Towards BPM7 and 2025 SNA

Issues Note on Individual Pension Trusts

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Introduction

- **Discussed at the October 2023 meeting of the AEG**, based on the example of Australia
- The AEG noted the **recommendation to treat arrangements similar to those in Australia for self-managed superannuation funds as social insurance type of schemes**
- However, the AEG also requested the editorial team to **refine the proposal after looking at similar arrangements in other countries** and considering carefully the potential impact on the accounts of this extension of the boundary for social insurance schemes
- This issues note contains further information on pension arrangements in the **United Kingdom** and the **United States**

Impact on national accounts

- **If considered as social insurance:**
  - Contributions to the trusts, including the investment income on the accumulated funds, would qualify as (imputed) social contributions
  - Payments out of the accumulated assets would be recorded as social benefits
  - Liabilities of the trusts and the related assets of households would be recorded as pension entitlements
- **If <u>not</u> considered as social insurance:**
  - Significant part of the trusts, i.e., the ones which only have one individual or family as beneficiary, would be consolidated within the households' sector, unless the trusts is resident in an economy different from the beneficiary; trusts with multiple beneficiaries would be considered as separate institutional units to be classified as captive financial institutions, while the assets of the households would be recorded as equity
  - Contributions to the trusts would not be recorded as social contributions but as financial investments in either the accumulated assets, or as financial investments in the equity of the trusts in the case the trusts are treated as separate institutional units.
  - Contributions made by employers for the benefit of their employees would not qualify as employers' actual contributions, but as part of wages and salaries which are subsequently invested in the trusts

The example of Australia

- In Australia, for example, the **government introduced compulsory superannuation** in 1991, to provide income in retirement; a specific part of this policy was the Superannuation Guarantee Act 1992, which created an **obligation for employers to pay a portion of employees' income to superannuation funds**
- Around, 1999, once again **under government encouragement**, saw the **creation of self-managed superannuation funds (SMSFs) for self-employed persons**, to establish and manage funds for their retirement; currently many groups of individuals and small business have SMSFs
- All superannuation funds, including SMSFs, must elect to be **regulated by the Superannuation Industry (Supervision) Act 1993, to receive concessional taxation treatment on contributions**
- Question is how to treat these trusts, as **social insurance or as privately managed investment portfolios**

The example of Australia (cont.)

- **It is recommended to treat these types of individual pension trusts as part of social insurance**:
  - Provide insurance against **social risks**
  - At least **one of the three conditions for delineating social insurance is met**: *The scheme is a collective one operated for the benefit of a designated group of workers, whether employees or self-employed persons, which may also include persons temporarily without employment, participation being restricted to members of that group*
  - **In the case of trusts set up by employees, the third condition may also be met**: *An employer makes a contribution (actual or imputed) to the scheme on behalf of an employee, whether or not the employee also makes a contribution*
  - Importantly, **arrangements do not necessarily have to be compulsory**; encouragement may be sufficient: *Social insurance schemes are essentially schemes in which workers are obliged, or encouraged, by their employers or by general government to take out insurance …*

The example of Australia (cont.)

- **It is recommended to treat these types of individual pension trusts as part of social insurance**:
  - **Additional criteria to delineate social insurance schemes from individual (life) insurance are also met***:*

    *… **collective arrangements** which provide policies, for certain industries or professions, **with a strong resemblance to similar arrangements organized by employers or government**. These schemes may, or may not, be **encouraged by government**; in the former case, this would strengthen the case for a classification as social insurance. In addition, to qualify as social insurance, generally **separate institutional units** should be established, which are **subject to regulation or supervision in line with or similar to other social insurance schemes**. In the case of pension-related schemes, an additional criterion for the qualification as social insurance is that **accumulated contributions are set aside for retirement income***

The example of the United Kingdom

- **Workplace related pensions** provided through an employer, but in some cases – particularly for multi-employer occupational schemes and **group personal pensions (GPPs) provided by insurance corporations** – the employer only facilitates a collective scheme and contributes to it
- In addition, there may be **individual personal pensions**, typically provided by insurance corporations
- All pension schemes are regulated UK's Prudential Regulation Authority (PRA)
- **Workplace related pension: social insurance**, even though participation is generally voluntary
- **Individual personal pensions: individual life insurance**
- **No direct equivalence with Australian SMSFs**; in the case of the self-employed persons, where in Australia SMSFs are used, in the UK, there is no special provision, and **self-employed persons generally use personal pension plans**

The example of the United States

- **US individual retirement accounts (IRAs)** are very similar to Australian SMSFs
- **IRAs are available to both those who are not covered by an employer plan and to those who want to augment their retirement savings in addition to their employer-sponsored plan**
- **Governed by the U.S. tax code**, which:
  - imposes limits on the contributions to these types of plans as well as rules that determine if contributions can be made with pre-tax dollars
  - earnings on the plans are not taxed until withdrawn in the future
  - rules for how the funds can be withdrawn, including any penalties that may result from early withdrawal (before age 59 ½) or failure to withdraw required minimum distributions once an individual reaches a certain age
  - once an investor reaches age 59 ½, there are no restrictions to how the funds can be withdrawn for traditional IRAs; retirement is not necessary
- **IRAs are treated as individual investment plan**, and the accumulated assets remain in the household sector, **mainly because of the individual nature of the pension arrangements**; even though the government clearly encourages these pension arrangements by providing restricted **tax incentives** to individuals, there seems to be **no additional characteristics which qualify these schemes as collective arrangements**

General reflections

- **Not that straightforward to lay out common criteria**
- **Various criteria for considering a scheme as social insurance, or not, are not truly discriminatory**
  - Payments made under the schemes would generally qualify as social benefits
  - Social insurance schemes do not necessarily need to be mandatory for the participants, participation may also be on a voluntary basis
- **It comes down to whether the schemes can be considered as collective schemes, or not**
- It is clear that schemes which are purely voluntary and where the "encouragement" by the government is restricted to providing, for example, tax incentives, cannot be considered as social insurance; the same holds for certain groupings of people who join together to get a discount on individual types of schemes

General reflections

- On the other hand, **contributions made by the employer is a clear criterion for considering schemes as part of social insurance**
- **Schemes being very similar to the ones with contributions from employers makes a case for considering them as social insurance as well**; here, similarity should be defined by reference to the exact arrangements and regulations in place, including the supervision of the schemes
- **It does not seem necessary to change, or further clarify, the current guidance in the 2025 SNA**; one may only want to **add a reference to individual pension trusts and similar arrangements**, in the sense that such arrangements may also qualify as social insurance provided the general criteria for social insurance are met

Questions to the AEG

To endorse the following **recommendations**

- **To treat similar arrangements to those in Australia for SMSFs as social insurance type of schemes**
- **To include a generic reference on the treatment of individual pension trusts in the 2025 SNA**

Thank you for your attention!