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EU-China Social Security Reform Co-operation Project

for The People's Republic of China

Cross-Frontier Portability within the European Union

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Cross-Frontier Portability within the European Union:

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W Birmingham: ITAT Expert for Old Age Insurance

* It may seem somewhat incongruous for an Englishman to be speaking in Shanghai on the subject of cross-frontier portability within the European Union at an Asian Conference on Pensions and Retirement Planning with a special focus on China. You may well ask what relevance it has to the conference theme. It may be that I myself have a personal interest in the subject as I am working here in China in a project jointly funded by the European Union and the Chinese Government on social security reform here in China. This has as one of its component elements the objective of bringing EU experience to bear on what is appropriate for future developments here in China. My international colleagues and I hope that China can benefit from the good experiences that Europe has to offer, but equally will learn to avoid some of the mistakes that European pension policy-makers and practitioners have made over the past half century. But is that relevant to you?

My topic today relates to the issue of how to provide social security cover for migrant workers who move from one EU Member State to another. That is not directly an issue for China. However, a major issue here in China is how best to provide social security cover for migrant workers who move between or within provinces, who move from a rural to an urban environment, or who change their employment from the public service to private or state-owned enterprises or vice versa, particularly where the move benefits, not only the individual, but also, as a element in overall labour mobility, benefits the national economy. Can European practice shed any light on how to resolve the social security and pensions problems that migration creates within a Chinese context? I hope that our European experience will be relevant.

* The Treaty of Rome that originally established the European Economic Community (EEC), the forerunner of today's European Union (EU), guaranteed freedom of movement for workers who moved between Member States. That principle has remained constant within the EU throughout half a century, albeit on occasions with transitional restrictions put into place following the accession of new Member States, such as the current temporary restrictions that some existing Member States placed on mobility on workers from the 10 new Member States. Thus, an Italian worker could, and still can, for instance, move to Germany to take up employment there under the same

conditions as a German worker and vice versa. The founding fathers of the EEC, however, foresaw that the principle of free movement would be compromised if national social security regimes operated in such a way that migrant workers were effectively treated less favourably for pension and other social security rights than workers who remained in a single Member State throughout their working lives. A loss of pension rights would be a positive disincentive to freedom of movement.

It was in this context that the Treaty of Rome included among its provisions on freedom of movement Article 51, which provided:

“The Council shall, acting unanimously on a proposal from the Commission, adopt such measures in the field of social security as are necessary to provide freedom of movement for workers; to this end, it shall make arrangements to secure for migrant workers and their dependants:

- (a) aggregation, for the purpose of acquiring and retaining the right to benefit and of calculating the amount of benefit, of all periods taken into account under the laws of the several countries;
- (b) payment of benefits to persons resident in the territories of Member States.”

That requirement, though slightly updated, still remains current.

* In implementing Article 51 and its successors, the EU has never attempted to harmonise social security within its borders. Nor is there a requirement that a Member State should provide any specific benefit. The Netherlands, for instance, does not provide a specific benefit for work injury – those injured at work being covered by the standard invalidity benefit. As there are currently 25 Member States, so there are 25 different social security systems: some more like each other; some less. There are differences, for instance, in contribution conditions – Denmark does not levy contributions for its basic pension, which is based on current and past residence in Denmark and is funded out of general taxation revenue – there are differences in pension liabilities – some states link pensions to previous earnings; others have a flat-rate pension – some states tax pensions; others do not. Some states have adopted a policy that the state should provide a high replacement rate for old age pensions; others, such as the Netherlands, United Kingdom and Ireland have had a policy of a relatively low state pension, but with a relatively high level of supplementary pension provision.

Instead of harmonisation, the EU adopted the principle of co-ordinating the different social security regimes of each of the Member States so that a

migrant worker who crossed national frontiers within the EU could benefit from the respective regimes of the states in which he worked. That principle applies now, not only to the 25 Member States, but also to the three other European Economic Area states, Iceland, Norway and Liechtenstein, and also to Switzerland. It also applies to the nationals of certain other states, eg Turkey and other applicant states, who come to work in the EU and for them, but not for EU nationals, their home state is treated as a participating state for co-ordination purposes.

* To implement the principle, the EEC adopted among its very first four Regulations provisions for co-ordinating social security. These were later amended and replaced with the adoption of two Regulations: 1408/71 on the principles of co-ordination and 574/72 on the implementing procedures. These are still current, albeit with a considerable number of subsequent amendments. The Regulations are due to be replaced in the near future, but the principles they encapsulate will be unchanged. Firstly they mirror the Treaty by providing that a Member State's social security regime must not discriminate against nationals of other Member States, either directly or indirectly, eg by imposing rules of long-term residence in the State, which it would be harder for migrant workers to satisfy.

The Regulations apply to all currently, and formerly, employed or self-employed workers and for certain purposes to members of their family. Originally they applied only to EU citizens and their family members (including non-EU spouses) – this particularly hit American employees of multi-national companies who were frequently moved around Europe - but they have subsequently been extended to cover other nationalities employed in more than one EU Member State. They also apply to periods before a Member State acceded to the EU. So when Bulgaria and Romania accede to the EU on 1st January 2007, the Regulations will apply to periods of Bulgarian and Romanian social insurance not only for periods after that date, but also for periods preceding that date. It means, therefore, that where retirees have been employed in one of those states and also in an existing Member State, each of the relevant states will have to review and possibly revise the pension award to apply the provisions of Regulation 1408/71 to the award.

Migrant workers covered by the Regulations are under the same obligations and have the same rights in a host Member State to which they move for employment, as nationals of that state. However, this can mean that a person who moves from state A, which provides a pension calculated at a high replacement rate, to state B, which provides a pension at a low replacement rate, may build up entitlement to a lower pension in respect of his period in state B than he would have built up, had he remained throughout in State A.

But his rights in state B would be at least equal for his period there to those of a person who had remained throughout his working life in state B.

* The principle adopted by Regulation 1408/71 is that a person should at any one time be subject to the social security legislation of only one Member State. That means that, if, for instance, a Portuguese worker goes to work in France, he should not simultaneously have to pay social insurance contributions to both the Portuguese and French social security regimes. As a basic rule, the Regulation provides for migrant workers and their employers to pay contributions only to the social insurance institution of the state where the worker is employed or self-employed, irrespective of where he lives or his employer's business is located.

There are, however, a few exceptions. A worker posted to another Member State for up to 1 year (extendible for a maximum of another 12 months) remains subject to the social insurance regime of the State from which he was sent, except when he is sent to replace another worker doing the same job. This is considered to be in the worker's interest, but also avoids Member States having to set up accounts for very short periods, especially if the state concerned does not become liable to provide any benefit.

Secondly, if two Member States agree that it is in a person's interest, they may agree that that person should remain subject to the social insurance legislation of his home Member State for a specified or indefinite period – some states are more willing to agree to such agreements than others. Because Brussels is the capital of the EU, far more nationals of other Member States move to Belgium than Belgians move to other Member States. As a result Belgium has been less willing to agree to such arrangements on the ground that it would have to meet the cost of medical treatment for non-Belgian residents who had not contributed to its social security regime to a far greater extent than another state would need to meet a similar cost for Belgians.

Thirdly, a worker may choose to continue to pay contributions voluntarily to his home state for old age, survivor's or invalidity pension purposes, while compulsorily required to contribute in the state where he is employed.

The corollary is that the Regulations give a worker the right to participate in the social security system in at least one Member State. A state cannot exclude a worker from its social security system on the ground, for instance, that he has not lived or worked long enough in the state to satisfy the conditions for participating in its social insurance scheme.

* Regulation 1408/71 provides for the exportability of pensions for old age,

survivors and invalidity to which a retiree has become entitled. A pensioner from another Member State who retires, for instance, to Spain is entitled to receive his pension in Spain at the same rate as it would have been paid if he had remained in the State from which the pension is payable. If the pension is increased in that State, or would be, if he were still resident there, the rate payable in Spain would also have to be increased by the same amount. The only difference that can occur in what the pensioner receives is where the exchange rate fluctuates between the currencies of the paying state and the state where the pensioner is resident. This problem disappears where both states have adopted the Euro as a common currency. But even here, the purchasing power of the pension, and so the pensioner's standard of living, may vary according to the cost of living in the respective Member States. Furthermore, the percentage by which the pension is subject to indexation is likely to be linked to the price or wage inflation rate in the state from which the pension is being paid, not that in which the pensioner resides.

Exportability does not apply to social assistance benefits and to certain non-contributory benefits for disabled people. Thus, a retiree with a pension supplemented by social assistance in the state where he retires who then, say, goes to live with his or her children in another Member State may export the pension, but not the social assistance supplement. However, residence in the first Member State can be aggregated with residence in the second towards the qualification of the equivalent social assistance and disablement benefits there.

I should note at this point that Member States have the right to exclude persons from another Member State, sometimes called "benefit tourists", who come to that state to claim social assistance and cannot provide for their own subsistence.

* Exportability itself does not assist in the acquisition of benefits. Many Member States lay down contribution or similar thresholds before benefits are acquired, analogous to China's 15 year requirement for the social pooling element of the old age pension. Without the Regulation a worker moving between Member States could find himself unable to qualify for benefit under the legislation of one or more Member States because he did not satisfy the State's minimum qualification conditions. It was to overcome this problem that the Treaty of Rome introduced the principle of aggregation. That principle applies to both "short-term benefits", eg for sickness, unemployment and work injuries, and to "long-term benefits", eg old age and survivor's, but for long-term benefits by the adoption of the more detailed principle of "aggregation and apportionment". Whether invalidity benefit is treated as a long-term or short-term benefit depends on the conditions for entitlement in the

State concerned.

* For short-term benefits, the principle of aggregation means that a person's contribution record (or the equivalent, where, as in Denmark, entitlement is based on residence, or if contributions have been credited) in all Member States is aggregated for determining whether the person satisfies the contribution conditions for entitlement to the benefit of the state where the person resides, or the condition arises. So, if, for instance, a person who has worked in Poland for 10 years goes to work in Sweden, but then after 18 months becomes incapable of work, the Swedish authorities must aggregate the person's Polish and Swedish contribution records towards satisfaction of the Swedish contribution conditions. After aggregation the award and payment of sickness benefit will then be by only the competent state, ie the state where he was last employed, in the example Sweden, (or to the state to whose legislation he was subject under one of the exceptions), at the rate laid down by its legislation. Work injury benefit is paid by the state in which the injury occurred or where the conditions for contracting the occupational disease existed, but with special provisions where a condition arises in one Member State, but is aggravated by employment in another.

As regards benefits in kind, eg medical treatment, these are provided to the worker and members of his or her family by the authorities of the state in which the worker resides, as if he had been insured under its legislation.

Such medical benefits are also provided in an emergency in the state where treatment is needed, or in a state to which the individual is authorised to go for treatment, eg where the treatment is not available in a particular state. The cost is then reimbursed by the competent state to the level provided by its own legislation – but some states have introduced reciprocal arrangements for non-reimbursement.

A pensioner entitled to a pension from more than one Member State, and his or her family members, are entitled to medical benefits under the legislation of the state in which he resides, except that, if he is not entitled to a pension from the state where he resides, the cost of the treatment must be met by one of the States from which he receives the pension, normally the one to whose legislation he was subject for the longest time. So if a pensioner who had worked in Portugal and Luxembourg retired to Portugal, the Portuguese authorities would be required to meet the cost of medical benefits, but if a pensioner who had worked in Sweden and Finland retired to Spain where he had never worked, the Spanish authorities would not have to meet the cost of medical benefits, which would have to be met by either the Swedish or Finnish authorities on the basis of to which of them he had paid contributions for the

longest period.

* For long-term benefits, each Member State to whose social insurance legislation a person has been subject for at least a year must apply the principle of “aggregation and apportionment” and pay a pension accordingly. This means that a retiree who has worked in more than one Member State will receive a pension from each of those States. Under the aggregation and apportionment arrangements the retiree may qualify to receive a pension, albeit a small one, from a state, even if he does not satisfy the state’s contribution threshold and the pension rate is less than the minimum pension payable under the state’s own legislation. The procedure is as follows:

- i) Each Member State in which the retiree has been employed and to whose legislation he has been subject must calculate what his entitlement is under its own national legislation alone – this may be zero, if the threshold is not satisfied;
- ii) Each State must then calculate a notional rate that would be payable under its legislation if the aggregate of contributions paid under all the legislation of all the states had been paid under its own legislation;
- iii) Each State then calculates the proportion of that notional rate that contributions under its own legislation bears to the aggregate;
- iv) Each State then pays the higher of the two rates, even if it is lower than the minimum normally payable under its own legislation, eg less than 15% of average salary, where 15% is the minimum.

This means that, unlike the position for short-term benefits, the State in which the migrant last worked does not have to meet the cost of a pension based on his whole working life, but it also means that a migrant does not cease to acquire pension rights as a result of his mobility. His employment in each Member State enables him to acquire at least the same pension rights as a result of the same employment as a worker who works only in that one State. Hence social insurance ceases to be a major disincentive to mobility.

* Let me give some examples.

Supposing a worker had worked and contributed for 40% of his working life in the Netherlands and 30% each in France and Germany, all three countries would calculate his entitlement under their own legislation. They would each then aggregate his contribution record and calculate the notional amount of their respective entitlements. The Netherlands social insurance institution would pay 40% of his notional Dutch pension, the French 30% of his notional French pension rate and the German institution 30% of his notional German pension rate, or in each case the amount of the pension under national

legislation, if higher. In practice, the 40% of his notional Dutch pension could be lower than the 30% of either the notional French or German pensions, as the Netherlands has comparatively lower pensions than the other two states.

Turning to the second example, the worker worked and paid contributions for 95% of his working life in Great Britain and 5% in Denmark. He would have paid sufficient contributions to qualify for the full pension under UK legislation and so, as that would be greater than the pension calculated under the aggregation and apportionment provisions, he would receive 100% of the British pension. He would not qualify for any pension under Danish legislation alone, but under the aggregation and apportionment provisions he would, in addition to the British pension, receive 5% of the notional Danish pension calculated on the basis of residence in Denmark throughout his working life.

The third example applies to a person who has paid contributions respectively in Great Britain and Ireland for 10% of their working life with the remaining 80% here in China or elsewhere outside the EU. He would have no entitlement under British or Irish legislation alone; so Great Britain and Ireland would have to aggregate their British and Irish contributions to calculate the notional amount. The British notional amount would be zero as the aggregate would still give no entitlement; the Irish notional amount would give a small pension at age 66. Thus the worker would receive no British pension, but would receive 10% of his notional Irish entitlement.

Let me give an analogy if aggregation and apportionment applied in a Chinese context. Currently a worker who moves from one city to another within a single province receives a social pooling pension from the second city at its expense, even though contributions would have been paid for the earlier period to the social insurance bureau of the first city. Under the introduction of an aggregation and apportionment system, the cost of the social pooling pension would be imposed proportionately on each city. Similarly a worker moving from a province with lower average earnings to a province with high average earnings would receive a social pooling pension from the second province based on its average earnings, albeit after a cash transfer on the transfer between provinces. The same would apply in reverse if the move had been in the opposite direction. Under an aggregation and apportionment system, a pension would be received from each province in proportion to the period of employment there based on the average salary in the awarding province.

* How does the system work and what are the procedures? The EU has produced a series of what are called “E forms”. These are numbered forms beginning with the letter E and are produced identically in every Community language. They provide details of a worker’s name, address, date of birth, date

of retirement, contribution or residence record, etc. – and subsequently pension awards by each state and ultimately the date of death - and are passed between each of the Member States in which the retiree has worked. So, if a worker had worked in both Estonia and Malta and no Estonian social insurance official spoke Maltese and no Maltese official spoke Estonian, they still be able to read and understand each other's forms because the item at, for instance, box 3 of the Estonian version would be identical to box 3 in the Maltese version.

This “E form” system permits a worker to make a single pension claim in the State where he resides that will enable him to claim a pension from all the EU or EEA states in which he has worked. The state that receives the claim copies it on to an E form which it sends to every other such state in which the retiree has worked so that they can calculate what pension, if any, they are liable to pay, and then report it back to the original state on another “E form”. However, because different States have different pension ages, a worker may become entitled to a pension calculated under the aggregation and apportionment provisions from one country before he qualifies for a pension from another.

* But what of the position where the worker has a non-state supplementary pension, ie a pension analogous to an enterprise annuity here in China? Such pensions, which are very common, particularly in the Netherlands, United Kingdom and Ireland, are not covered by Regulation 1408/71. Instead two separate EU Directives apply in this field. (Nb Whereas an EU Regulation, such as 1408/71, applies directly in every Member State, a Directive lays down an objective but requires Member States to adopt their own legislation to achieve that objective.)

Directive 98/49 provides for portability of such pensions. A person who has vested pension rights from a pension arrangement in one Member State is entitled to receive the pension in another Member State at the same rate as would be payable in the state from which the pension is awarded. It also provides that a person who moves to employment in another Member State is entitled to the same preservation and/or transferability rights – which I shall explain later - as he would receive if he took up other employment in his home state. However, it does not require the new employer to provide a pension scheme equivalent to those provided by the former employer.

Another Directive 2001/23 on what are called “Acquired Rights” on change of employment complements the position where a company is taken over, or workers are transferred to a new employer. It does not require Member States to enact legislation to require the new employer to provide identical supplementary pension provision for old age, survivor's and invalidity benefits

as the old employer, but it does require Member States “to adopt measures to protect the interests of employees and of persons no longer employed in the transferor's business at the time of the transfer in respect of rights conferring on them immediate or prospective entitlement to old age benefits, including survivors' benefits, under supplementary schemes”. Some Member States have, however, introduced legislation to require the new employer to make similar, but not necessarily identical, provision to that of the old employer following a take-over or transfer of staff.

* A more recent Directive 2003/41 came into effect in September 2006 and applies to pension schemes not covered by Regulations 1408/71 and 574/72. This Directive provides for a new variety of cross-frontier pension arrangements. It requires Member States to introduce procedures to enable an employer in one Member State to make use of a pension scheme established in another to provide supplementary pensions for its employees. This is designed, for instance, to enable an employer with employees in more than one Member State to operate a single pension scheme for all its employees. It also allows workers whom the employer transfers to another Member State to remain in the same pension scheme. However, before the employer can operate a pension scheme in another Member State for its employees in a particular Member State, it must meet conditions laid down in the Directive and the provisions of the state's national social and labour law and satisfy the Regulators of both States that it does. Pension schemes in one Member State may also use the services of a fund manager and custodian established in another Member State, provided that they are authorised by the regulatory authorities in the state where they are established. The respective Regulators have to exchange relevant information and, where necessary, one Regulator may ask its opposite number to impose penalties or even to withdraw the authority to operate.

The Directive lays down requirements to be met by pension schemes (enterprise annuities) in each Member State as regards registration, funding, actuarial valuations, the ring-fencing of pension scheme assets and supervision. A pension scheme in a Member State may invest outside that Member State in accordance with the “prudent person” principle to safeguard the interests of members, but individual Member States are prevented, with limited exceptions, from imposing quantitative restrictions on investment. Pension schemes are required to publish a written statement of their investment principles and must provide relevant information to their members and beneficiaries on their pension rights, including preservation and transferability rights on change of employment.

* Finally what options are available to a worker with occupational pension

(enterprise annuity) rights on leaving one employment and moving to another? It is possible for a worker to have a refund of contributions, but this removes the right to a pension. Several EU states have now removed this option, except possibly for workers who have participated in the scheme for less than a short minimum period. Many Member States consider that it is not in the workers' interest to lose pension rights on a change of job, but nor is it in the interest of the State concerned if the result means that the state has to pay out social assistance or some form of minimum standard of living guarantee because the retiree has chosen to forgo a pension by taking a contribution refund.

Firstly, a group of employers, eg in a particular industry, may jointly establish and participate in a single arrangement. This is common in the Netherlands. If a Dutch textile worker moves from one textile employer to another, he is likely to remain in the same private pension scheme and his, and his employers', contributions will all go towards providing his pension. (In Spain, certain trade unions have established supplementary pension schemes for their members with rights that continue to accrue whatever employer the trade union member works for. Last month a Dutch trade union announced that it was considering establishing a supplementary pension scheme for self-employed workers.)

Secondly, the pension rights may remain preserved in the pension scheme established by the former employer. If it is a defined contribution scheme, they will continue to be invested and receive investment income, even though no additional contributions will be paid. The worker will become entitled to a pension from the scheme, or, more likely, entitled to the purchase of an annuity, at the scheme's pension age (or earlier on ill-health grounds). If the scheme is a defined benefit scheme with benefits based on final salary, analogous to the scheme for public employees here in China, the rights will remain as calculated on the basis of years of participation in the scheme or of employment and the salary on leaving. In some countries the preserved rights will be revalued wholly or partly in line with wage or price inflation so that, when the member retires, the rights will wholly or partially have maintained their real value.

Thirdly, as an alternative to preservation of pension rights in the scheme in which they were acquired, some Member States give members the legal option to transfer their rights to another pension scheme, whether established by the new employer or by an insurance company, or to use them to purchase a deferred annuity contract. If the first scheme is a defined contribution scheme, the cash value of the amount in the participant's individual account in that scheme is transferred to an individual account in the second scheme, subject possibly to deduction of an administrative cost. If the first scheme is a defined benefit scheme, similar to the public service pension arrangements here in

China, the amount transferred, including from an unfunded scheme, is calculated on the basis of the cost of providing a pension at the rate so far accrued. An analogous calculation has to be undertaken if a transfer is received by a defined benefit scheme.

* So what relevance do the EU portability and transferability provisions have here in China? Well, workers move. Some move from the public service to enterprises, or vice versa, and some from the defined benefit public service scheme to the state social security scheme with social pooling and individual accounts, or vice versa. Others move between municipalities and counties within a province or from one province to another, either changing or retaining their hukou. The province or municipality from which they retire may be required to meet the whole of the pension cost even if much of the working life was spent and contributions paid elsewhere. No wonder that some bureaux seem unwilling to accept participation from workers aged 50+. Aggregation and apportionment might resolve that problem.

Rural workers may become urban workers. Where there are schemes for rural workers, what happens if they move to take up urban employment? Chengdu, for instance, permits transfers from the rural to the urban scheme, but many cities do not.

Farmers who have compulsorily lost their land may become urban workers or start work in rural enterprises.

Participants of an enterprise annuity may leave the employer who has established it, probably to work for another employer who has not.

And convincing migrant workers without a labour contract of the advantages of building up pension rights, when currently they may lose any rights that they have built up when they move is an issue that may be addressed.

There are major differences, of course, between the EU and China, but there are similarities and that is what our EU/China Social Security Reform Co-operation Project is designed to identify and consider. I hope, therefore, that European experience in the field of protection of pension and social insurance rights for cross-border migrant workers does have something to say to the Chinese situation and can assist to some extent in resolving the issue of migrant workers' pension position here.

W Birmingham
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