Czechmate: New government will end auto-enrolled DC plan

By Kerry Pechter *Wed, Dec 18, 2013*

The Czech experiment with a voluntary, auto-enrolled national defined contribution plan (a "second pillar" plan to supplement the primary pay-as-you-go plan) will end. Balances will be rolled into the optional "third pillar" supplemental pension. Confusing? Czech!

The Czech Republic’s incoming coalition government says that it intends to close down that country’s recently-created “second-pillar” pension system by the beginning of 2015, IPE.com reported. Only 83,753 Czechs had joined the plan as of the end of November.

The coalition, led by the Social Democrats, will merge existing second-pillar accounts with the voluntary “third pillar” defined contribution plans. It’s not clear what will happen to the thousands of second-pillar members without an existing third-pillar account.

The second pillar plan was introduced in 2013 by the former government of Petr Nečas. It was funded by diverting 3% of the nation’s 28% social contribution (similar to our payroll tax), plus 2% of wages from members. The system was voluntary, but employees were auto-enrolled in it and participation, once begun, was irrevocable.

Parts of the second pillar program were unpopular, such as the requirement for workers to contribute an additional 2% of pay and their lack of access to their money before retirement. The low, legally capped commission that financial intermediaries would receive from pension companies also reportedly weakened support for the second-pillar plan.

Since 1996, the Czech Republic has had a universal pay-as-you-go “first pillar” old age pension funded by a mandatory 21.5% employer contribution and a 6.5% employee contribution. The earnings base on which pensions are assessed is 100% up to CZK 8,400 per month, 30% between CZK 8,400 ($417) and CZK 20,500 ($1,019), and 10% above this sum.

This pension could be supplemented with a voluntary defined contribution plan (the third pillar), and participants could choose between a state asset manager and private investment management. At the beginning of this year, the former government created a second pillar, characterized by auto-enrollment, and the third pillar was closed to new accounts and contributions.

The move to shut down the second pillar had been expected. Bohuslav Sobotka, chairman of the opposition Social Democrats (CSSD) and leader of a three-party coalition, had said that his party would scrap the system if it won the next election, scheduled at the time for 2014.

The Social Democrats didn’t have to wait that long. Nečas resigned in June following a series of scandals. The interim leader, Jiří Rusnok, lost a confidence vote in August, precipitating an early general election last October.

The change would have a minimal impact on Czech finances, unlike Poland's current second-pillar overhaul.

"My expectation of this outflow is CZK800m (€29m) in 2014, slightly more than 0.2% of the state budget for pensioners," said Pavel Jirák, chief executive and chairman of the board at KB Pension.

"It was more of a political than an economic issue. The change is expected from the beginning of 2015. None of the participants would lose their second-pillar money through the merger, in accordance with the Czech constitution," he added.

"We are still convinced the creation of the second pillar was the right step towards diversifying financial sources for retirement, and a good long-term solution given the unfavorable demographic trends and their negative impact on state pension financing," he added. "So we are against this merger – but without any power to stop or influence it," he added.

According to Pensionfundsonline.co.uk:

- The minimum age at which payments can be received from a Czech pension fund is 60, provided a minimum number of contributory years, which is regulated by each pension fund.
- If money is withdrawn from the account before this age, the state matching contributions have to be repaid and there is additional taxation. Generally, money can be withdrawn as a lump sum or in the form of regular installments.
- The state matches employees' contributions depending on their level of contributions. For member contributions between CZK 100-199, the state adds CZK 50 plus 40% of the member contribution above CZK 100.
- If the pension plan member contributes between CZK 200 and 299, the allowance is CZK 90 plus 30% of the sum above CZK 200. The allowance gradually increases with the highest allowance (CZK 150) for members contributing more than CZK 500.
- Employers can deduct their contributions from their tax base up to 3% of an employee's assessment base. Employer contributions of up to 5% of their wages are exempt from income tax for the employee.