# Constructing Multi-pillar Pension System in an Emerging Market Country. Experience of Poland with Implications for Albania

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# Overview

I Old pension system and reasons for change

II Constructing the new pension system

III What place for supplementary pensions

IV Conclusion, lessons learned

# Main shortfalls of the previous retirement system (till 1999)

- No individual accounts
- No correlation between contributions paid and retirement benefits
- Concessions to politically strong social groups
- Sensitive to the process of aging of the society
- Inflows to the system insufficient to cover the outflows what caused deficit of the system

# Budgetary subsidies to the social security

- 1991 ➔ 7,5 %
- 1995 ➔ 16,8 %
- 1998 ➔ 18,0 %
- 1999 ➔ 21,3 %

the percentage of state budget spending

# Architecture of the new pension system in Poland

- Mixed type, partly based on pay-as-you-go rule and partly on capitalization of contributions.
- Contributions paid to the system are accounted for or accumulated on individual accounts and managed by specialized entities
- Pension benefits vary with the amounts of contributions paid.
- Because of individual accounts created for every insured, system has no demographic problems
- State guarantee of a minimum pension

# Comparison of previous and new pension systems - main differences

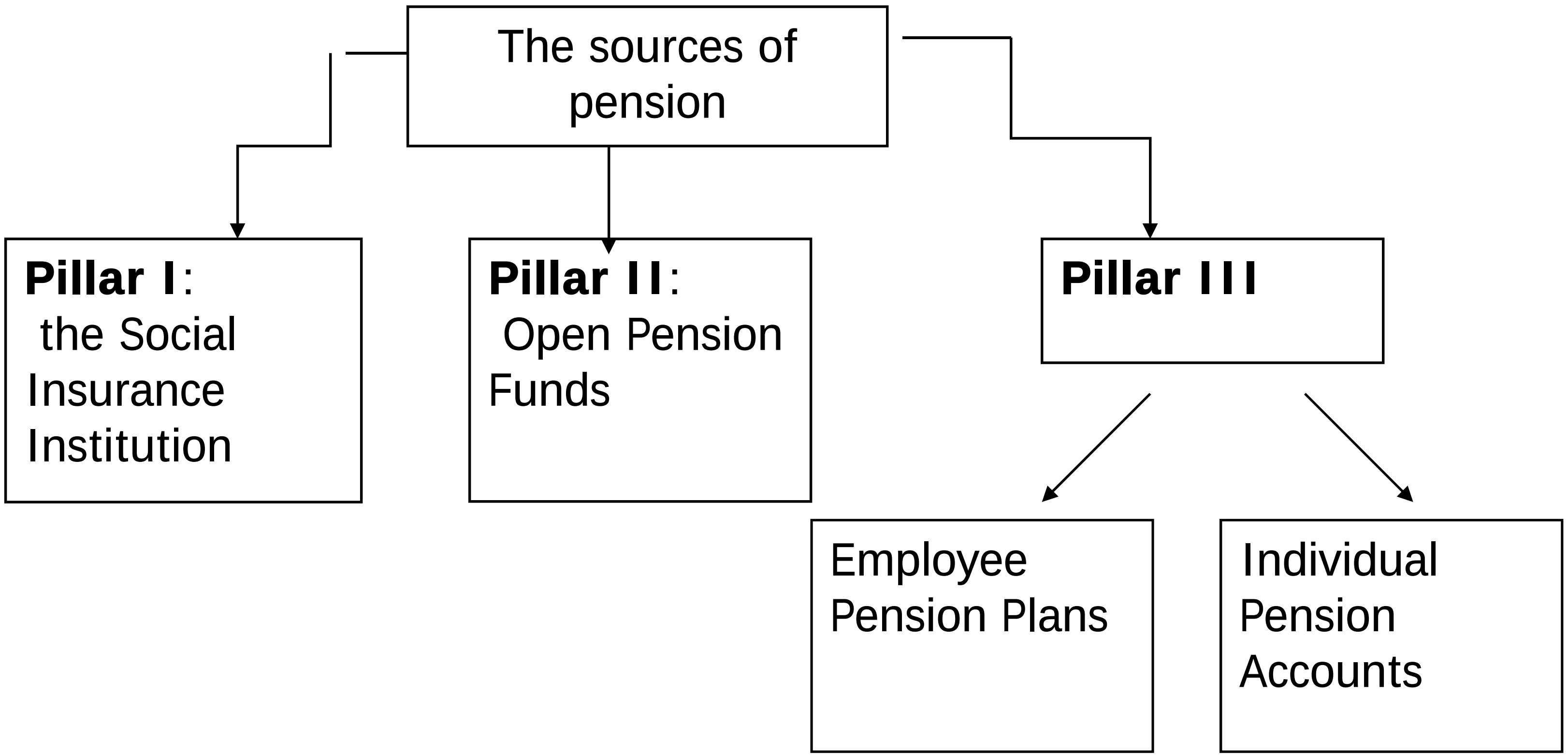
| PREVIOUS PENSION SYSTEM | REFORMED PENSION SYSTEM |
|---|---|
| No individual accounts | Individual accounts of insured |
| No correlation between contributions paid and the future benefit | Strict correlation between contributions paid and the future benefit |
| System very sensitive to the demographic processes – especially to the aging of society | No sensitiveness to the demographic situation |
| A lot of concession for particular professions | No concessions for anyone in the system |
| | |

# Elements of the pension systems

**(the two distinct approaches)**

| WORLD BANK | OECD/EU |
| --- | --- |
| • I pillar - mandatory PAYG system | I A — I pillar |
| • II pillar - mandatory funded system | I B — I pillar |
| • III pillar - voluntary occupational, or individual pension plans | II pillar |

# Pension system in Poland



# Open pension funds in Poland

- The fund shall be created by a licensed society
- Fund has no bankruptcy ability
- The only task of the fund is to accumulate participants contributions and invest optimising the security and profitability
- Participant contribution supplies monthly the individual account in the fund with the amount representing 7,3% of the „contribution base (pre-tax salary + derivatives)

# Supplementary savings - the way to increase the retirement benefits

**Occupational Pension Plans** can be a tool to stimulate additional savings supporting state pensions.

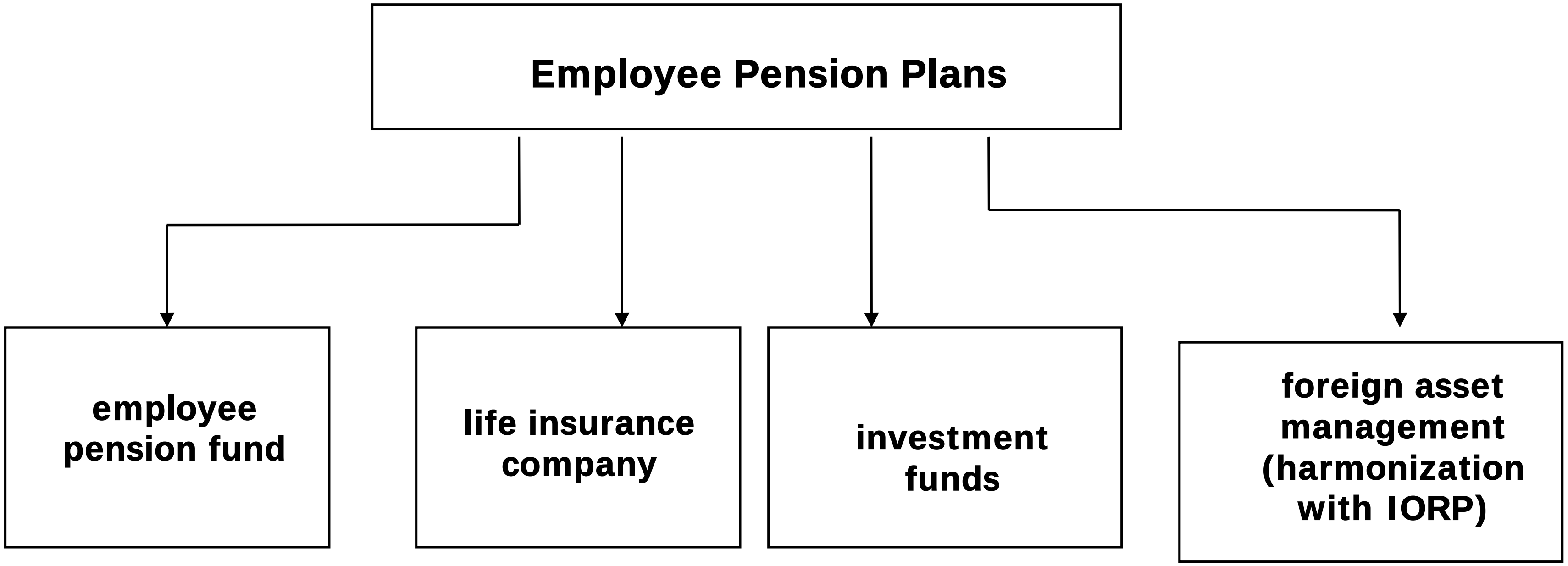
**Pros:**

for the state ➔ extra savings

for employee ➔ extra retirement benefit

for employer ➔ higher attractiveness

# Employee Pension Plans – forms



# The 3rd Pillar of Pension System – legal basis

## 1. Employee Pension Plans

Act of 22 August 1997 on Occupational Pension Schemes with the most important amendments from years 2000 and 2004

## 2. Individual Retirement Accounts

Act of 20 April 2004 on Individual Retirement Accounts

# Employee pension plans – general characteristics:

- occupational, capitalized, administrated by private entities,
- defined-contribution plans,
- TEE: tax-exempt-exempt (contributions are taxed, profits and payments are exempted from taxation)
- established by employers for their employees,
- agreements:

- ***between employer and staff representative,***
- ***between employer and financial institution,***

- every employee pension plan is registered and supervised by the supervisory authority (KNF),
- a few employers can establish one pension plan – multi-company plan,

# Employee pension plans – changes:

Apart of the main principles ruling the PPE, many elements of the system were changed/modyfied over 10 years from the start of the system, for example:

- basic contribution financed by employer (max. 7% of salary) – originally the employee covered the contribution himself; it changed in 2000;
- pension benefits payments are possible in cases defined in law – the cases were changing,
- **transfer savings from plan to individual pension account - possible from 2004**,
- the possibility to cancel or terminate pension contract or decrease the amount of contributions (i.e.:in case when the company is in a poor financial situation) – the amendment introduced in 2004
- transformation of selected forms of group pension savings into PPE – to maintain social insurance contribution relieves. Employers were requested to notify the authority of such transformations by the end of December 2005.

In 2005, 461 of 597 new registered PPE were established through transformation.

# Individual pension accounts (IKE)

- capital, administered by private entities,
- TEE: tax-exempt-exempt (contributions are taxed, profits and benefits are exempt from taxation)
- agreement between individual person and financial institution,
- possible financial institutions:
- **investment funds**
- **life insurance companies**
- **brokerage house**
- **banks**
- 1 person = 1 account,
- Quantitative limits of contributions.

# Possible Impact of the reforms

- On pension system
- On workers
- On pensioners
- On capital markets
- On consumers and the market in general

# Conclusions (general)

- Multipillar reforms with higher degree of funding can be implemented in countries with:
  - high implicit debt
  - strong attachment to PAYG pillar
  - increasing dependency rates
- Privatization proceeds, if available, are an excellent source to cover transition costs
- Extensive education helps to shape the reform

# Conclusions (as to the start)

- Problem areas at the beginning are:
  - contribution collection
  - membership record (dormant accounts)
  - Organizig salesforce (timing)
- Strong capital base is crucial for operators
- Implementation capacity can easily be overestimated

# Conclusions (as to the operation)

- A hard look needs to be given to:
  - Structure of the market (competition)
  - Liberalizing investment restrictions
  - Costs and charges
  - Doing away with the minimum return requirements

Thank you for your attention!

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