Individual Accounts in Social Security Reform: Lessons from Abroad and Special Considerations for Women

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Within the past few decades many countries have established individual accounts as a part of their national retirement system. The characteristics of these individual account systems vary greatly among countries. This essay will examine a system comprised entirely of mandatory individual accounts (Chile), one that has voluntary individual accounts as a carve-out of social security benefits (United Kingdom), and one that has mandatory individual accounts as a carve-out of social security benefits (Sweden). When discussing individual accounts various issues arise including transition costs, management of funds, and administrative costs. Depending on their system, countries have responded to these issues differently. The experiences of other countries and their responses to the problems they have faced serve as lessons to the United States as it discusses incorporating individual accounts into its social security system.

This article summarizes the national retirement systems in place in Chile, the UK and Sweden followed by a discussion of the aforementioned three issues and what the policy implications could be or should be for the United States. Finally, there is an analysis of how women fared under these systems and issues that American women should be informed of as discussions of Social Security reform continue.

**SUMMARY OF PENSION SYSTEM**

**CHILE**

During the 1970s Chile's retirement system was stressed. Fewer and fewer workers were supporting each retiree, down from
12 workers per retiree in 1955 to 2.5 in 1979. In addition, the system was highly complex with over 100 retirement plans resulting in an assortment of contribution rates and benefits. In 1981, to correct these problems within the retirement system, the Chilean government became the first country in the world to switch from a pay-go system to a system of mandatory individual accounts.

The new system mandated that new entrants to the labor force (and old workers who opted in to the new system) contribute 10 percent of earnings (pretax) to an individual account as well as approximately 3 percent additional to cover disability insurance and life insurance. Employers and the self-employed are not required to contribute; however, the self-employed can set up retirement accounts in a similar manner at their choosing.

Upon retirement, individuals have choices as to the distribution of their accounts. The first option is an annuity providing a life-long benefit. In Chile, annuities must be indexed for inflation and include survivor benefits. The second alternative is called a programmed withdrawal. Though determined annually according to life expectancy and account balance, this option tends to provide larger monthly benefit. However, this option can also result in very small benefits and perhaps outliving resources entirely in later years of retirement.

An important component of the reformed Chilean retirement system is the minimum benefit guarantee. The

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2 Id.
3 Id. at 13. Although CBO puts the disability and life insurance figure at three percent, Turner indicates a range of 2.50 percent to 3.74 percent. John Turner, Individual Accounts for Social Security Reform: International Perspectives on the U.S. Debate 44 (2006).
4 CBO, supra note 1, at 12-13.
6 Williamson, supra note 5, at 3.
minimum benefit is roughly the equivalent of 75 percent of minimum wage and is funded by general revenues. There is a minimum benefit guarantee for workers contributing for 20 or more years who do not have enough funds to pay for a minimum benefit defined by the government.\(^7\) The minimum benefit also applies to retirees who chose to take scheduled withdrawals and have exhausted their funds. Additionally, workers who contribute for less than 20 years receive an anti-poverty benefit.\(^8\)

**UNITED KINGDOM**

Since the passage of the Old-Age Pensions Act in 1908, the UK has had a minimum poverty level benefit for workers.\(^9\) This first tier benefit was not earnings related. Public pensions were not related to earnings until the implementation of the graduated pension in 1961.\(^10\) The second tier offered low benefits and did not cover all of the working population. Workers could opt-out of this public pension system as long as they were enrolled in an employer defined benefit program called occupational pensions.\(^11\) Over time the second tier evolved. A reform in 1986 allowed workers to opt-out to establish an individual retirement account or appropriate personal pension (APP).\(^12\) More recently (2001) stakeholder pensions were introduced targeted at workers who earn close to the national median but are still without a private pension

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\(^7\) CBO, *supra* note 1, at 14.


\(^11\) Id.

\(^12\) CBO, *supra* note 1, at 33.
In 2002 SERPS became State Second Pension (S2P) which initially offered an earnings-related benefit but, as of 2007, it offers a flat-rate benefit through contributions that are earnings related. Low-income earners were thus encouraged to stay within the system, while higher income earners were encouraged to opt-out. This paper will focus on the 1986 reform allowing appropriate personal pensions.

Contribution rates to the voluntary individual account are the same as if an individual had not decided to opt-out and employers are still mandated to contribute their normal amount. Employees contribute “2% on the first £64 (about U.S.$100) of weekly earnings, plus 10% on weekly earnings between £64 and £485 (about U.S. $800); employers pay 3%-10% of employee’s weekly earnings up to £485 according to wage brackets, plus 10% of total additional earnings.” Contributions are remitted to the National Insurance Fund throughout the year. The money is held there for approximately 18 months. Then the Department of Social Security pays a rebate to the workers directly into their APP. As age increases, so does the rebate from a low of 3.4 percent to a maximum of 9 percent of earnings. Individuals with an APP also receive a 1 percent rebate of their income tax, which was devised as an incentive to encourage workers to choose APPs.

Sometime between ages 60 and 75, workers with an APP must annuitize to the extent that their account was funded by tax

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14 Id. at 25; see also Turner supra note 3, at 49.
16 KORCZYK, SUPRA NOTE 13, AT 27.
17 LIU, SUPRA NOTE 10, AT 26.
18 CBO, SUPRA NOTE 1, AT 33.
19 BLAKE, SUPRA NOTE 15, AT 3.
20 CBO, SUPRA NOTE 1, AT 33.
21 Id.
22 Id. at 34.
rebates and government rebates. This gives individuals the benefit of annuitizing at times when the interest rates are relatively high. For a married person, an annuity must provide a 50 percent survivor’s benefit. For the remainder of the account, an individual may take up to a 25 percent lump sum payment. However, the balance of the account must be annuitized or scheduled lifetime withdrawals taken. There is no minimum benefit guarantee within the APP system, though participants are still eligible for the minimum poverty level benefit.

**SWEDEN**

The old Swedish pension system consisted of two tiers. The first was a basic minimum pension which was not means-tested, while the second was an earnings-related benefit. Both were financed through a pay-go system solely made up of employer contributions. In total, the two pensions equaled about 65 percent of the “average income based on the best 15 years of at least 30 years of employment....” Reforms in 1994 and 1998 changed the defined benefit system to an amalgamation made up of defined benefit and defined contribution characteristics.

The current pension system in Sweden consists of three tiers. First is the guaranteed pension which is a means-tested basic minimum benefit. It is funded through general revenues. The second is an earnings-related supplementary benefit financed through a pay-go system. The third tier is the premium pension, which is the defined contribution portion of the Swedish system. Through employer and employee contributions, 2.5 percent of

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23 BLAKE, _SUPRA_ NOTE 15, AT 4.
24 CBO, _supra_ note 1, at 35; see also GAO, _supra_ note 8, at 45.
27 Anderson, _supra_ note 25, at 293.
28 INDIVIDUAL ACCOUNTS: LESSONS FROM SWEDEN, _supra_ note 26, at 1.
earnings are placed into individual accounts.\textsuperscript{29} The premium pension does not provide any disability benefits.\textsuperscript{30}

When a worker first claims premium pension benefits, the entire balance of the account must be annuitized. Annuities can be taken as fixed or variable and participants also have the choice of single annuity or a joint and survivors’ annuity.\textsuperscript{31} Annuities are provided either by the Swedish government or by a company of its choice.\textsuperscript{32} The mandatory annuitization of individual accounts serves to reduce risk by providing timing options of annuitizing and partial annuitizing.\textsuperscript{33}

\textbf{TRANSITION COSTS}

\textbf{CHILE}

Workers who decided not to switch to the new system and retirees already receiving benefits continued to contribute and receive benefits as they did under the old system. However, the Chilean government had to decide how to compensate workers who had contributed to the pay-go system but switched to the new system. First, employers were directed to give a one-time 18 percent wage increase to those workers roughly equivalent to the employer’s previous contribution to the pay-go system.\textsuperscript{34} This was

\textsuperscript{29} Id. at 2; see also Elizabeth Tedrow, Social Security Privatization in Other Countries – What Lessons Can be Learned for the United States, 14 Elder L.J. 35, 53 (2006); see also Anderson, \textit{supra} note 25, at 293. The total contribution rate is roughly equivalent to rates under the old system when factoring in the 16 percent that goes towards the second tier pension. There is no discussion about the ratio between employee contribution rates and employer contributions ratio for the 2.5\%. \textit{See INDIVIDUAL ACCOUNTS: LESSONS FROM SWEDEN, supra} note 26, at 2.

\textsuperscript{30} INDIVIDUAL ACCOUNTS: LESSONS FROM SWEDEN, \textit{supra} note 26, at 2.

\textsuperscript{31} Id. at 9-10; see also LAWRENCE H. THOMSON, URBAN INSTITUTE, ADMINISTERING INDIVIDUAL ACCOUNTS IN SOCIAL SECURITY: THE ROLE OF VALUES AND OBJECTIVES IN SHAPING OPTIONS 14 (1999), \textit{available at} http://www.urban.org/UploadedPDF/retire_1.pdf.

\textsuperscript{32} Thompson, \textit{supra} note 31.

\textsuperscript{33} Id. at 14-15; see also INDIVIDUAL ACCOUNTS: LESSONS FROM SWEDEN, \textit{supra} note 26, at 9.

\textsuperscript{34} Williamson, \textit{supra} note 5, at 1.
instituted so that employees would receive the same compensation under the new system as they had under the old system. In addition, workers who made the switch were given "recognition bonds," but only if they had twelve monthly contributions in the last five years. The value of the bond was determined with a complex, four-part calculation. At retirement the value of the bond is added to the pension fund, often accounting for a large part of a retiree's income.

As a result of the social security reform, the Chilean government had to decide how to finance these extra expenses. In preparation for the pension reform, there was a major tax reform in 1975. This raised tax revenues by simultaneously launching a value-added tax, simplifying the income tax, and strengthening tax enforcement. By the time the pension reform was implemented, Chile registered a surplus of 5.5 percent of GDP.

UNITED KINGDOM

In order to entice workers to opt-in to an APP, the UK government had to provide incentives. It did this by offering incentive payments, tax rebates, contribution rebates, and a small reduction in future rebates which all resulted in a favorable situation for workers. This arrangement was costly to the UK, though it is hard to pinpoint an exact figure for a few reasons. First, those opting out of SERPS only accounted for a small portion of the population, around 15 percent. Second, opting out is not permanent. An individual may opt back into SERPS in subsequent years so there is no way to know how long an individual will be a part of SERPS.

Transition costs have been managed in the UK by utilizing laxity in the National Insurance Fund (NIF). The NIF regularly

35 CBO, supra note 1, at 12; see also Korczyk, supra note 13, at 9.
36 CBO, supra note 1, at 15.
37 Williamson, supra note 5, at 1-2.
38 CBO, supra note 1, at 16.
39 Blake, supra note 15, at 6; see also Tedrow, supra note 29, at 48.
40 Liu, supra note 10, at 33.
41 Thompson, supra note 31.
offsets its account by using funds from general revenue. As a result, the UK government is not overtly concerned with transition costs.\textsuperscript{42} Additionally, contribution rates to the NIF can be altered up to 1 percent without Parliamentary approval.\textsuperscript{43} The structure of the SERPS program has also helped ease transition costs. Because it is a relatively new program, not many individuals are currently receiving benefits under SERPS. The UK government has also cut future benefit levels from 25 percent of income to 20 percent of income.\textsuperscript{44}

\section*{SWEDEN}

The transition in Sweden to the new partially defined contribution system is expected to take around 20 years.\textsuperscript{45} A major cost during the transition will be the creation of a new government department, the Premium Pension Agency (PPM in Swedish). The PPM serves as the clearinghouse for the entire premium pension tier. Though envisioned to be self-financing, high start-up costs forced the PPM to borrow from the government.\textsuperscript{46}

Another cost during this transition is an education campaign by the National Swedish Social Insurance Board. Workers are confronted with numerous investment choices\textsuperscript{47} and the government tries to ensure that workers understand their options and make informed decisions. Three main groups were targeted: 1) motivated participants with investment experience, 2) unmotivated participants with no desire to choose funds and 3) motivated participants who lacked knowledge to make informed decisions.

\begin{thebibliography}{9}
\bibitem{liu} Liu, \textit{supra} note 10, at 34; see also Tedrow, \textit{supra} note 29, at 48.
\bibitem{cbo} CBO, \textit{supra} note 1, at 35.
\bibitem{id} \textit{Id.} at 36.
\bibitem{anderson} Anderson, \textit{supra} note 25, at 295.
\bibitem{turner} \textsc{John Turner}, AARP Public Policy Institute, \textit{Administrative Costs for Social Security Private Accounts} 2 (2005), \textit{[hereinafter Administrative Costs]} available at \url{http://www.aarp.org/research/legis-polit/ssreform/fs120_ss_costs.html}; \textit{see also Individual Accounts: Lessons from Sweden}, \textit{supra} note 26, at 2.
\bibitem{tedrow} There are 660 funds which Swedes can choose from. Tedrow, \textit{supra} note 29, at 53.
\end{thebibliography}
investment decisions. The educational campaign aimed to provide information to all three groups through mailings, public service announcements, and advertisements.\textsuperscript{48} Educational campaigns were also run by management companies before the switch in systems occurred to entice workers. Their costs amounted to approximately $94.4 million.\textsuperscript{49}

**Implications to the US**

The US, if it chooses to reform its pensions system to include individual accounts, will undoubtedly incur transition costs. For example, contributors to the Social Security system will want the benefits they were guaranteed and a government agency may need to be created or a current one improved upon. Knowing that these costs will be incurred means the government has to plan for these costs. Executing changes in taxation prior to a reform of the pension system, like Chile did in reforming the tax system six years ahead of the pension reform, would be of great benefit to the American people. Rarely do Americans favor tax increases so that is probably not a viable option, but stronger enforcement of current tax laws in conjunction with minor changes to the tax code could heighten revenue enough to make a major change to the pension system workable.

While planning ahead may be difficult to do, it is necessary. The UK did not plan ahead for costs incurred during the implementation of the APPs. However, the UK has flexibility in raising revenue that is not available in the US. For instance, when the NIF needs more money it can borrow from general revenue or raise contribution rates. Such laxity is not found in the American political system and it is highly unlikely that pension reform would be accompanied by such elastic regulations.

The creation of the PPM in Sweden meant Sweden incurred transition costs. However, the US does not necessarily need to create a new agency if it decides to change its pension system. An individual account pension system could be run through the Social

\textsuperscript{48} INDIVIDUAL ACCOUNTS: LESSONS FROM SWEDEN, supra note 26, at 8.

\textsuperscript{49} Tedrow, supra note 29, at 53.
Security Administration or the Federal Retirement Thrift Investment Board, both of which are highly involved with the public or state pension systems. Certainly there would be some costs incurred from such expenditures as training and hiring new employees, but the costs would be comparatively less than in Sweden because an entirely new department would not need to be constructed. Additionally, the agency could be structured in such a way as to be self-financing after a short transition period as the PPM is in Sweden (discussed later in this paper).

**MANAGEMENT OF FUNDS**

**CHILE**

AFPs are government authorized companies created solely to manage pension funds.\(^5^0\) There were originally twelve AFPs in existence but that number has fluctuated from twenty-one in 1993 to a low of six in 2005.\(^5^1\) Workers are allowed to choose the AFP they desire to manage their account but, initially, the AFPs could only manage one fund.\(^5^2\) In addition, in the early years of the individual account system, individuals were allowed to switch between AFPs as much as they wanted as long as they transferred their entire account.\(^5^3\) This fostered a competitive relationship between AFPs, which was motivated by commissions the AFPs’ employees enjoyed upon enticing new clients.\(^5^4\) However, the competition between AFPs and the individuals’ ability to switch between AFPs did not result in a better financial situation for Chilean workers. Instead, the system’s design encouraged AFPs to adopt the same general investment strategy. Heavy penalties accrued for falling outside specific levels of return during the twelve month accounting period, resulting in AFPs making low risk investments.\(^5^5\)

\(^{50}\) Williamson, *supra* note 5, at 1.
\(^{52}\) *Id.* at 5; see also Thompson *supra* note 31.
\(^{53}\) Thompson, *supra* note 31, at 7.
\(^{54}\) Turner, *supra* note 3, at 58.
\(^{55}\) Williamson, *supra* note 5, at 5.
Over the years, the Chilean government has enacted significant changes to AFPs and the way they manage individual accounts. In 1997, a minimum stay requirement was enacted forcing individuals to remain with an AFP for at least six months. Two years later, the accounting period gradually began to shift from twelve months to thirty-six months. A second fund (Fund 2) was permitted by law in 2000. Only individuals within 10 years of retirement were eligible for this conservative fund which could only be invested in fixed-rate instruments.

Within a few years, the system went through another overhaul. AFPs were forced to provide four different types of funds (simply called Fund B, C, D, and E). AFPs were also given the option of offering Fund A but were not so mandated. Fund 2 became Fund E, and is the most conservative fund. Fund 1 (the only Fund available before 2000) became Fund C. Fund A, the optional offering, is the riskiest fund in the Chilean system. The difference between funds is the “maximum percentage that they may invest in variable-rate instruments (such as equities) and fixed income (such as bank deposits, mortgages, or government paper that offer a low level of risk of variability).” Individuals can designate the funds in which they wish to invest (in any ratio that they desire) with few restrictions. Men over age 55 and women over age 50 are not allowed to allocate their pension to Fund A. If, upon retirement, an individual keeps a portion of their pension fund in an AFP, they are only allowed to use Funds C, D, and E. Workers who do not designate their fund allocation are placed in funds dependent upon their age.

The government does provide a minimum and maximum guaranteed rate of return. If AFPs fall below the guaranteed rate, they must use a special reserve fund, which was designed specifically for this purpose, to meet the minimum rate of return. If that does not cover the difference, then they must use corporate

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56 Turner, supra note 3, at 58.
57 Williamson, supra note 5, at 5; Kritzer, supra note 8, at 68.
58 Williamson, supra note 5, at 5.
59 Kritzer, supra note 8, at 67.
60 Id. at 68-69.
61 Williamson, supra note 5, at 5.
assets to obtain the needed money. In situations where the fund is unable to provide all the accounts with the minimum benefit, the government provides the necessary money. The AFP’s funds are then disbanded and the accounts are switched to other funds. When AFPs exceed the maximum rate of return, the excess is placed into the reserve fund.62

Under the new reforms the minimum and maximum rates of return differ among funds.63 Generally, rates of return in the Chilean system have been high. The gross annual return (inflation adjusted) has been more than 10 percent from 1981 until 2002. However, high administrative costs have cut into the rate of return that workers in the system actually enjoy.64

UNITED KINGDOM

APPs are managed through financial institutions such as banks, mortgage companies and insurance companies.65 Individuals are allowed to choose whichever provider they desire.66 Each financial institution offers multiple investment plans with different risk levels among which the individual can choose to allocate funds.67 There is no guaranteed rate of return in the UK’s system.68 The UK government imposes few regulations over the financial institutions that hold the APPs.69 One is that APPs should only be encouraged when it is in the best interest of the worker.70 Additionally, providers must adhere to the prudent-man rule meaning that investments must be diversified. “No more than 10 percent of investments may be made in the same asset, and plans may not invest more than 5 percent in the company offering the plan.”71

62 Id. at 6-7.
63 Id. at 7-8.
64 Id. at 7; see also Korczyk, supra note 13, at 11.
65 GAO, supra note 8, at 42; see also Liu, supra note 10, at 28.
66 Liu, supra note 10, at 28.
67 GAO, supra note 8, at 45.
68 Blake, supra note 15, at 9.
69 Thompson, supra note 31, at 13.
70 Turner, supra note 3, at 83.
71 CBO, supra note 1, at 37.
This lack of governmental oversight has caused problems within the APP system. Specifically, shortly after the 1988 reform, financial institutions aggressively marketed APPs to individuals who would be better off staying with SERPS/S2P. In excess of 2 million people, or more than 40 percent of individuals who initially opted to participate in APPs, were affected. Compensation by the financial institutions to the misled workers has totaled approximately $19.4 billion. In response to the "mis-selling scandal" the UK government implemented new regulations. Only trained individuals can work as pension advisers and they must use a computer program to evaluate if APPs are proper and beneficial to the worker. Pension advisors must attach an explanation as to why the APP is in the best interest of the worker. In addition, each recommendation is double-checked and workers are allotted a 14 day period in which they can cancel the contract.

In contrast to the financial institutions involved in the mis-selling scandal, two large insurance companies advised hundreds of thousands of clients, that it was not in their economic best interest to remain in the APP system. Every 5 years, the Government Actuary’s Department (GAD) reevaluates the reduction in social security benefits and the contribution to individual accounts. In 2004, Prudential and Norwich Union informed their clients that the new rate was too low. That year alone, 500,000 individuals left their APPs and returned to SERPS/S2P, a dramatic increase due to the insurance companies’ advice.

While those workers were well-informed of the status of their accounts, other workers struggle to find information about their own situation. Information on financial institutions’ rates of return is not available, thus making an informed decision about

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72 Turner, supra note 3, at 83; see also GAO, supra note 8, at 43; see also Blake, supra note 15, at 9.
73 Blake, supra note 15, at 9.
74 GAO, supra note 8, at 43.
75 CBO, supra note 1, at 38.
76 Blake, supra, note 15, at 5.
77 Id. at 4.
78 Id. at 5.
which financial institution to choose nearly impossible. Furthermore, “active fund management [does] not necessarily deliver superior investment returns.”\(^7\) Information on rate of return is scarce and the affects on retiree income will not be seen until around 2020.\(^8\)

**SWEDEN**

Numerous funds are available for workers investment. In 2000, 455 funds were available, growing to 625 in 2002.\(^1\) By 2006 the number had reached 660.\(^2\) Mutual funds must be licensed in Sweden to be registered with the PPM. In addition, funds are mandated to consistently provide information on expenses of the fund and the rate of return. Mutual fund companies can manage up to 25 funds per company or 50 when a corporation owns several mutual fund companies.\(^3\) Funds must meet the European Union’s diversity requirements excluding Swedish equity funds which are dominated by a single company.\(^4\)

Individuals are free to choose the fund or funds (up to 5)\(^5\) in which they invest. In 2001, two thirds of workers chose to actively invest their contributions. In 2001, only 18 percent of new participants elected to make an investment decision.\(^6\) When workers decide not to make an investment choice their contribution is put into the government’s default fund. This fund aims to achieve higher than average rate of return with little risk.\(^7\) The government offers one other fund which workers must specify. The second fund can invest 100 percent in equities whereas the first fund can only invest between 80 and 90 percent in equities.\(^8\)

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\(^7\) Liu, *supra* note 10, at 36.
\(^8\) *Id.*; see also Korczyk, *supra* note 13, at 29.
\(^1\) *INDIVIDUAL ACCOUNTS: LESSONS FROM SWEDEN,* *supra* note 25, at 3-4.
\(^2\) Tedrow, *supra* note 29, at 53.
\(^3\) *INDIVIDUAL ACCOUNTS: LESSONS FROM SWEDEN,* *supra* note 26, at 4.
\(^4\) Turner, *supra* note 3, at 54-55.
\(^5\) Tedrow, *supra* note 29, at 53.
\(^6\) *INDIVIDUAL ACCOUNTS: LESSONS FROM SWEDEN,* *supra* note 26, at 7.
\(^7\) *Id.* at 4.
\(^8\) *Id.* at 5.
There is one partial rate of return guarantee in the Swedish system. This occurs during the holding period between time of contribution and the placement of funds in the PPM. Contributions are only placed in PPMs one week a year so there is a holding period of roughly one year.\textsuperscript{89} During this time there is a set rate of return on contributions. In 2001, it was 3.5 percent, near the rate of return on government debt.\textsuperscript{90} There are no other guaranteed rates of return in the entire Swedish system.\textsuperscript{91} Many funds, upwards of 60 percent, were established upon the implementation of the premium pension. For those funds, rates of return in past years were not available.\textsuperscript{92} In the early years of the premium pension the world equity market did not do well leading to negative rates of return ranging from -7.4 percent in 2000 for the default fund to -33.1 percent in 2002 for funds chosen by active participants of the premium system.\textsuperscript{93} There is some concern that the default plan may be jeopardizing the rate of return for ethical reasons because the government will not invest in companies that have violated human rights, child labor laws, and environmental protection laws.\textsuperscript{94} However, it is too early to tell what result the ethical standards will have on rate of return in the long run.

\textbf{IMPLICATIONS TO THE US}

One important factor the US needs to consider when discussing individual accounts is the financial sophistication of individuals. There are diverse education levels among Americans, and there would likely be differing interest levels in individual accounts. A lot of choices, as in Sweden, would frustrate those without significant knowledge of financial markets, whereas limited choices, as in Chile, would frustrate the financially savvy. Both Sweden and Chile offer a government-managed fund for

\textsuperscript{89} Turner, \textit{supra} note 3, at 52-53.

\textsuperscript{90} \textsc{Individual Accounts: Lessons from Sweden, supra} note 26, at 3.

\textsuperscript{91} \textit{Id}.

\textsuperscript{92} \textit{Id}. at 4.

\textsuperscript{93} Turner, \textit{supra} note 3, at 57-58.

\textsuperscript{94} \textit{Id}. at 56; \textit{see also} \textsc{Individual Accounts: Lessons from Sweden, supra} note 26, at 5.
those that do not want to make their own choice. This is a good idea for the US government to include in pension reform. Although it would directly involve the government in managing pension funds, it would ease the burden on the current Social Security system (independent of the form that the individual accounts take). In addition, it would provide a safe option to those with limited or non-existent investment experience.

Sweden’s particular system of managing funds would not work well in the US because all contributions are placed in mutual funds in only a single week. If the US were to apply such a system, the affect on financial markets would be significant. The US must create a system that would not distort the domestic or international financial market considerably because dramatic swings in the market would have far reaching consequences.

The most important lesson to learn from Chilean and the UK experiences is that reforms may be necessary to correct unexpected results and to create the best system for the individual country as possible. Sweden will probably have reforms to make to the system, but because of the pension reform’s short existence there is no history in this area. It is important for the US to take time to plan a good, sound system, but it is more important that the system is reviewed regularly to identify any problem areas and work on improvements.

**Administrative Costs**

**Chile**

Administrative costs in the Chilean individual account system run quite high. AFPs are allowed to charge management fees for “new accounts, mandatory contributions, voluntary contributions, transfers from one pension fund to another in excess of two transfers per year, and scheduled withdrawals.”\(^\text{95}\) In addition, if a retiree chooses to annuitize, the AFP can charge an additional fee up to 5.3 percent of account balances.\(^\text{96}\) Fees cannot be charged based upon the amount held in a pension fund which

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forces the AFPs to charge fees on contributions. In turn, this forces current contributors to support the management of funds for inactive contributors.97

Generally, low-income earners have a higher percentage of their contributions going to cover fees than high-income earners.98 However, for both low-income and high-income earners, the percent of contributions covering fees varies depending on the AFP they use. For low-income earners, 8.99 percent to 29.7 percent of contributions went to pay for administrative fees as of September 2002. High-income earners had rates of 1.02 percent to 24.2 percent.99 When considering average rate of return in light of administrative costs, rates drop from over 10 percent to around 7 percent.100

There have been successful legislative efforts to reduce fees that AFPs can charge resulting in the government mandating a reduction in fees. However, such reductions have been delayed so administrative costs still run extremely high.101 To Americans used to the low administrative costs associated with Social Security, the high administrative costs of the Chilean system would be unacceptable even when the reforms are in place. But for Chileans, the administrative costs in the current system (without reforms) are equivalent, or perhaps less,102 than the inefficient pay-go system and the system provides greater benefits at retirement.103

**UK**

Administrative costs run high in the UK system of APPs. The costs stems from front-loading charges, high annual management fees, and monthly management fees.104 Some fees are

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97 CBO, *supra* note 1, at 22.
98 Williamson, *supra* note 5, at 8.
100 *Id.; see also* Williamson, *supra* note 5, at 8.
101 Kritzer, *supra* note 8, at 68.
102 "... the total costs of the new system are 42 percent lower than the average costs of the old pay-as-you-go system..." CBO, *supra* note 1, at 23.
103 Thompson, *supra* note 31, at 3.
104 Blake, *supra* note 15, at 9; *see also* Liu, *supra* note 10, at 36.
even indexed to wage and price increases. Administrative costs decline when workers stay with the APPs for longer periods of time (because of the front-loading charges). In 1998, fees reduced average gain by 3.2 percent of assets yearly over a 10-year period and 1.7 percent when over a 25-year period. Fees for annuitizing benefits run even higher, upwards of 10 percent of the value of benefits received by retirees. This results in a reduction of rates of return by 1.5 percentage points. Financial institutions regularly change their fee structures making it difficult for workers to see the total costs of fees.

Not all administrative costs are covered by these fees. The costs incurred by the UK government in overseeing the system are taken out of general revenue. Workers lose additional money because their contributions stay with the government for 18 months before they are placed in workers' accounts. Workers do no receive any interest for the 18 months that their contributions sit with the government. This holding period was specifically structured to trim administrative costs.

The UK has taken steps to force the financial institutions to disclose the costs of fees on workers' accounts. Financial institutions must publish information on rates of return before and after fees have been levied. Nonetheless, administrative costs still run quite high. One study reports that fees cost workers between 40 and 45 percent of the value of their account.

**SWEDEN**

Sweden has designed its individual account system in a way that minimizes administrative costs. The creation of the PPM

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105 Liu, *supra* note 10, at 36.
106 Turner, *supra* note 3, at 38; see also ADMINISTRATIVE COSTS, *supra* note 46, at 3; see also Blake, *supra* note 15, at 9.
110 Turner, *supra* note 3, at 64.
112 Id. at 9; see also Turner, *supra* note 3, at 63; see also ADMINISTRATIVE COSTS, *supra* note 46, at 3; see also GAO, *supra* note 8, at 42.
is instrumental to keeping administrative costs low, in part because of scale economies. In particular, processing everything through a central administration allows for the low administrative costs. For instance, "centralizing all of the paperwork associated with the maintenance of the individual accounts will allow this function to be performed much more efficiently than if performed individually by each fund." The central agency also lowers administrative costs because the PPM can "match buy and sell orders internally, limiting its transaction with the actual fund operator to the net amount of all of the individual transactions."

To prevent the high administrative costs arising from sales and advertising costs, Sweden has negated the need for a sales staff. To begin with, mutual fund management companies only know the total investment from PPM, not the individual investors. Thus, the mutual fund management company only needs to offer investment management services and does not need to acquire distribution channels, avoiding the need for a sales staff, commissions and the like.

The fee arrangement includes a .3 percent charge on account balances and a money management fee. Both are charged annually by the mutual fund but the entire .3 percent charge is transferred to the PPM. The money management fee has to be the same that the mutual fund charges outside of the PPM system, which serves to keep this fee lower than otherwise could be expected. A portion of the money management fee is returned to the PPM because it covers the majority of administrative functions. The PPM then passes those rebates on to participants. The fees paid to the PPM by financial institutions will help make the PPM self-financing in the future.

113 INDIVIDUAL ACCOUNTS: LESSONS FROM SWEDEN, supra note 26, at 2.
114 Tedrow, supra note 29, at 54.
115 Thompson, supra note 31.
116 Id.; see also INDIVIDUAL ACCOUNTS: LESSONS FROM SWEDEN, supra note 26, at 3.
117 INDIVIDUAL ACCOUNTS: LESSONS FROM SWEDEN, supra note 26, at 5; see also Turner, supra note 3, at 57; see also Thompson, supra note 31.
118 Turner, supra note 3, at 71-72.
119 ADMINISTRATIVE COSTS, supra note 46, at 2.
By focusing on reducing administrative costs, Sweden has kept its administrative costs extremely low. Total administrative costs are about half of Chile’s administrative costs.\textsuperscript{120} Because of the relatively short period that the PPM system has existed, rates of return are hard to find. In constructing a system with low administrative costs, Sweden compromised in other areas of the pension system most notably by maintaining a long holding period between receiving contributions and depositing them into the PPM.

**IMPLICATIONS TO THE US**

Using a government agency to collect contributions and run the entire pension system has been helpful in reducing costs in both Sweden and the UK. The US would face special difficulties in implementing such a system because of its much larger population. On top of the almost 20,000 employees currently working in the Social Security Old-Age and Survivors Insurance program, an estimated 7,700 to 33,600 more employees would be needed if the US modeled their system upon Sweden’s system.\textsuperscript{121} However, the large size of the US would help minimize administrative costs by larger scale economies. That means, with detailed planning, a reformed pension system in the US could keep administrative costs even lower than Sweden which already has much lower administrative costs when compared to other countries.

The type of individual account system in place – mandatory or voluntary carve-outs – is another important characteristic that highly influences the administrative costs. Even with a governmental agency in place, the UK’s administrative costs run high because of the complexity of the system (i.e. workers can opting in to and out of the APP system whenever they wish and varying rebates from NIF depending on age). It is the simplicity of the Swedish system, coupled with innovative procedures (like negating transaction fees) that have resulted in low administrative costs.

\textsuperscript{120} Turner, *supra* note 3, at 62.

\textsuperscript{121} ADMINISTRATIVE COSTS, *supra* note 46, at 3.
Finally, the UK has reduced administrative costs by holding contributions for long periods of time before placing them in individual accounts, whereas Chile's processing occurs at a much faster rate. Regulations for US 401(k) plans require that contributions are credited into the individual's account by the 15th business day of the month following the contribution,\textsuperscript{122} so it is likely that Americans will not be willing to wait extended periods of time, which they are not accustomed to. The Swedish system which guarantees a rate of return during its holding period may be more acceptable to Americans than the UK's system.

Administrative costs in a pension system involving individual accounts will probably be higher than that found in the current Social Security system. However, the Swedish system demonstrates that the government can keep administrative costs low if that is a goal when creating the pension system.

\textbf{SPECIAL CONSIDERATIONS FOR WOMEN}

Under various proposals utilizing individual accounts to reform the Social Security system, women and men may fare differently. Major concerns for women include length of time in the work force and spousal and survivor's benefits.

\textbf{LENGTH OF TIME IN WORK FORCE}

As a group, women tend to spend less time in the work force than their male counterparts. Though women are experiencing growth in labor force participation rates, they

are still more likely than men to be out of the labor force at any age, to experience discontinuous work histories, and to be employed part time – all of

\textsuperscript{122} Blake, \textit{supra} note 15, at 5.
which have implications for their ability to accrue pension credits and save for retirement.\textsuperscript{123}

If Social Security reform includes requirements for a longer benefit computation period, many women would not be able to fulfill the requirement or would have to work to an older age before they would be eligible. For instance, if the benefit computation period for Social Security was 38 years in 1999, only 15 percent of retiring women would have qualified compared to 57 percent of men.\textsuperscript{124}

The Chilean reform raised similar issues. On average, for every year that men contribute to the pension system, women contribute seven tenths of a year. By the time that benefits are paid out, women are projected to receive 30-45\% of men's benefits. As a result, it is anticipated that women will comprise 70\% of Chileans receiving the guaranteed minimum pension.\textsuperscript{125}

This is a key part of Social Security reform that women must understand. Increases in benefit computation period would affect women currently contributing to the Social Security as well as generations to come. Decisions to stay home with children, even until the kids reach school age, could drastically worsen the financial situations of parents when they reach retirement age. Failing to qualify for Social Security benefits would force women to rely on spousal and survivor's benefits available to them.

**SURVIVOR AND SPOUSAL BENEFITS**

Survivor and spousal benefits help to keep individuals above poverty by providing a source of income independent of their own work experience. Every married man in Chile is required to buy a joint annuity when he decides to receive his


\textsuperscript{124} Id. at 16.

\textsuperscript{125} Korczyk, supra note 13, at 13.
benefits in annuity form. In contrast, married women only have to buy a joint annuity when their husband is disabled. Overall, spousal benefits are expected to increase women’s benefits from 30 - 45 percent to 70 – 90 percent of married men’s benefits in Chile because the spousal benefits are in addition to any benefits they have earned on their own work history. While this feature is extremely beneficial to married women, single women fare no better under the reformed Chilean pension system.

The UK provides a different strategy to entitle women to survivor benefits. The surviving spouse is entitled to a basic state pension benefit arising from the work record of their spouse, regardless of the pension system the spouse was enrolled in. When the surviving spouse does not have enough years contributing to the pension system, they can receive up to 60% of the basic state pension based on their spouse’s earnings. Additionally, married men are required to provide a 50% survivor’s benefit when they annuitize.

When considering reforming the American pension system using individual accounts, women should be better off if there is a requirement that mandates husbands (and wives when their earning record allows) to have a joint annuity. Additionally, it would be best for women if annuities were based on a unisex life charts. Unisex life charts mean that the benefit amount is calculated on an average life expectancy for the American population. Since women have a longer life expectancy than men, they would receive higher benefit payments than if the annuity was calculated based gender specific life expectancy. Thus, in retirement, money would be reallocated from men to women.

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126 Joint annuities provide benefits for life for the two people they cover. Id. at 14.
127 Id. at 14.
128 Single women are an important section of the retired Chilean population because divorce does not exist in Chile. Annulment, which implies that a legal marriage never existed, is the only option. This severely limits former spouses’ rights to pension benefits. Id. at 14-15.
129 Id. at 30.
130 Blake, supra note 15, at 4.
131 INDIVIDUAL ACCOUNTS: LESSONS FROM SWEDEN, supra note 26, at 9.
Countries that have already reformed their pension systems to include individual accounts provide the US a wealth of information to help guide the American debate. They have developed diverse systems that fit the needs of their respective country. The US has to decide which features or aspects of a pension system are most desirable and focus on those features. Compromises in one area might be necessary to reach the goals in another area as exemplified by the Swedish in settling for longer holding periods in exchange for having lower administrative costs.