary of the process of pension reform in the countries where relevant answers were received.

## Denmark

Normally one of the government parties will issue a proposal for reform. Any proposal has to be presented and considered by the parliament three times, before the parliament can vote on it. Typically, there will be a hearing in the process of making a new law, where various organizations or people in Denmark are asked to give their opinion. A law can't be passed in less than 30 days. The overall goal with the process is to make sure that everything has been considered before making a new law.

The best description on how the government thinks when it comes to pensions is the saving of money. They are willing to go all the way to make the population self-sustainable when they retire, so that there is basically no public pension left. This has been the main goal since 2000, and all changes have resulted in forcing the population to save up money in lifelong annuities and cutting back on public retirement, both in terms of amounts and social welfare.

## Finland

The principles of the scheme are largely agreed in connection with the negotiations between the labour market organisations. The State also participates in the negotiations, which means that the earnings-related pension scheme follows a so-called tripartite administrative model - the State, the employees and the employers. The coordination and preparation of the earnings-related pension legislation is administered by the Ministry of Social Affairs and Health. The Finnish Centre for Pensions, the pension providers, the labour market organisations and the Finnish Pension Alliance TELA, which lobbies for employee pension providers, participate in the preparation of legislation. The amendments to earnings-related pension acts will come into force once the Parliament has handled and approved the changes and the President has confirmed the acts with his or her signature.

The advantage of the tripartite administrative model is that the decisions are made in cooperation. However in the latest change the State had a strong impact on the outcome, partially due to the economic situation in Finland.

Since the pension system is partially funded, emphasis need to be given so that the distribution of the costs are equally distributed between different generations as well as to avoid short term reactive decisions while making decisions for future changes.

## Netherlands

The departments of Social Affairs and Finance will together draw up a headline note. This will generally be tested with the pension organizations, pension providers and parliament for comments, reactions and support.

If the way forward is more or less clear these departments will draw up a proposed bill, which will generally will be offered publically for consultation. After taking into account the comments and reactions, a bill will be drafted that will be sent through the legislative procedure with the Council of State, the House of Representatives and the Senate. Economic and financial effects of the proposed bill will be calculated by the CPB during the legislative process (see section 6).

The process is very thorough and takes the different views of stakeholders into account. However that is also is a potential problem, since there will be a lot of reactions to any proposal that will also filter through to parliament which can delay or obstruct the intended changes.

The financial framework for pension funds was amended from 1 January 2015. The intended reform was much bigger, but this didn’t seem feasible after consultation with stakeholders. The current framework therefore is a compromise between the previous system and the intended system. A major hurdle was bringing accrued benefits under the new framework.

In general there is a major generational conflict as a result of the current system, where pension funds need to cut benefits if their solvency rate is too low, which is impacted by the market interest rates. Retirees generally wish to take more risk in the valuation of benefits, which again can impact the younger generations and younger generations are looking for a more individualized system.

## Singapore

There is not a prescribed process for pension reform in Singapore. Much reform is driven at the discretion of the government. The government had been heavily criticized in prior years for not taking more views from the general public and hence the Advisory Panel was set up. However the role of the Advisory Panel is very much to provide recommendations only, and the government ultimately decides on what and when to implement.

The advantages of the current process are that the process of change is quite fast and often seamless as there are very few layers in approving changes to the CPF. The disadvantages, of course, are sometimes the interests and view of the general public may not be reflected. Hence the establishment of the Advisory Panel is a very positive step for Singapore.

The best example of the current process is the enhanced CPF Life (i.e. the lifetime annuity). For years the government debated and received critical feedback that retirees needed a safety net or support to ensure they did not outlive their retirement savings. The government was opposed to the idea of a pure DB annuity scheme as it did not want to absorb any risk. The Advisory Panel recommended a DC type annuity structure where all retirees' monies are pooled but their income could see slight fluctuations depending on experience. This was approved by the government and the enhanced CPF Life program was launched.

## Sweden

The state DC system has been adjusted in recent years, so that big pension increases for pensions in payment (based on a strong development of Sweden's finances) are somewhat capped. But on the other hand and as a consequence, if Sweden's economy is really weak in some years, then pensions in payment are not reduced as much as they would otherwise have been.

One area where "the system" has not managed to solve is the right to move pension capital between providers (i.e. in pillar 2). This can lead to people having many small retained benefits among many providers, rather than bundling them in one bigger policy with one provider.

## Switzerland

Initially a Report is compiled by the Federal administration in cooperation with the Bundesrat (federal council). Public consultation follows with the parties, interested public and NGO's invited to voice their opinion about the proposal. The complete Bundesrat reviews the law proposal and sends it to Parliament.

If the two chambers differ on a proposal, a committee consisting of members of both chambers works to formulate a compromise. The final text will become law after a waiting period of at least three months after official publication of the new law.

If within three months after publication at least 50,000 voters are asking for a vote about the new law or if a change of the Constitution is necessary, there will be a public vote, otherwise the law will take effect without vote
.
The above process can be very slow. It leads however to very balanced results, because one-sided decisions will inevitably lead to a popular vote with the possibility of the rejection of the law.

The complicated legal system, with the ability of the public to veto legal changes has led to the situation, that changes which are unpopular but necessary from an actuarial point of view cannot be realized. One example is that the necessary increase of the normal retirement ages from 65 for men and 64 for women to 67 is highly improbable. Also the conversion rate from accrued capital at age 65 into an annual pension remains on the outdated and excessive level of 6.8% (it should be lowered to about 5.4%). As a consequence, the investment surpluses of pension plans are used to finance this excessive conversion rate instead of increasing the benefits of all the insured.

## United Kingdom

The main driver for reform is government. There is no independent body overseeing or recommending policy, although of course many parties contribute to the debate and/or lobby for change. State and private pension provision is underpinned by detailed legislation covering structure, tax rules, member protection issues and DB funding, and any reforms are achieved through new and amending legislation.

Planned changes are often subject to open consultation. However, this process sometimes tends to focus on a relatively narrow set of questions around set proposals.

The fact that change is driven by successive governments is often seen as promoting short term thinking, and piecemeal policy arising from competing agendas (for example, Treasury versus Welfare).

Successive reforms in the area of private schemes are seen as having resulted in a system of huge complexity leading to high costs as well as disengagement among both sponsors and individuals.

Some of the current tensions include:

- EU legislation and rulings sometimes conflict with existing UK law and practice, necessitating review.

- Funding requirements for DB schemes and the increase in minimum DC contributions from April 2018 are seen as conflicting with commercial pressures on sponsoring employers.
- Intergenerational tensions, with the perceived voter power of the older generation sometimes seen as driving certain policy decisions.
- Introducing additional member protections without disproportionately increasing the burdens on schemes and providers.

## USA

Within the US Congress, several committees play a central role in shaping retirement legislation. In the Senate, these include the Finance Committee, whose jurisdiction includes all tax aspects of retirement policy as well as Social Security, and the Health, Education, Labor and Pensions (HELP) Committee, which oversees non-tax aspects of retirement plans, including Title I of the Employee Retirement Income Security Act of 1974 (ERISA). ERISA sets uniform minimum fiduciary, funding and disclosure standards for managing and administering private retirement (and welfare) plans.

In the House of Representatives, the Ways and Means Committee's retirement policy jurisdiction is generally parallel to that of the Senate Finance Committee. The Education and the Workforce Committee's retirement policy jurisdiction is generally parallel to that of the Senate HELP Committee.

Within the Executive branch, retirement policy is driven largely by the Department of Labor (DOL) and its Employee Benefits Security Administration (EBSA); the Department of the Treasury and its Office of Tax Policy; and the Pension Benefit Guaranty Corporation (PBGC).

The current policymaking process allows input from many interested parties. However, this has contributed to a growing patchwork of plan types, special rules and overlapping requirements. This is especially true in the employer plan system, where plans must negotiate a battery of tests regarding coverage, contributions, benefits, disclosure and other attributes to qualify for favourable tax treatment.

In addition, as retirement issues have become more politically charged, Congress and regulators have often been slow to address legal uncertainties and make improvements to the system. This "gridlock" has also encouraged regulators to push the boundaries of executive authority to implement controversial reforms such as sweeping new fiduciary standards for investment advice and state-run retirement plans for private-sector workers. At the same time, frequent legislation – particularly provisions solely aimed at raising revenue – adds to the uncertainty and undermines plan sponsorship.

In three of the past five years, Congress has enacted substantial increases in the premiums that single-employer defined benefit pension plan sponsors must pay to the PBGC. These increases have been used mainly to justify new spending on unrelated federal programs under a federal budget accounting quick, even though premiums can only be used by the agency's insurance program. Many plan sponsors are concluding that the only way to reduce the growing burden of PBGC premiums is to leave the pension system, undermining retirement security for many as well as the financial health of the PBGC.

With Congress unable to enact federal reforms that would expand retirement plan coverage, the Department of Labor recently finalized rules that clear the way for states to offer retirement plans to private-sector workers, including a legal “safe harbor” for state-mandated automatic payroll deduction Individual Retirement Accounts (IRAs). The Department also issued final rules permitting certain other government entities, such as cities and counties, to implement retirement plans if no state-wide program exists. More than one city has already expressed interest in doing so (e.g., New York City and Philadelphia).

Although the laws enacted to date appear to focus on employers without retirement plans, many employers - particularly large multi-state employers - are concerned about the potential erosion of ERISA’s nationally uniform regulatory framework and possible state compliance patchwork if these and other state programs also apply to employees not currently covered by an existing employer plan. Additionally, state-mandated measures could be adopted requiring that a plan have certain provisions like automatic enrolment, certain kinds of investments or a specified level of employer contributions. There are also questions about the reach of state laws, conflicts between state and/or local jurisdictions and rules governing rollovers to employer-sponsored plans.

Competing policy priorities can also frustrate sound retirement policy. While there is broad support for expanding tax-advantaged savings opportunities and enhancing retirement security, proposals to overhaul the tax code and reduce the federal budget deficit have often included provisions that would adversely affect retirement plans. These include proposals to reduce or modify current tax incentives and raise PBGC premiums.

## Summary

It is apparent that even within these examples; there is a huge range of pension reform processes. However with the possible exceptions of Finland and Singapore, none of these countries seem to have well-designed and well understood process of pension reform. Inevitably, financial and/or political pressures on governments can and do lead to short term decisions which may not always promote sustainable retirement income systems that provide adequate benefits for all. For example, neither the revised financial framework for pension funds in the Netherlands and the PBGC changes in the USA provided optimal results for funds members over the longer term. Similar outcomes have been seen in Australia as short term political decisions take priority!

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