THE DESIGN OF SUPPLEMENTARY PENSION SCHEMES IN POLAND AND LONGEVITY RISK: CURRENT SITUATION AND PROPOSED CHANGES

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Agenda

- Architecture and main features of Polish pension system
- Consequences of pension reform for public finance and future retirement-income
- Construction of supplementary pension schemes and longevity risk.
- Conclusions and recommendations

The Architecture of Polish pension system - public systems

- Since January 1st 1999 two public pension systems for employees and self-employed:

 - the old one inherited from socialist era (one-pillar, PAYG, Defined Benefit);

 - the new, mixed system of retirement protection consisting of a publicly managed

 defined contribution scheme and mandatory private pension scheme (single-purpose open pension funds, so called OFEs) implemented since 1999

 - both public systems will co-exist till 2034.

The Architecture of Polish pension system - Third pillar

- Supplementary, voluntary pension schemes (3rd pillar), very small coverage:

  - occupational pension schemes (PPEs) – only about 2% of working force

  - individual pension accounts (IKEs) – only about 6% in working age

  - new individual pension protection accounts (IKZEs, will be introduced in 2012)

The Architecture of Polish pension system

III PILLAR

fully-funded DC pension schemes
•occupational pension schemes (PPEs),
•individual pension accounts (IKEs),
• new individual pension protection accounts (IKZEs – from 2012)
voluntary

SUPPLEMENTARY

II PILLAR

Single-purpose
open pension funds(OFEs)
fully-funded, DC
contribution 2,3%, **compulsory**

NDC PAYG
contribution 5%, **compulsory**

PUBLIC

I PILLAR

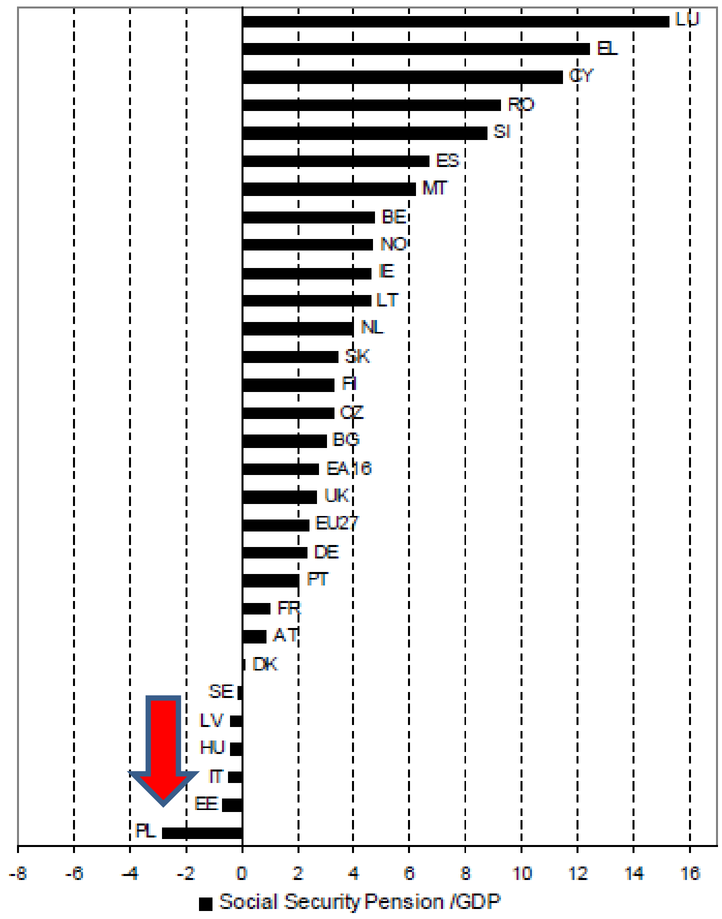
Social Insurance Institution (ZUS), PAYG, NDC
contribution 12,22% , **compulsory**

Key indicators of Polish pension system and demography

• Total population	mln.	**38.8**
• Population over age 65	% of working population	**20.6**
• Public pension spending	% of GDP	**10.6**
• Statutory pensionable age	men	**65**
	women	**60**
• Total fertility rate		**1.23**
• Life expectancy at birth **(in 2010)**	years	**72 Males / 80.2 Females**
• Life expectancy at birth (expected, in 2050)	years	**80,2 / 86,7 Females**
• Old-age dependency ratio in 2011		**20**
• Projected old-age dependency-ratio in 2050		**55**

Source: *Statistical Yearbook 2010*, GUS *(Central Statistical Office in Poland), Aging Report 2009, EU (data updated 2010)*

Consequences of pension reform for public finance



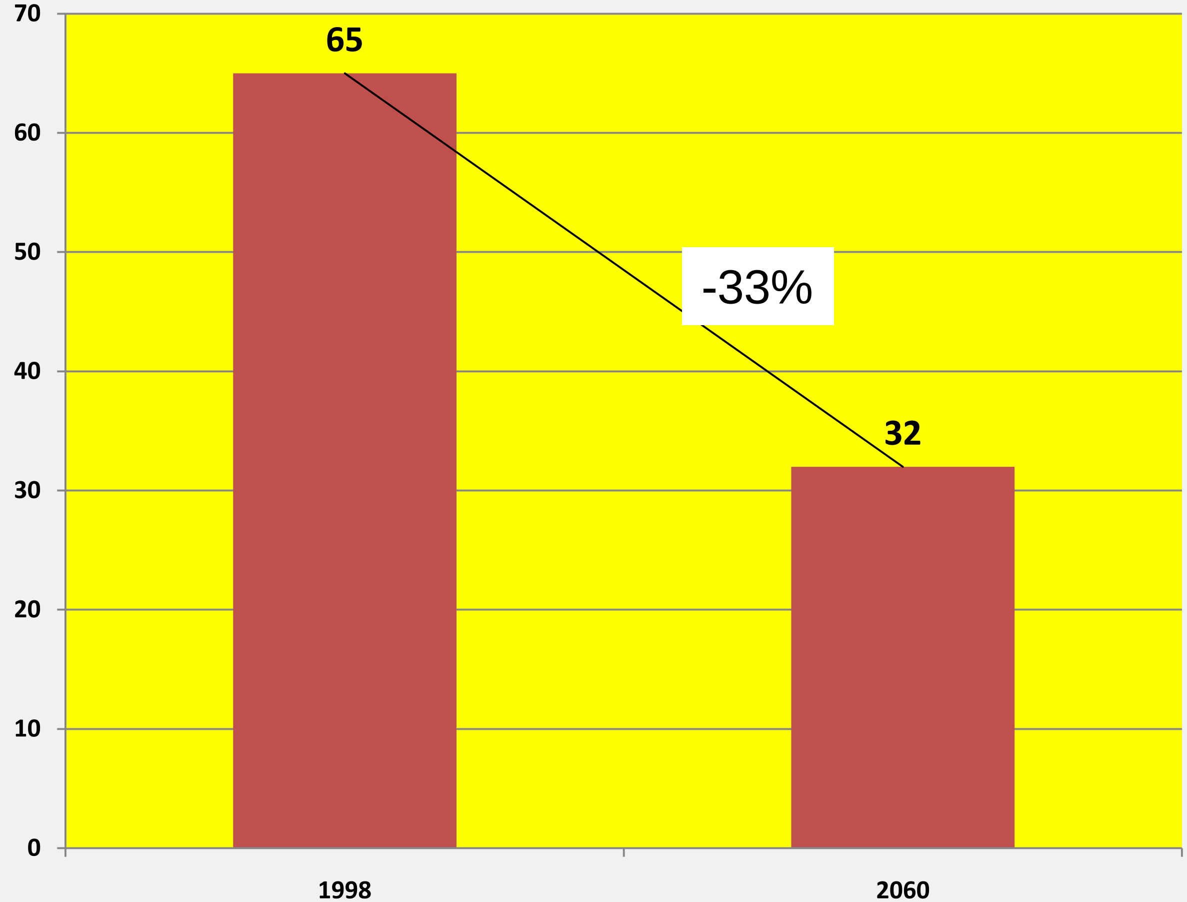
Source: Ageing report 2009, available at: http://ec.europa.eu/economy_finance/publications/publication13782_en.pdf, data as updated at the Ageing Working Group in 2010.

Expected reduction in public pensions expenditure as a share of GDP over 2007-2060 (in percentage points)

- the result of changed pension formula (from DB to DC)

Source: Aging Report 2009, EU (data updated 2010)

Consequences of pension reform for retirement income



- Expected decrease of replacement rate in public pension system (-33%!)
- High poverty risk in retirement
- Longevity risk, especially in funded part of the public pension system

Source: Economic Councol to the Polish Prime Minister, 2011

Consequences of pension reform for retirement income

- The primary objective of pension system: economic security in old age, can be achieved in Poland only with the help of additional pension schemes.
- Because of the low level of average earnings in Poland (about 40% of the EU-27 average) and relatively high level of obligatory contributions to public pension system (20% of brutto earnings) there is little room for additional pension savings.

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Construction of supplementary pension schemes and longevity risk

- The new public pension system in Poland, implemented since 1999 and radically modified in 2011, will not be able to provide adequate level of retirement income.
- Shall additional or supplementary pension schemes be able to compensate the financial gap in retirement income created by public pension system?
- How serious is longevity risk for the participants of additional/supplementary pension schemes in Poland?

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Construction of supplementary pension schemes and longevity risk

- Longevity risk is generally determined by design (construction) of pension schemes, especially in pay-out (decumulation) phase of the system.
- All supplementary pension schemes in Poland (occupational pension schemes – PPEs, individual pension accounts – IKEs and new individual pension protection accounts – IKZEs, available from January 1st 2012) are organized on DC basis.
- In all of these schemes lump sum payments are possible.

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Construction of supplementary pension schemes and longevity risk

- All voluntary additional pension schemes in Poland are fully- funded, organized on DC basis and exposed to many kinds of risks (including longevity risk).
- But there are significant differences in pension schemes design (in pay-out phase) which influence their sensitivity to this kind of risk.

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Key features of the occupational pension schemes (PPEs)

Coverage	Vesting period	Payment age	Tax advantages to participants (exemption from capital gains tax)	Contributions tax deductible by employers	Lump sum payments*/ income draw-down*
Workers 18 or older	None	60	Yes	No	Yes

*tax exemption from capital gains tax

PPEs available as:

- an agreement with mutual investment fund
- a unit-linked group life insurance agreement
- a corporate pension fund (PFE) run by specially licenced employee pensions society (PTE)
- a scheme managed by a foreign manager

Key features of the individual pension accounts (IKEs)

Coverage	Payment age	Tax advantages to participants (exemption from capital gains tax)	Lump sum payments*/ income drowdown*
18 years or older/ 16 years (workers)	60	Yes	Yes

* tax exeption from capital gains tax

IKEs available as:

- mutual investment fund
- life insurance
- brockerage account
- (special) bank account

Key features of the individual pension protection accounts (IKZEs)

Coverage	Payment age	Tax advantages to participants (exemption from personal income tax)	Lump sum payments/* temporaty annuities* (at least 10 years)
18 or older/ 16 (worker)	65 Male 60 Female	Yes	*tax exemption from personal income tax, no tax exempion by payment

IKZEs avaliable as:

- mutual investment fund
- brockerage account
- life insurance
- bank
- voluntary pension fund

Conclusions

- Limited diveristy of supplementary pension schemes in Poland (in accumulation and decumulation phase of the scheme).
- No scheme with compulsory annuitisation in pay-out phase or other longevity-hedging instruments.
- None of the supplementary pension schemes in Poland is resistant to longevity risk.
- Even with supplementary pension schemes Polish citizens are not sufficiently protected against longevity risk (the risk of outliving their assets).
- Both supplementary individual pension schemes (IKEs and IKZs) and occupational pension schemes (PPEs) are not optimal from the viewpoint of future pensioners, as far as longevity risk is concerned.

Recommendations

- Modifications in decumulation phase of all 3 supplementary pension schemes (till 20% income drawdown, 80% of assets – lifetime annuities).
- Unification of both forms of individual pension savings (tax exceptions in both accumulation and pay-out phase connected with life annuities as payment method).
- Much more pension education (the task for public and private financial institutions and for government).