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Subject: Ex-ante consultation on the statistical treatment of existing in the Polish pension system accounts on which information about contributions paid (ZUS) and assets accumulated (OFE) are registered

Ref.: Your letter RN-5-0713-01-37/2013 dated 27 December 2013

Dear Ms Jeznach,

Following your letter of 27 December 2013, Eurostat is now in position to provide its preliminary opinion on the appropriate statistical recording of existing accounts in the Polish pension system on which information about contributions paid (to Social Insurance Institution - ZUS) and assets accumulated (in open pension funds - OFE) are registered.

Accounting issue

During the dialogue visit to Poland on 8-9 July 2013, the planned reform of the second (funded, defined-contribution) pillar of the Polish pension system i.e. open pension funds (OFEs) was discussed. It was agreed that the Central Statistical Office (CSO) will consult Eurostat on this reform once a concrete proposal is available for statistical analysis. In December 2013, the Polish parliament adopted the law *on amendment of certain acts in relation to the definition of principles for pension payments from funds collected in open pension funds*. Among other reforms, it provides for moving 51.5% of the assets accumulated in the second pillar (OFEs) to the first, pay-as-you-go, pillar (ZUS). The value of transferred assets is to be registered on the already existing accounts in ZUS, the so-called *sub-accounts*. The sub-accounts were created during the 2011 reform of the pension system when a part of the 2nd pillar contributions were diverted to the 1st pillar and entered on these accounts subject to indexation by the rate of nominal GDP growth. In 2011, Eurostat expressed its view that the sub-accounts should be classified in the general government sector (sub-sector of social security funds, with ZUS) with no associated assets or liabilities to be recorded in the balance sheet of ZUS.¹

¹Eurostat ex-ante advice on the changes in the Polish pension system 2011: http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/documents/570653_Let_FL_Ms%20Jeznach_%20Polish%20pension%20funds.pdf

Your ex-ante consultation seeks a confirmation of Eurostat's opinion on the statistical treatment of sub-accounts in the context of the envisaged changes to the Polish pension system. Other statistical aspects of the reform will be consulted with Eurostat at a later stage.

Documentation provided

With their letter, CSO provided Eurostat with a description of the Polish pension system including the presentation of the past and the on-going reforms. It was complemented by information on the current statistical treatment of the above mentioned accounts as well as a proposed approach by CSO after the new law enters into force (according to both ESA95 and ESA2010 methodologies).

Description of the case

Planned transactions in relation to the sub-accounts

The adopted amendments envisage that on the 3rd of February 2014, OFE will transfer to ZUS assets (Treasury securities, bonds guaranteed by the State Treasury as well as cash) to a value corresponding to 51.5% of the total value of assets accumulated on the account of each member of the pension fund as of the 31st of January 2014. Information about the value of the transferred assets will be recorded on the sub-accounts created in 2011 in ZUS.

The Treasury will acquire the treasury securities from ZUS in exchange for a guarantee of payments from the Social Insurance Fund of the future pension benefits that correspond to the value of those assets, as registered on the individual sub-accounts by ZUS.

Other categories of assets (i.e. bonds issued by the BGK, cash) will be transferred by ZUS to the Demographic Reserve Fund to be used to cover payment of current pensions.

In addition, assets accumulated by participants in open pension funds will be transferred to the Social Insurance Fund in tranches on a monthly basis during the 10 years preceding their retirement age (or less during a transition period) and information about their value will be recorded on the sub-accounts in ZUS. Transfers will be made in cash only and will be used to pay current pensions.

Functioning of the sub-accounts

The law defines the sub-account as part of the account of the future beneficiary in ZUS on which the institution records information about: indexed contributions paid and default interest, indexed value of assets transferred from OFE on the 3rd of February 2014 as well as the indexed value of assets transferred from OFE during last 10 years before retirement. It is indexed annually by the average annual GDP growth rate over the 5 most recent years.

The pensions will be paid out by ZUS. The pension formula will remain unchanged compared to 2011, i.e. funds both from individual account and from the subaccounts will be divided by average life expectancy. The pension will be continued to be paid out until death, and does not stop when the average life expectancy is passed. The government will assume the longevity risk. The unisex life expectancy tables calculated by GUS will be used in the calculation of pensions. The pension will be continued to be paid out until death, and does not stop when the average life expectancy is passed.

Benefits will be indexed in line with the current rules (by an average annual price index of consumer goods and services in the preceding year, increased by at least 20% of real growth of average monthly wage/salary in the preceding calendar year). Payment of the minimum benefit will be guaranteed provided that the beneficiary has a sufficient period of service.

Rules concerning inheritance for those who are not yet retired remain unchanged compared to 2011 reform. For those who were married on the day of death half of the residual value of the corresponding sub-account is 'transferred' (information about their value is registered) to the sub-account of the spouse. The other half is paid in cash to those indicated by the deceased. Inheritance after retirement is only possible if a pensioner dies within the first 3 years after retirement.

The sub-account will keep its unfunded character. Contributions to the sub-accounts are used to pay current pensions. They are neither invested in a fund nor ring-fenced in any financial instruments. No liabilities vis-à-vis the individual scheme members will be recognized in the balance sheet of ZUS.

Methodological analysis by Eurostat

Applicable accounting rules

The following accounting rules are relevant for the analysis.

- ESA 95, Annex III, social security schemes of government;
- The Eurostat Manual on government deficit and debt (MGDD) Part I Delimitation of the general government sector and Part III General Government and public corporations

From September 2014:

- ESA 2010, Chapter 17: Social Insurance including pensions
- The Eurostat Manual on government deficit and debt (MGDD), Implementation of ESA10, Part I Delimitation of the general government sector and Part III General Government and corporations controlled by government.

Availability of national accounting analysis

In their letter, the Polish authorities presented the statistical analysis of the case under ESA95 and ESA2010 methodologies. They considered that since the reform implements no changes to the functioning of *sub-accounts*, the current ESA95 treatment should remain unchanged i.e. the sub-accounts should be classified within the general government sector and no liabilities should be recorded. In their opinion, it should be also valid under the ESA 2010 for statistics prepared after September 2014.

Analysis

Eurostat has carefully analysed the envisaged amendments to the Polish pension system in relation to the functioning of the sub-accounts. The main issue was to determine if there are any changes that could influence Eurostat's view on the statistical treatment of sub-accounts expressed in 2011.

Particular attention was given to the fact that the contributions to the sub-account remain to be used to meet current pensions in the pay-as-you-go scheme of the 1st pillar, rather than held in a specific fund to meet future pension payments.

The role of the Demographic Reserve Fund was confirmed to be solely a reserve fund to cover both short and long-term deficiencies in the Social Security Fund to pay the current pensions.

Eurostat also noted that the reform introduces no major amendments to the inheritance rules relating to the sub-accounts. The indexation rate and the formula for calculation of pension benefits also remain unchanged.

In the context of the above and the methodological analysis performed in 2011, Eurostat is of the view the current ESA 95 statistical treatment of the sub-accounts remains valid in the context of the

envisaged reform of the Polish pension system. The sub-accounts should be treated as a part of the unfunded pension scheme with no liabilities recorded for the pension entitlements.

Furthermore, Eurostat highlights that the ESA 2010 implements no material changes to the relevant detailed rules for classification of pension funds and recording of related assets/liabilities. In this regard, there should be no change to the statistical treatment of subaccounts in the statistics produced under ESA 2010 after September 2014.

Conclusions

On the basis of the above considerations and the provisions of ESA95 and ESA2010, Eurostat confirms its view expressed in 2011 that the sub-accounts are to be classified within the general government sector and no liabilities are to be recorded for these sub-accounts.

Procedure

This preliminary view of Eurostat is based on the information provided by the country authorities. If this information turns out to be incomplete, or the implementation of the operation differs in some way from the information presented, Eurostat reserves the right to reconsider its view. To this end Eurostat would request to be informed of the final details of the operation (contract and accompanying papers where relevant) when they are available, or (should this be the case) information that the planned operation has been abandoned.

In this context, we would like to remind you that Eurostat is committed to adopting a fully transparent framework for its decisions on debt and deficit matters in line with Council Regulation 479/2009, as amended, and the note on ex-ante advice, which has been presented to the CMFB and cleared by the Commission and the EFC. Eurostat intends, therefore, to publish all future official methodological advice (ex-ante and ex-post) given to Member States, on the Eurostat web site. In case you have objections concerning this specific case, we would appreciate if you let us know. In any case (regardless of whether you have objections or not) we would like to receive an answer from you on the issue no later than **24 February 2014**.

Yours sincerely,

(eSigned)
Laurs Nørlund
Director