

Proposed changes to Portuguese Social Security

Over the past few months we have seen several government announcements about likely changes to the rules of the social security scheme. We now understand that firm recommendations for changes have been put forward for comment and we expect that we will see legislation published later in the year with a view that the new rules will take effect from 1 January 2007.

Proposed Changes

1. Link retirement age to life expectancy

The government has proposed linking the normal retirement age under the scheme (currently 65) to a life expectation metric. Thus people who choose to retire before “normal retirement” will face reductions in their old age pension entitlement. For citizens who wish to retire early the government has put forward the following options:

- Make additional voluntary contributions towards a funded account managed by the State;
- Receive a lower benefit.

For those citizens who wish to work after normal retirement age, they will be offered an increased benefit. This extra benefit will be higher for citizens who have already contributed towards the scheme for over 40 years at age 65.

2. Accelerated phasing-in of the career average benefit formula

The 2002 reform in social security saw the scheme’s rules alter from a final 10 year salary benefit to a re-indexed career average benefit. In addition, the accrual rate changed from a flat 2% to the new scaled accrual, starting at 2.3% for lower salaries, reducing to 2% for high salaries. In most cases the career average benefit is lower than the final 10 year benefit. The new career average scheme was to take effect from 2017 onwards but the government has proposed that the new rules apply from 2007 onwards. Pensions would be calculated using a prorate method based on contributory periods before and after 2007. There are 3 components to this regulation:

- People who retire before 2017: their benefit is calculated based on a prorated method of both sets of benefits (old final 10 year and new career average) weighted by service before and after 1 January 2007.
- People who retire during or after 2017: their benefit is calculated based on a prorated method of both sets of benefits (old final 10 year and new career average) weighted by service before and after 1 January 2002.
- People who joined the scheme after 1 January 2002: their benefit is calculated based upon the new career average structure.

3. Link pension increases to the growth in the economy

The government has proposed linking pension increases to purchasing power and economic growth. Pensions in excess of 1.5 times the monthly national minimum wage (i.e. €579 pm) could even decrease if the growth in the economy drops below 2%.

4. Introduction of a maximum pension

The proposal calls for a ceiling when calculating pension benefits on the final 10 year component of the calculation.

5. Encouragement for larger families

It has been proposed to levy different contributions for different citizens. Accordingly people who are under age 35, or have more than 2 children will have lower contribution levels. Maternity benefits will also be increased for mothers having more than 1 child.

6. Flexible retirement age

Current social security rules allow citizens to retire from age 55 onwards subject to certain conditions and a penalty based upon the number of years of anticipated retirement prior to age 65.

This early retirement factor is set to increase from the current 4.5% pa to 7% for retirements between age 60 and normal retirement and to 7.5% if a person retires under age 60.

As mentioned in point 1 above, late retirement will also be encouraged through higher benefit levels.

7. Revised Pre-retirement legislation

Currently employees may enter into a pre-retirement agreement with their employers. This agreement leads to lower social security contributions but benefits continue to accrue normally.

The government is proposing lower accruing benefits and higher contribution rates, although still below the standard rates.

8. Creation of special long term savings accounts managed by the State

As mentioned in point 1 above, the government wants to encourage private long term savings.

The anticipated long term savings vehicle will operate as a savings account which will grow through voluntary contributions plus investment income generated by the backing assets. The proposed legislation has the vehicle being managed by the State with a provision to subcontract to the private sector to help manage the assets. The rules surrounding this regime are still to be clarified.

9. Overhaul of the contribution requirements

The government wishes to review the full structure of all contributions towards the scheme. This will include:

- A revision of the definition of earnings subject to social security as well as the removal (as far as possible) of all special contribution rates for special cases such as government appointees, professional sportsmen, church members, domestic servants and voluntary membership of the scheme;
- A revision of contributions from self employed citizens;
- A revision of special concessions (for example the pre-retirement conditions);
- Expansion of the definition of earnings subject to social security such as:

- Representation and travel allowances in excess of pre-defined limits;
- Company vehicles used for personal use by employees;
- Indemnity payments in excess of pre-determined limits;
- Insurance premiums for employee benefits and contributions to pension plans which permit benefits to be paid in the form of lump sums.

10. Survivor Benefits

Similar to point 4 above, it is proposed that survivor benefits are also limited and in some cases removed from certain benefits.

In the case of orphans' benefits, the government has proposed an increase in benefits for larger families.

11. Disability Benefits

The government wishes to implement a series of changes, including benefit levels, better protection for total and permanent disability and restrictions on receiving disability income and income from work at the same time.

12. Unemployment benefits

Finally the government wishes to introduce measures to combat fraudulent and abusive claims.

Note: These measures are only informative at this stage as the legislation surrounding these reforms has still to be passed and may be altered from what is described in this note.

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