
Poland's pension makeover offers a cautionary tale

By Editor Test *Wed, Jan 26, 2011*

In the 1990s, Poland reformed its Social Security-type system and introduced personal accounts. Now they've got chaos.

In the 1990s, Poles faced a situation like the one the U.S. faced in early 2005, when Social Security reform dominated domestic politics. Supporters of reforming Poland's state pension, including the central bank, the stock exchange, and the pension fund industry, said the state pension was unsustainable because of Poland's aging population. They called for a diversion of a portion of the payroll tax to privately-run DC pension funds.

Pension reform was enacted. Poles used to contribute 19.5% of their pay to the DB state pension. Since the reforms, however, they've diverted 7.3% of that to the DC pensions. But the government can't seem to afford the diversion away from public coffers. Its public debt is 55.5% of GDP. Anything over 55% triggers automatic public spending cuts, including freezes of pension benefit increases.

In the 2000s, the privately-run pension funds were roiled by financial crises. Personal account values fell, jeopardizing retirement security. Liberals now argue that the pension reforms of the 1990s were a mistake.

Last autumn, prime minister Donald Tusk told his chief adviser, Michael Boni, to revise the rules for managing the DC funds. Boni's proposals were published in October and included:

- **Target-date investing.** The existing, one-size-fits-all portfolio, which includes an equity cap of 40% of the net asset value of the portfolio, and a 5% limit on overseas investment, would be replaced with three sub-funds, A, B and C. "A," for new entrants to the labour market, would be a high risk, high-growth portfolio. The equity limit for "B" would be raised to 45%, for mid-career workers. When workers reach 55, their funds would be incrementally transferred to "C," a low-risk portfolio with a 15% limit on equities. Workers could delay or accelerate their move to "C" by up to five years.
- **Lower fees.** A reduction in the up-front management fee, currently capped at 3.5% of contributions, to 2.8% for sub-funds A and B, and 2.1% for sub-fund B. However, as an incentive to improve performance, the pension fund management companies could earn a 2% profit fee.
- **No more costly poaching.** Client soliciting (acquisition) by pension fund companies of members of other funds will be curtailed and banned outright by 2014. In the meantime, agents would only be able to contact by email, phone or post, not in person. The reasoning is that the management companies are spending large sums of monies on poaching each others' clients. Companies competing for new entrants to the labour market would have to supply them with historical returns.

In mid-November, Boni proposed the creation of retirement (pension) bonds. Returns of the illiquid bonds, in 20 and 30-year maturities, would be linked to GDP growth and redeemable at maturity by the state Treasury. Boni assured the parliament that the bonds would not count as public debt under EU criteria. Most observers are said to be baffled by the proposal.

Prime minister Tusk at one point suggested that participation in the DC schemes could be voluntary. His

deputy, Waldemar Pawlak, announced that the 2011 budget was being drafted on the basis of suspended contributions, but Pawlak was contradicted by the finance ministry, which drafts the budget. Tusk has reassured pension fund members and the markets generally that he won't adopt Hungary's strategy of effectively nationalizing its DC system.

As of 2011, Polish DC contributions will be reduced to 5% from 7.3%. The reduction in new DC monies could total close to €5bn in 2009 and €4.4bn in the first three quarters of 2010. That will hurt the Warsaw Stock Exchange and the Polish private pension funds, which are heavily invested in equities. According to the stock exchange, in the first half of 2010, payroll DC contributions funded 21% of equity trading.

With 65-odd IPOs completed in the first 11 months of 2010, the Warsaw exchange is also one of Europe's leading venues for new issues. The exchange is concerned that reduced DC contributions would decrease liquidity and reduce available capital. Fifteen IPOs set for November 2010 were reportedly postponed due to the prospect of declining pension contributions.

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