New pension system in Poland and the development of life insurance

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As from January 1, 1999 a new pension system has been introduced in Poland. The previous monopoly of a defined benefit pay-as-you-go scheme, where all pensions were paid out of current tax revenues, has been replaced with a so-called three-pillar system.

The origins of the reform are closely linked to an increasingly poor performance of the old system. As in many other countries the old retirement system - although still viable to pay the due pensions for some time to come - from actuarial point of view was bankrupt, being incompatible with the changing demographic structure of the Polish society characterised by falling birth-rate and increased life expectancy.

Under the new three-pillar system the sources of financing the future pensions are diversified. The first and the second pillar are a universal and obligatory part of the pension system, where benefits will be closely related to contributions paid in throughout the whole working life.

The first pillar financed with 5/8 of the obligatory contribution will remain largely of repartition kind, but will operate according to the principle of the defined contribution.

The first pillar of Poland's pension system is very similar to the Swedish model. Just like in Sweden, the first pillar will be governed by the inter-generation capital of pension rights, where payment of the pension depends on: (1) the amount of paid contributions valorised by the index related to the pace of real wage-fund growth i.e. the total of all income across the economy on which contributions are charged and (2) average life expectancy calculated at the moment of retirement jointly for women and men.

A fully capital Demographic Reserve Fund was established to balance fluctuations of the income in the first pillar. The first pillar is not a continuation of the previous system. The rights to pensions acquired under the old system were calculated for the very last day of its functioning (31 December 1998) and converted into PLN. This "initial capital" will have appeared at individual accounts by 2003.

The second pillar of the Polish pension system has much in common with solutions used in many countries of South America (Argentina, Chile) and in Mexico. This mainly concerns strictly technical issues. The fundamental difference consists in the introduction in Poland of the regulations, which make the second pillar a part of the social security system. In particular this consists in the fact that the only form of using the accumulated means is the purchase of lifelong pension from an insurance company. Moreover Poland's second pillar is in many ways functionally joined with the first pillar and they are one entity.

The second pillar, financed with 3/8 of the obligatory contribution, is supported by open pension funds (joint stock companies) chosen by employees. The pillar has been operative since April 1, 1999. Persons obliged to transfer a part of their contribution to the second pillar - born not earlier than in 1969 - have to choose by the end of September 1999 a pension fund, where their savings will be accumulated within the second pillar. Persons born before 1969 have to make a decision to choose a fund by the end of December 1999. Their decision to split the contribution (join the second pillar) is irrevocable.

The third pillar of the Polish pension system is very similar largely modelled on solutions in

place in the USA and Great Britain. The difference lies in the alternative treatment of the participation in the pillar. That ensues from the fact of the existence of the second pillar in Poland, which is not in place in those countries.

The third pillar - on a voluntary basis - will function as adjustment of income allocation across lifetime to individual needs.

The new element of the third pillar introduced by the reform are the so-called Employees' Pension Programmes. Their introduction aimed at facilitating the use of the third pillar to the insured at large and to those persons who - due to age or health-related condition - could have problems with the participation in regular programmes available at the marketplace. In the third pillar, contributions will be paid into life policies, pension and investment funds. Enterprises will be allowed to establish voluntary pension funds for employees and mutual insurance funds. Contributions will be paid on income after tax but the benefits will not be taxed. However, incentives have been introduced in the third pillar aimed at encouraging employees and employers to establish group pension schemes. Pension funds in the third pillar have nothing in common with the funds operating in the second pillar.

The new pension system, which diversifies the social contribution into three different channels, will have a positive influence on the development of life insurance in Poland. The life insurance, which until 1989 had a limited importance in Poland due to the "paternalistic" state protection system, experiences now booming growth. In 1991 three life companies wrote premium totalling PLN 0.2bn corresponding to only 14% of the total insurance market volume.

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In 1998 the premium volume of the whole Polish insurance market amounted to PLN 15.6bn (*), out of which PLN 5.4bn have been originated by 24 operating life companies. So far roughly 0.2% of the total life premium comes from retirement insurances. It is expected that this type of insurance will grow rapidly in the nearest future as a direct consequence of the new pension system in force since January 1, 1999.

Indeed, until August 1999 about 6m Poles have already joined one of the 19 licensed open pension funds (almost all of them are run by insurance companies) and this number is likely to reach 10m employees at the end of 1999. Many of them will use their own savings to purchase additional retirement pension investing into the voluntary third pillar, whereby the life insurance companies will be directly involved.

Bearing in mind the still relatively low per-capita spending for life insurance (in 1998 approximately PLN 140) the growth potential for this type of business in Poland is excellent. ■

* The prevailing rate of exchange at the end of 1998: 1PLN = 0.26 USD.