

# Pension System Reform in the Czech Republic

April 1st, 2011

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# Design of the Czech Pension System

- The Czech Republic is one of the last European countries to carry out Pension System Reform
- Absence of II. Pillar (Occupational Pension Funds or Fully Funded) and Direct State Subsidy in III. Pillar are the main differences from standard EU pension systems
- Strong willingness of politicians to implement Pension System Reform

Criteria	I. Pillar	III. Pillar	
	Pension Insurance	Pension Funds	Private Insurance
<b>State Guarantee</b>	yes	no	no
<b>Personal Coverage</b>	all working population	individual	individual
<b>Participation</b>	mandatory	voluntary	voluntary
<b>Financing</b>	pay as you go	fully funded	technical reserves
<b>Type of Plan</b>	defined benefit (DB)	defined contribution(DC)	DB/DC
<b>Benefits</b>	depends on service years and level of wage	depends on contribution and return	depends on contribution and return
<b>Tax Incentives</b>	yes	yes	yes
<b>State Subsidy</b>	no	yes	no



# Key Weaknesses of the Czech Pension System

- **State PAYG is unsustainable from even a medium term perspective:**
  - Demographic trends among the worst in Europe
  - State budget pension deficit, appearing over the past two years (almost 1% GDP yearly despite high social security payments), would become significantly larger without reform
- **Lack of diversification due to absence of other substantial retirement sources (94% of pensioner sources come from PAYG)**
- **PAYG Pillar payout is too egalitarian: Pension levels almost the same regardless of level of contribution**
- **Due to design, current III. Pillar does not represent a sufficient additional source for retirees**
- **Little willingness to save money for retirement at all, let alone the minimum funds necessary to maintain standard of living**



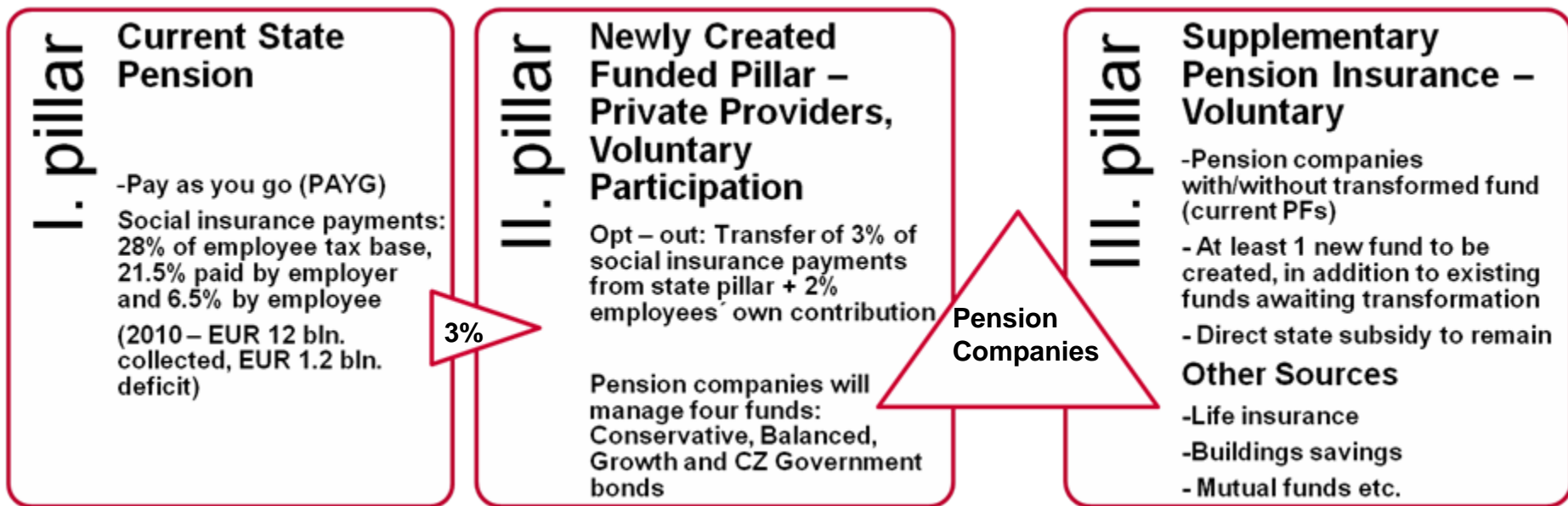
- **THEREFORE, REFORM IS UNAVOIDABLE; While reform is being prepared by the government , it is unfortunately badly communicated and lacks political consensus**



# Overview of the Pension System Reform (PSR)

- PSR is similar to reforms already implemented in other CEE countries and has three stages:
- „Small“ Reform – Changes in I.pillar (PAYG system)
- „Big“ PSR – Creation of II.pillar: Fully funded system planned from 1.1.2013
- Transformation of current III.pillar Pension Funds into Pension Companies

## *Proposed structure of CR Pension System from 1.1.2013*





## Why has the Czech government opted for the 'out of date' World Bank Three-Pillar Model (with several exceptions)

- Time constraints precluded complete rebuilding of current pension system; NDC system not proposed due to negative impact expected on below-average wage earners (2/3 of the working population); Current PAYG system is more generous to below-average earners than need be
- Intended reduction of high labour tax burden and increase of Czech economic competitiveness; Occupational pensions are therefore not proposed
- Voluntary participation without II.pillar opt-out, a compromise between mandatory and voluntary pensions, results from differing views of government coalition parties
- Lessons learned from CEE experience: 3% transfer from PAYG (limited level of deficit) and long-term financing by VAT harmonization at 17.5% (from 10% and 20%)
- PAYG to remain main source for retiree pensions; Parametrical changes – such as later retirement age as per life expectancy and reduction of early retirement – to be introduced
- Government also sought to increase level of personal savings, therefore introduced an additional 2% of employee contributions
- Current pension funds infrastructure to be used in implementation (EUR 9bil. of AUM)
- Investment advisors and financial intermediaries to be allowed to operate and distribute upon regulator approval; Level of commission to be regulated
- Key Questions: Will the Czech government realize the reform? Will the reform survive changes in government?