Pension reform in the Czech Republic

Present situation and future prospects

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Basic pension insurance – I. pillar

PAYG, DB, mandatory

Contribution rate 28 %
Retirement pensioners 2,8 mil.
Average replacement rate 41,1 %
Expenditures 9,4 % GDP
Supplementary pension insurance with a state contribution – III. pillar

Funded, DC, voluntary

Participation – more than 94 %
Participants – 4,5 mil.
Problem – low contributions => low pensions
Mostly lump sum withdrawal
Main problems and risks

• Ageing (one of the highest rate in EU)
• High level of income redistribution
• Low importance of the third pillar
• Financial and Economic crisis?

=> Need of changes in the pension system
Goals of the pension reform

• Diversification
• Fiscal sustainability
• Spread intergenerational burden
• Strengthen contributory principle
The scope of pension reform

I. pillar

Parametric changes in PAYG

– pension formula parameters adjustment (reduction of ceiling for contribution, accrual factor change, retirement age growth, )

II. pillar

Establishment of the II. pillar (DC)

III. pillar

Pension fund transformation
Pension reform schedule

Parametric changes in PAYG

• Bill passed by government in February 2011
• Assumed adoption of the bill by parliament – June 2011
• Effective date September 30, 2011

Reform of II. pillar and III. pillar

• Adoption of the bill by parliament – beginning of 2012
• First contracts signed in July 2012
• Effective from January 2013
Parametric changes – I. pillar

Pension formula parameters adjustment

• reduction of the ceiling for contributions
  – 400% of the average wage
• accrual factor change for early pension

=> Strengthen the link between pension and contributions (contributory principle)
Replacement rate
(contribution period - 40 years)
Parametric changes – I. pillar

Retirement age

- equalize retirement age (67) by 2034
- then continuous growth by 2 months/year

Indexation of pensions

- CPI growth (100%) plus real wage growth (1/3)
- no “indexation bonus“ is possible

Reference period - life long
Expected mean time spent in retirement

- Women: 0 children
- Women: 1 child
- Women: 2 children
- Women: 3 or 4 children
- Women: 5 and more children
- Men
Impact of parametric changes

% HDP

Základní varianta
Návrh

rok

2012 2017 2022 2027 2032 2037 2042 2047 2052 2057 2062 2067 2072 2077 2082 2087 2092 2097
Establishment of the II. pillar

✓ Facultative participation

✓ Participant - everybody who entered labour market, maximum age 35

✓ From January, 2013 till July, 2013 - no age limit for entering the II. Pillar

✓ 3 % opt-out (28 % - 3 %) from I. pillar + 2 % paid by participant
Establishment of the II. pillar

✓ Transformation of pension funds into pension companies

✓ Pay out phase:
  • Lifetime annuity
  • Lifetime annuity with 3 years guaranteed survivors pension
  • Term annuity - 20 years

✓ Transformation deficit will be balanced by unifying VAT at the level of 17.5%
Changes in the III. pillar

- Providers – transformed pension funds = pension companies
- Separation of pension fund assets to client’s and administrator’s part
- Change in the state contribution
  - higher participation of client to achieve the state's contribution in the same amount as now
- Effective as soon as possible