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 withdrawl

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

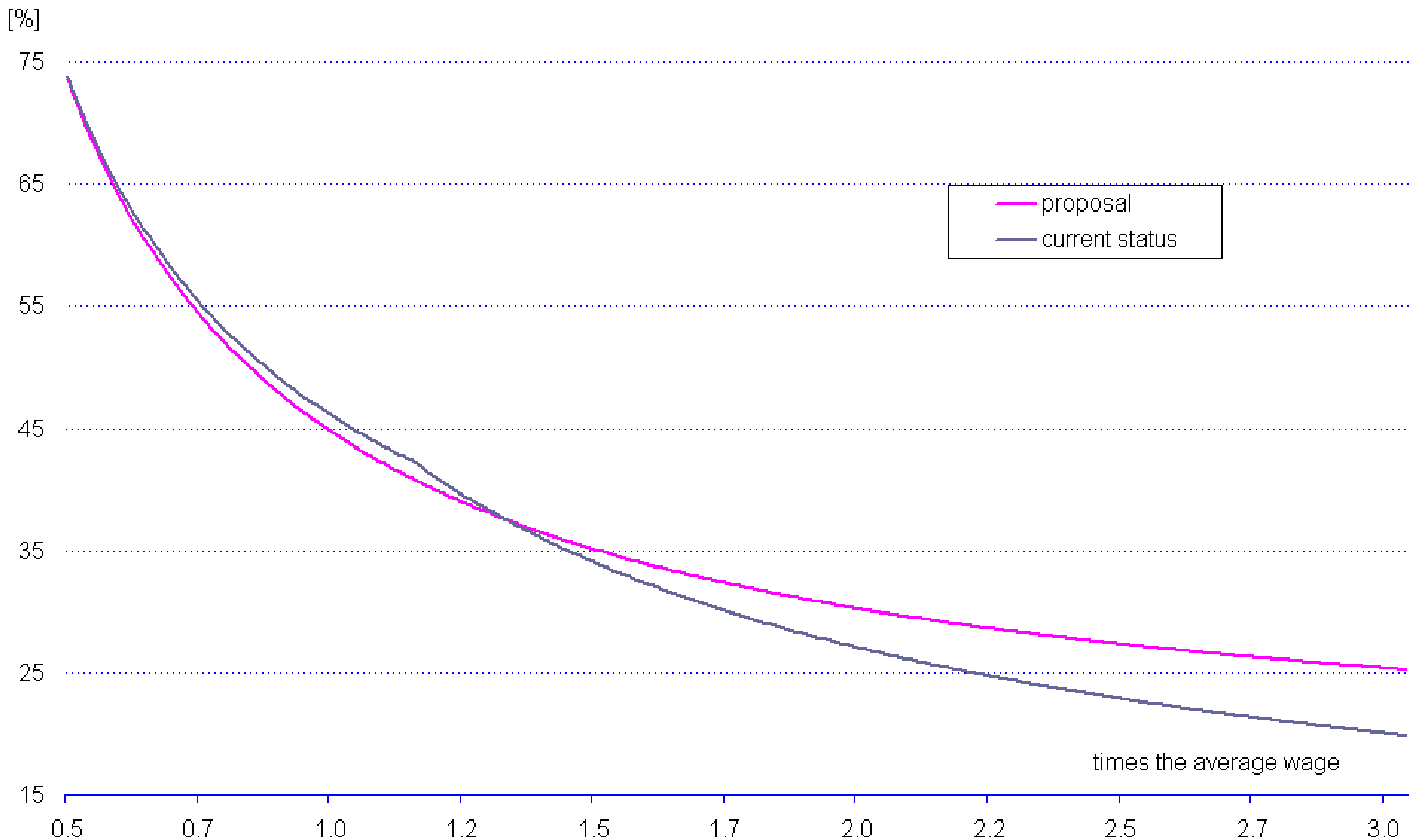
Parametric changes – I. pillar

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

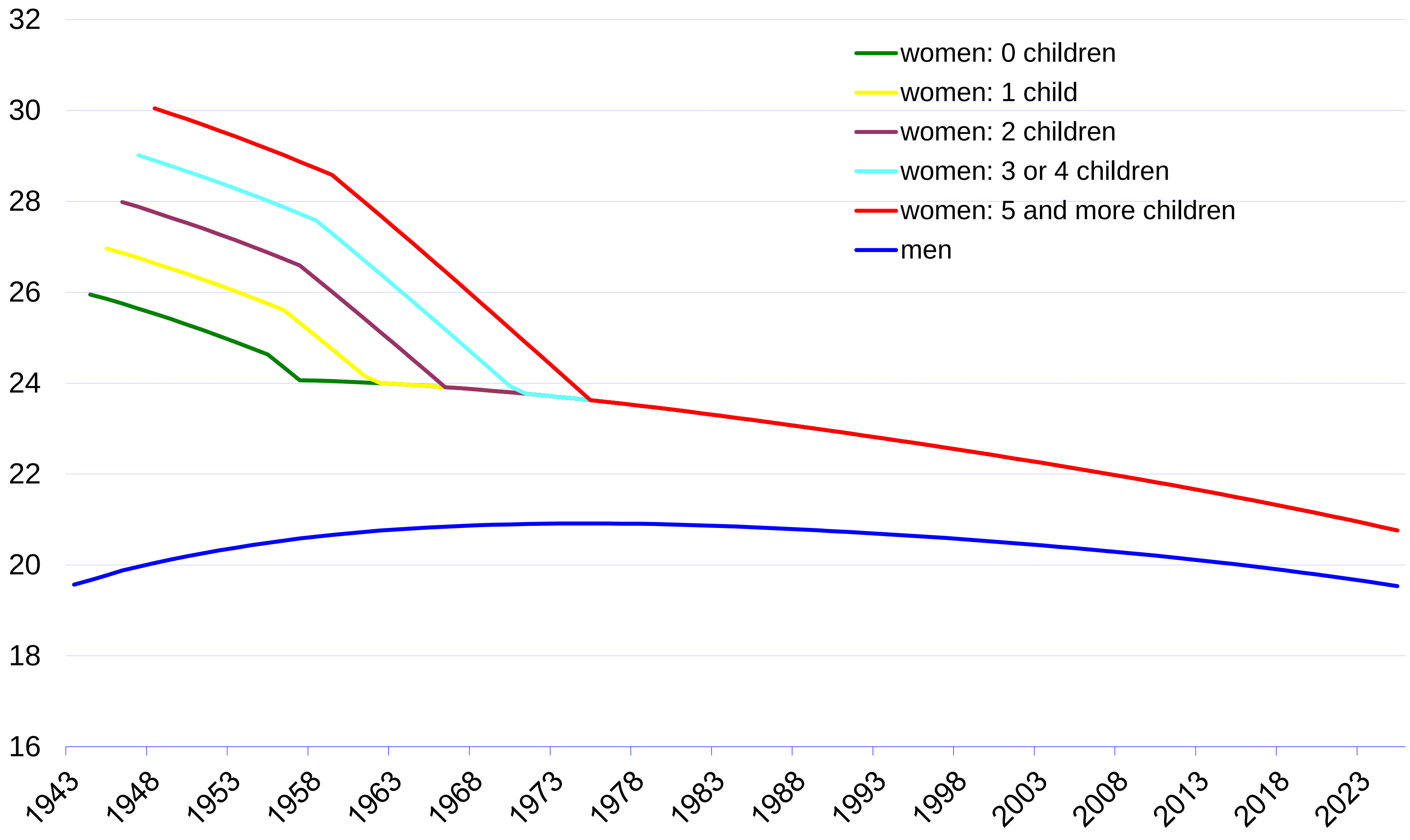
- equalize retirement age (67) by 2034
- then continuous growth by 2 months/year

Indexation of pensions

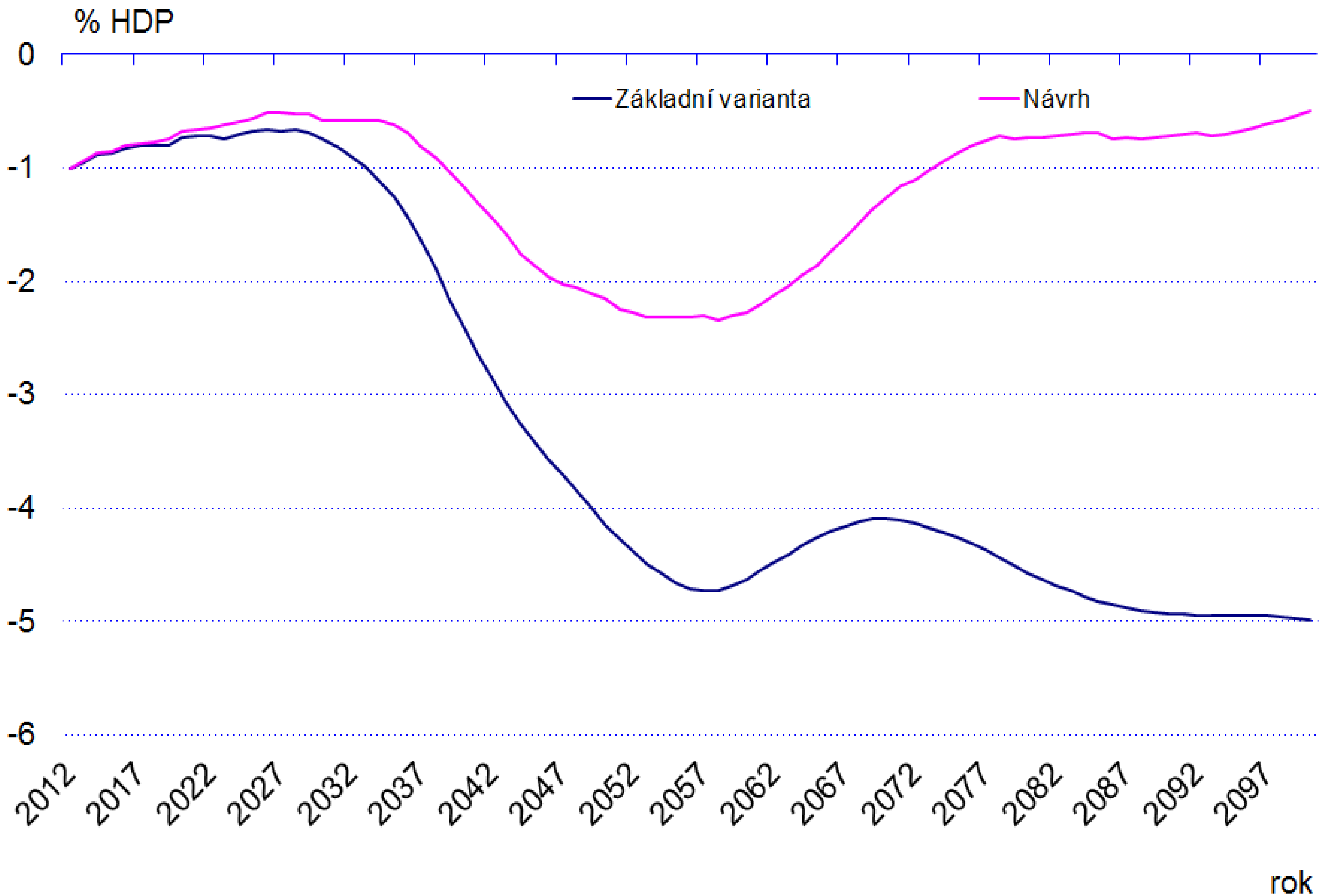
- CPI growth (100%) plus real wage growth (1/3)
- no “indexation bonus“ is possible

Reference period - life long

Expected mean time spent in retirement



Impact of parametric changes



Establishment of the II. pillar

- ✓ **<u>Facultative participation</u>**
- ✓ **Participant - everybody who entered labour market, maximum age 35**
- ✓ **From January, 2013 till July, 2013 - no age limit for entering the II. Pillar**
- ✓ **<u>3 % opt-out (28 % - 3 %) from I. pillar + 2 % paid by participant</u>**

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 states contribution in the same amount as now
- Effective as soon as possible