SGH

Polish Pension Group

Pension Reform in Poland

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Stages of pension system changes in Poland

Pension system after economic transition

Pension system in early 1990s: restoring adequacy

1. Early retirement further widespread to absorb excess workers due to jobs destruction in the transforming economy
2. Level of benefits below adequacy due to high inflation level
   - recalculation (revalorisation) of all pensions in 1992
   - Introduction of permanent pension indexation anticipating inflation levels
   - New pension defined-benefit pension formula
     - linking pensions to individual wage level and employment history (1.3% of wage for each year of work)
     - redistributional part (24% of average wage)

Need for pension reform in 1990s

Pension system in early 1990s: restoring adequacy

Pension system development from early 1990s led to its unsustainability in long run:

- Contribution rate for social security: from 15.5% to 45% of payroll
- Replacement rate: 70-80% of wage
- Average retirement age: 55 for women and 60 for men
- Pension expenditure reached 14-15% of GDP in mid 1990s

Problems in pension system:

- Short-term: rising deficit, widespread early retirement, actuarially imbalanced, groups outside (farmers, military, judges..)
- Long-term: population ageing caused by approaching retirement of baby-boom generation and falling sharply (to lowest-low) fertility rate

Current adjustments to pension systems turned out to be ineffective, the pension reform became inevitable

Wave of pension system reforms in the region and worlwide conducive to the change

The new pension system in Poland – „Security through diversity”

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The new pension system concept elaborated between 1996 and 1998, implemented from 1999

It did not follow the typical „pillar” approach, but focused on close link between contributions and benefits

Moving from NDB to NDC+FDC scheme:

- non-financial defined contribution (12.22% of wage)
- financial defined contribution (7.3% of wage) – more visible part of the changess
- voluntary pension savings: employee pension plans, individual retirement accounts (2004), individual retirement protection accounts (2009)

Coverage:

- All born after 1948 (exceptions: farmers, judges, prosecutors)
- Born between 1949 and 1968 had a choice of the version of the new system (NDC only or NDC+FDC)
- NDB: born before 1949

The new pension system in Poland – „Security through diversity”

The new pension system in Poland – „Security through diversity”

- An exchange of the old system with the new one: NDC being the ”spine” of the entire concept
- Protecting working generation: towards a balance of interest of the working generation and the retired one
- Separation of old-age and other social insurance risks
- Clear separation of redistribution and income replacement role:
  - NDC as device of pure income allocation in the lifecourse
  - Contributions for selected periods financed from the public funds
  - Minimum pension guarantee (top-up) financed from the state budget
- Regaining financial stability in the long run: close to actuarially balanced pension formula
- Life expectancy (annuity) factor announced annually by Central Statistical Office
- Incentives to postpone retirement decisions

The new pension system in Poland: implementation experience

15+ years of reform implementation

INITIAL PLAN:

NDC + FDC operating from 1999

Indexation of pensions close to CPI

Diversification of FDC investment strategies from 2004

Early retirement removed from 2007

Transition costs financed partcially through removal of early retirement

REALITY:

Initial plans implemented, but some elements remained not solved (annuities, multi-funds)

Indexation close to wage growth until 2004

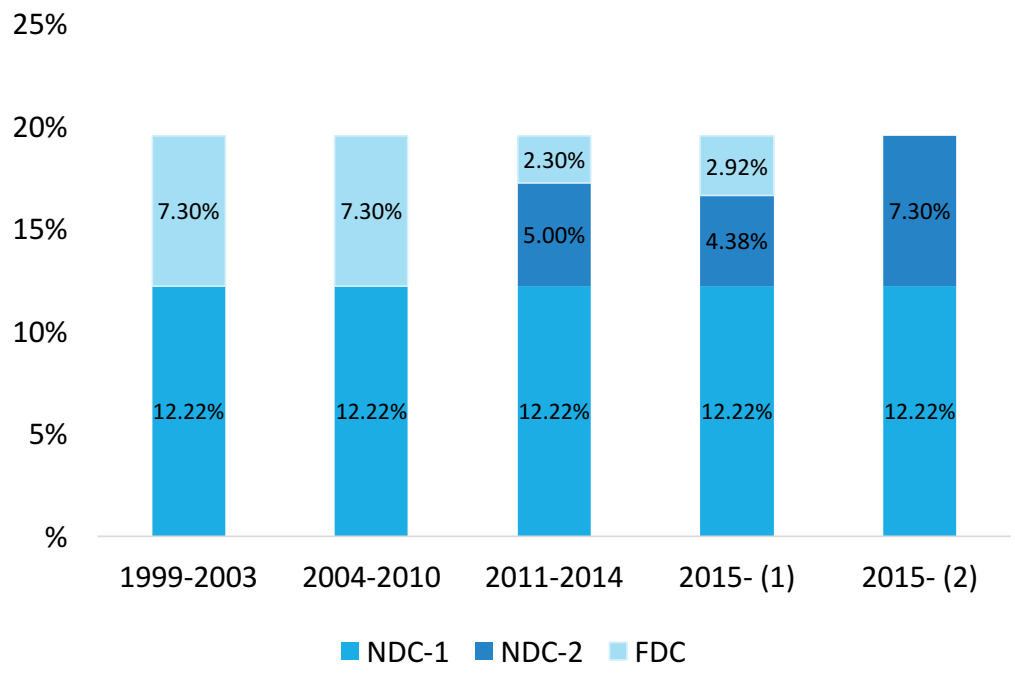
No diversification of FDC investment strategies

Early retirement prolonged by two years, additonal early retirement rights for men granted in 2008

Increased social insurance deficit due to reduction of disability contribution from 2008

Individual accounts

15+ years of new system implementation



Initial split of NDC+FDC changed

FDC contribution reduced from 2011

New NDC-2 account indexed to GDP growth introduced in 2011

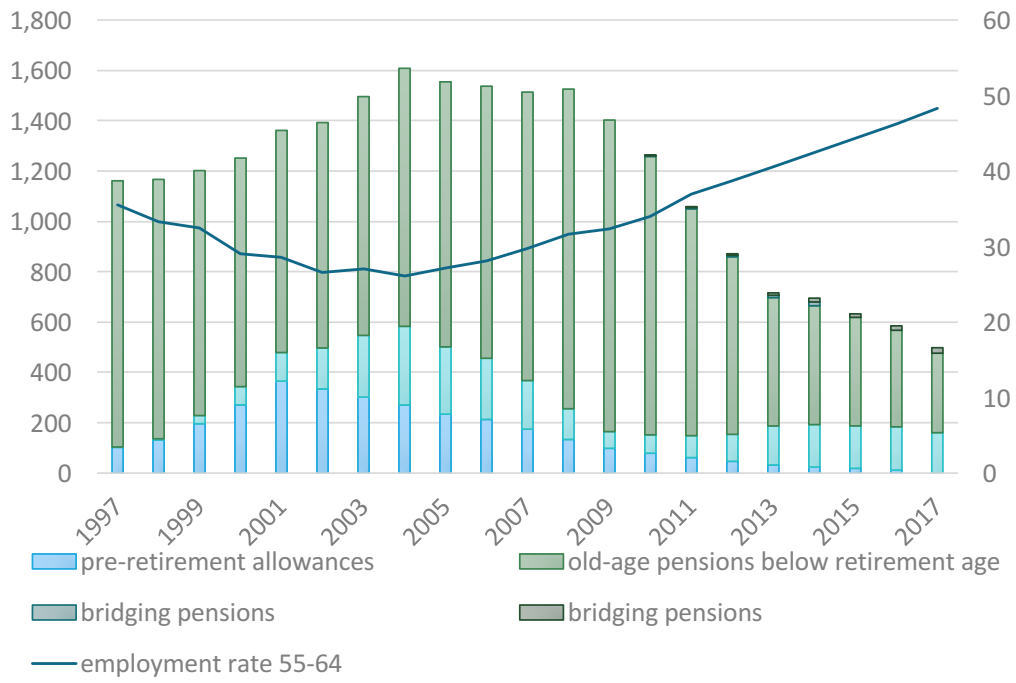
NDC-2 account reflects FDC part diverted to NDC:

- Smaller contributions: 2011 and 2015 changes
- Redeemed government bonds (c.a. half of pension savings) in 2011
- Opt-out contributions from 2015
- Pre-retirement slider

Change in the policy towards early retirement

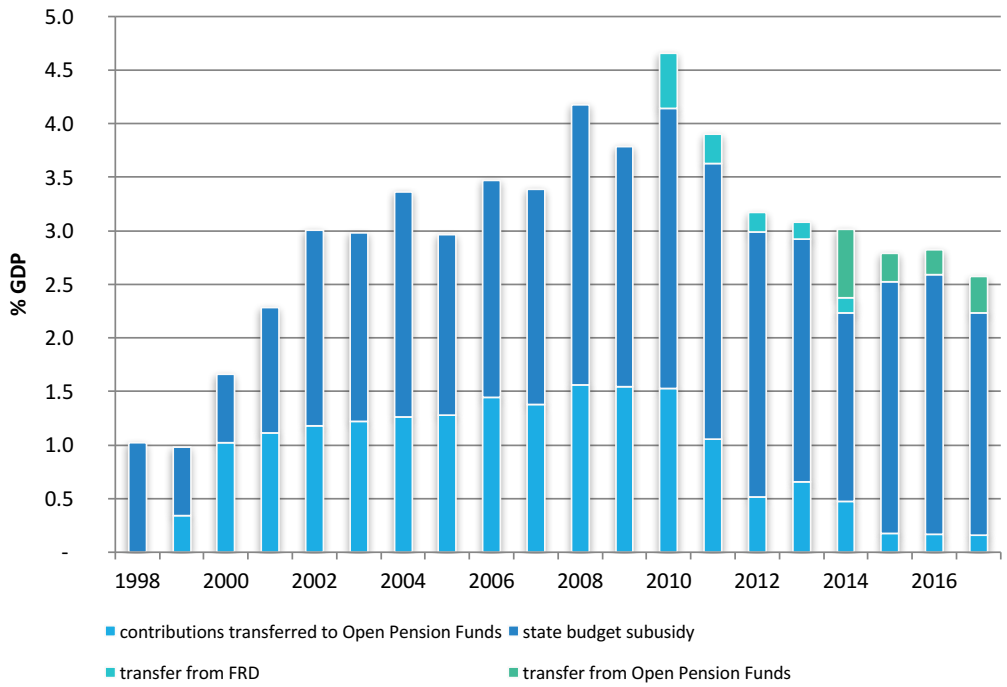
15+ years of reform implementation

- The reform plan was to reduce early retirement
- During first years: early retirement expanded through pre-retirement transfers
- Possibility of early retirement extended from the end of 2006 till the end of 2008
- The final plan of „bridging pensions" introduced from 2009
- Quick reduction of early retireees and rise of employment rate



Financing of the pension system

15+ years of new system implementation



High pension system deficit adding to transition costs

- Postponed withdrawal of early retirement
- More generous pension indexation
- Falling contribution revenue

State of the pension system in 2018

Pension system after economic and fiscal crisis

NDC holds, its construction allows to maintain long-term balance

The FDC:

- Changes announced: 25% of assets transferred back to PAYG and 75% to individual retirement accounts

Further changes:

- Reversing the raising retirement age to 67 for men and women and back to 60/65
- Pension indexation: partially lump-sum
- Minimum pension raised to 1000 PLN per month

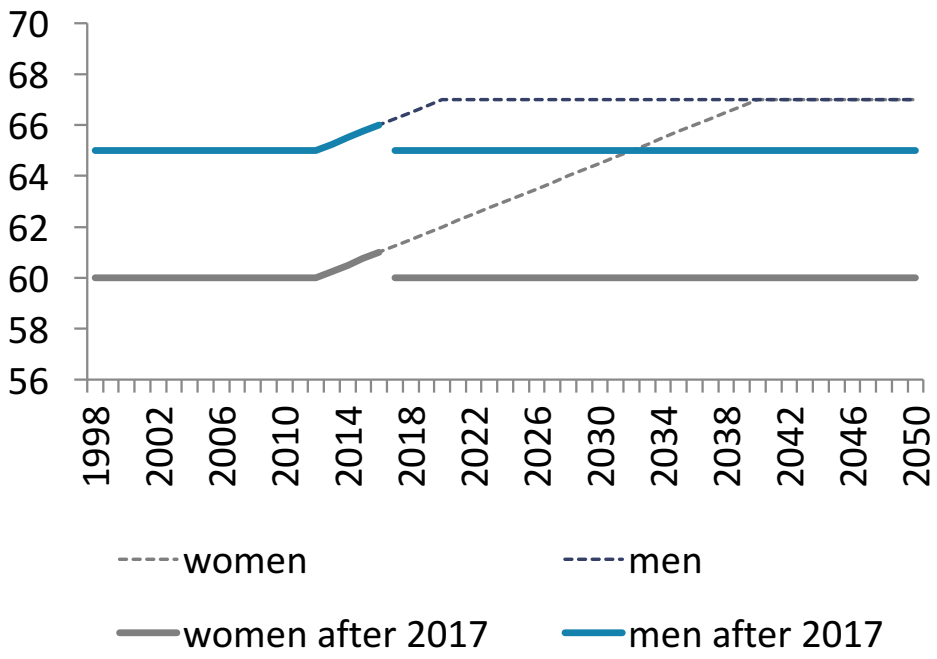
Review of pension system in 2016

- Pensions for people with short working careers
- Limitations on combining work and retirement

Retirement age

Pension system after economic and fiscal crisis

- Traditionally different retirement age of men and women: 65 and 60
- Initial reform proposal of equalising retirement age not supported by the politicians
- Gradual equalisation of retirement age to 67/67 approved from 2013
- In 2017 the raise of the retirment age reversed to 60/65: 417 thousand new retirees, higher inflow continues in 2018
- Removal of early retirement is still a step forward



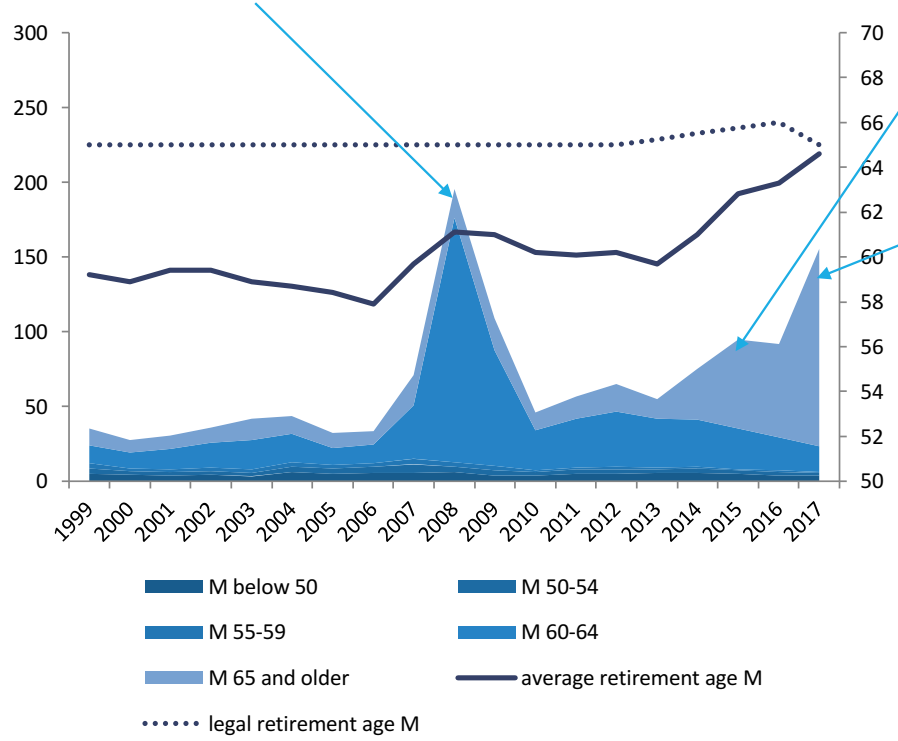
Inflow of new pensioners

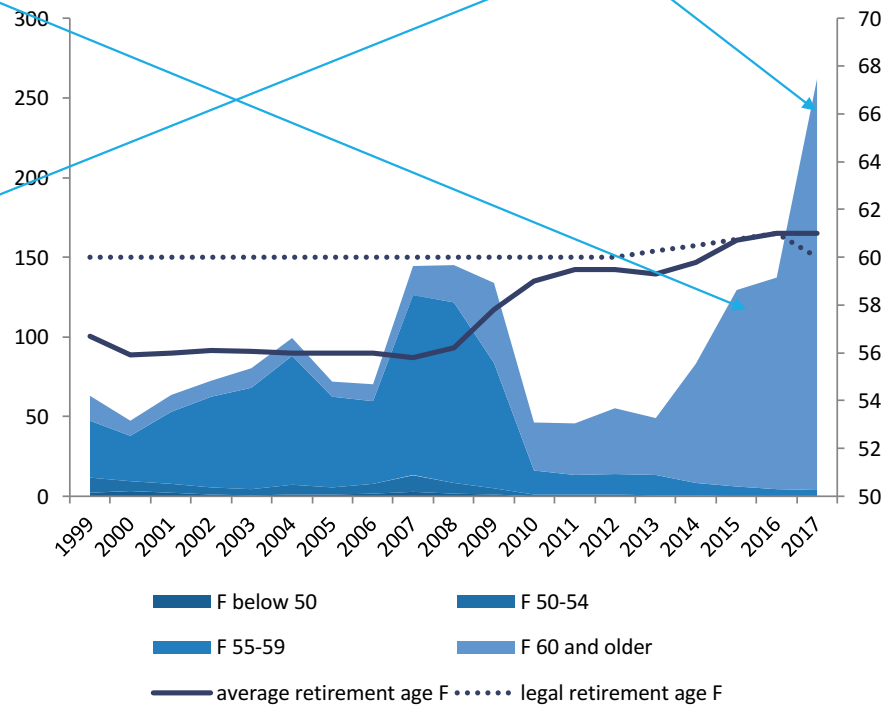
15+ years of reform implementation

Constitutional tribunal ruling on early retirement for men

Pension age reached by „reform cohorts"

2017 decline of retirement age





Sustainability and adequacy of pension system as of today

Pension system after economic and fiscal crisis

Reduced social trust towards pension system, undermining the generational contract and social sustainability

- Government can take away pension saving
- Multiple pension accounts: NDC, quasiNDC, FDC, 2 types of individual retirement accounts with different tax treatment, Employee Pension Plans (still underdeveloped)

Population ageing puts significant pressure on labour market development which will affect pension system

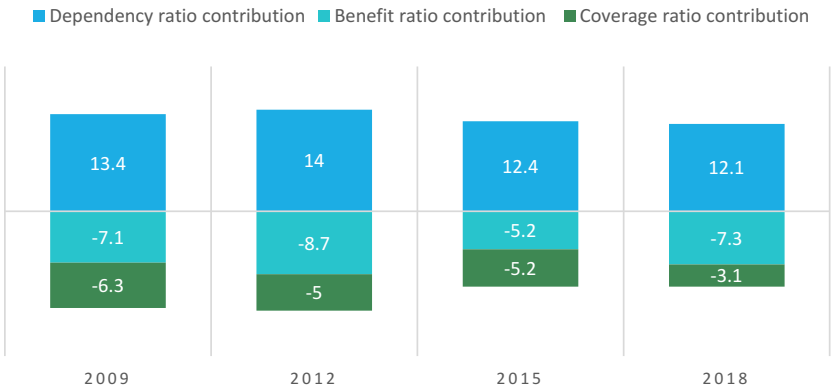
Gender gap challenge

- With different retirement age there will be a rising gap between pensions of men and women
- The average pension after reduction of retirement age:
  - Total: 2080.30 PLN
  - Men: 2699.52 PLN
  - Women: 1614.39 PLN (59.8% of men's pension)
- In time, with the labour market gender gap, the difference will be increasing

Long-term stability of the NDC system in Poland in the light of reform reversal….

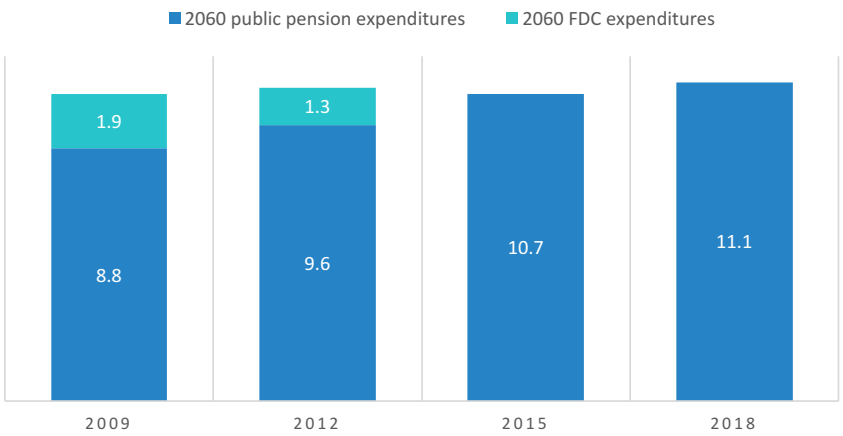
RETIREMENT AGE AND ADEQUACY TRADE-OFF…..

DECOMPOSITION OF 2060 PENSION EXPENDITURE CHANGE – DEPENDENCY, BENEFITS AND RETIREMENT AGE

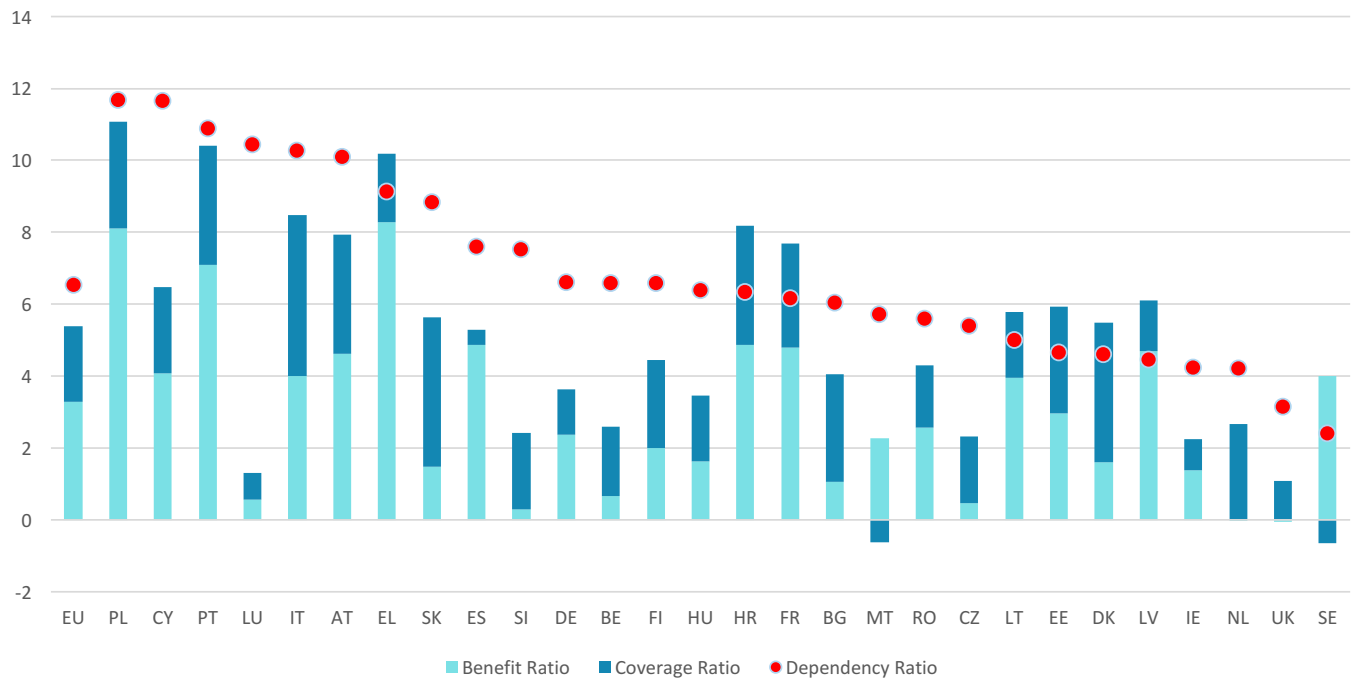


… AND LONG-TERM EXPENDITURE OUTCOMES

CHANGING NDC-FDC MIX



Increasing age is more difficult than decreasing benefits in many EU countries



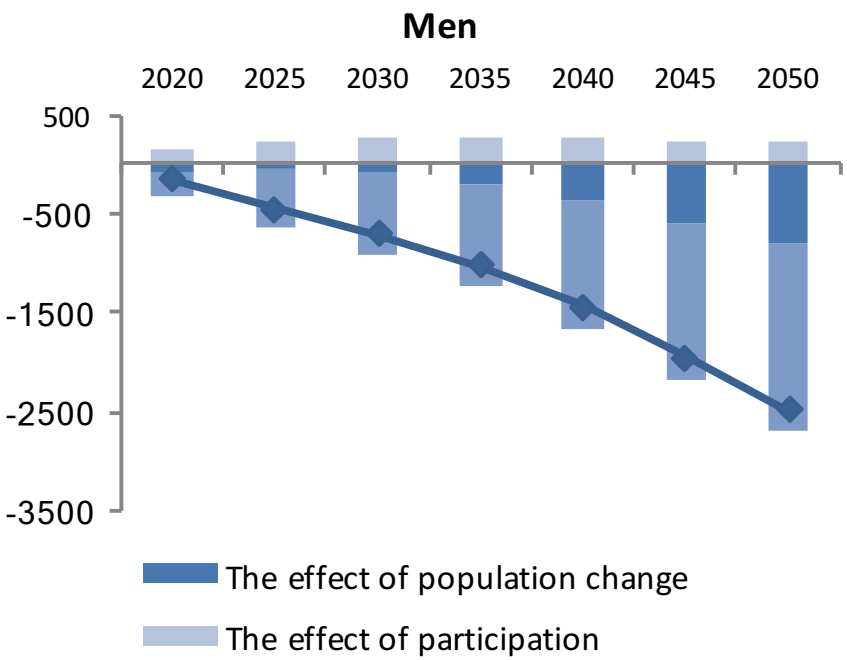
	Coverage Ratio Contribution	Benefit Ratio Contribution	Total
EU	32,4	50,4	82,8
PL	25,4	69,4	94,8
CY	20,5	35,0	55,5
PT	30,3	65,2	95,5
LU	7,2	5,3	12,5
IT	43,8	39,0	82,8
AT	32,8	45,8	78,6
EL	21,0	90,7	111,6
SK	47,0	16,8	63,7
ES	5,7	64,0	69,7
SI	28,3	3,8	32,1
DE	19,1	35,7	54,9
BE	29,3	10,1	39,4
FI	37,5	30,4	67,9
HU	28,5	25,6	54,1
HR	52,5	77,0	129,5
FR	47,2	77,6	124,8
BG	49,3	17,8	67,1
MT	-11,0	39,9	29,0
RO	31,0	45,7	76,7
CZ	34,4	8,7	43,1
LT	36,7	79,1	115,8
EE	63,6	63,9	127,5
DK	84,4	34,9	119,3
LV	31,4	105,6	137,0
IE	20,3	32,8	53,1
NL	63,3	-0,2	63,1
UK	34,3	-1,4	32,9
SE	-26,9	166,8	139,9

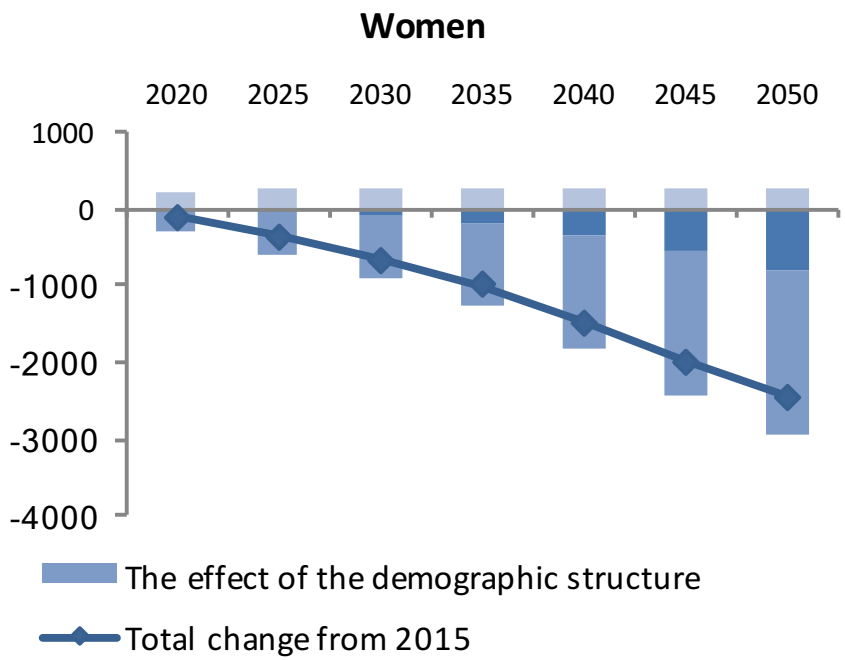
Source: 2018 Ageing Report

Labour market challenges

- Low employment rate
- Excessive use of fixed-term contracts
- Interruptions in working careers
- Informal employment
- Labour market segmentation also linked to different pension sub-systems

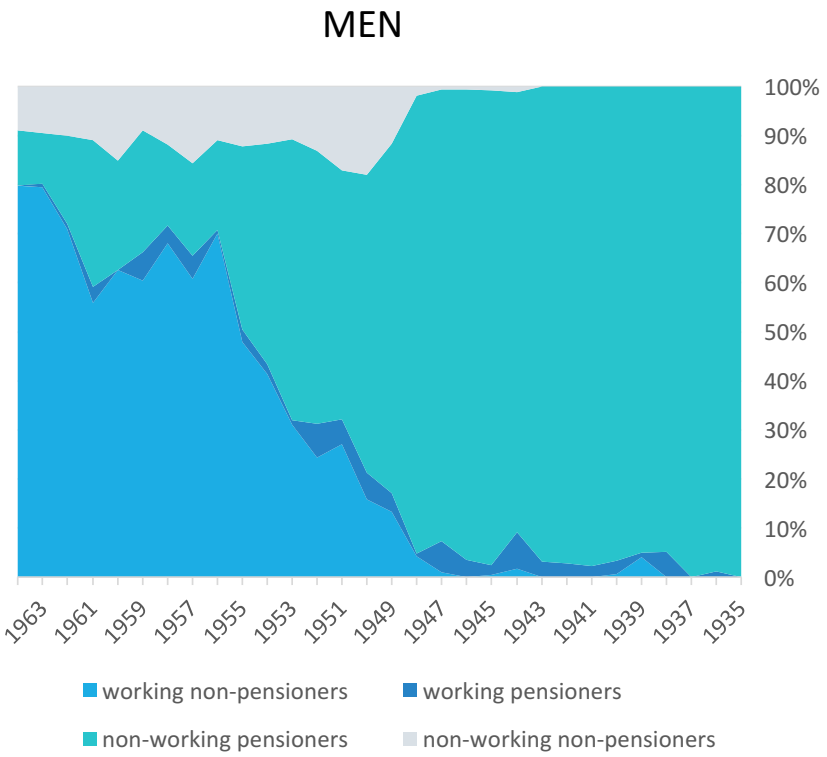
Population ageing will lead to shrinking workforce

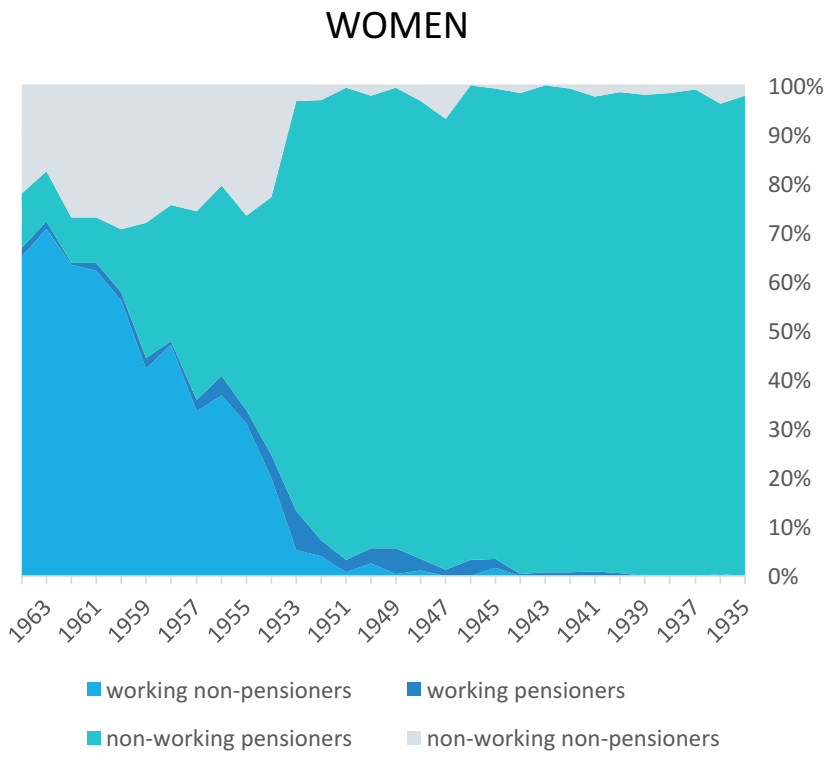




Source: (Kiełczewska and Lewandowski 2017)

Emerging challenge: coverage





Adequacy and solidarity

- Future benefits paid from the NDC system reach the upper possible level at current contribution rate, employment rate and public sector expenditure
- NDC benefits reflect the real demographic and economic situation in the country, they automatically adjust to the changes in these conditions
- As such, they should not be compared with promises of other types of OA pension arrangements and with the current level of benefits that would lead to the bankruptcy of the pension system
- At the individual level, individuals can adjust their OA income, by postponing retirement decisions

2019 addition: Employee capital plans

- Auto-enrollment scheme covering all employees
  - Large employers (250+ employees): from July 2019
  - Medium-sized (50+ employees): from January 2020
  - Small (20+ employees): from July 2020
  - Micro: from January 2021
- Long-term savings plan (until age 60) run by asset managers: investment, pension or insurance companies
- Covers all workers below 55 (optional for those in ages 55-70), with possibility to opt-ut
  - need to confirm opt-out every 4 years
- Contributions:
  - employers 1.5% + up to 2.5%
  - employee 2% + up to 2%
  - public funds: 250 PLN entry payment plus 240 PLN annual payment
- Investment: with defined date sub-funds (fund 2030, fund 2040… fund 2070)
- Fees: up to 0.5% of assets plus 0.1% conditional on returns

2019 addition: Employee capital plans

- Payouts
  - 25% lump-sum, and the remaining 75% in programmed withdrawal in at least 120 monthly payments,
  - 100% in the form of a joint programmed withdrawal in at least 120 monthly payments
  - transfer withdrawal to a term deposit,
  - transfer payment to the insurance company for liftime or fixed term annuity

Future: co-ordinated policies to enhance more stable and longer working patterns

- Extending working lives through gradual increases of retirement age
- Flexible retirement options above retirement age to smooth transition from work to retirement
- Lifelong learning policies supporting developing and updating skills at all ages
- Coordinated policies related to reconciliation of work and family lives for parents
  - Access to childcare facilities, particularly for children up o 3 years of age
  - Daily care for school children
  - Coherent and flexible system of leaves (maternity, paternity, parental and family leaves)
- Current government policies go in the opposite direction: lower retirement age, cash transfers encouraging labour market withdrawal

Pension system is not a cure for the failure of labour market policies

Discussion on open ends

- Retirement age
  - Low at European standards
  - 5 years gap between men and women, leading to gender pension gap
- No flexible retirement options
- Complex structure of the pension system
  - Multiple accounts, including NDC1 and NDC2
  - FDC under constant manipulation with uncertain future
  - Different voluntary pension savings options, not transparent for workers
- System not universal with groups outside (miners, military, farmers, judges)
- NDC not properly accounted in the National Accounts system

Discussion on open ends

- The change of the proportions between NDC and FDC was politically and short-term driven
- This decision did not change the essence of the system (actuarial balance), however, largely undermines trust towards the pension system
- Slow progress in pension education and information policy
  - ✓ Annual account statements are crucial

Summary and conclusions

- Despite political manipulation with the FDC system, the NDC was crucial for maintaining the sustainability of the entire OA system
- Accelerating population ageing is the crucial challenge for the coming decades
- Improving both sustainability and adequacy of the NDC pensions in Poland depends on the labour market performance
- Rising retirement age remains the key challenge

Take-away for other reformers:

- Reforming the pension system is a long-term endeavour, hurdles and reversals are not risk but certainty!
- Managing adequacy and sustainability is a challenge
- Changing benefits is easier than raising the retirement age