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Directorate C: National and European Accounts

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Ms Maria Jeznach
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Subject: Changes in the Polish pension system

Dear Ms Jeznach,

Thank you for your letter on the amendment of the Polish pension system.

After a detailed examination of the issue, Eurostat is now in the position to provide its preliminary opinion on the appropriate statistical recording of the amendment, notably the classification of the new sub-accounts established under the amendment.

Background

The Polish 1st pillar pay-as-you-go system is a notional defined contribution scheme based on notional accounts where each individual account is credited with theoretical "points" to represent contributions paid by the insured person. The points are subject to a growth rate decided by government regulations. The 1st pillar pension scheme is classified to the general government sector as an unfunded social security scheme, with no liabilities recorded in the government balance sheet.

The Polish 2nd pillar pension scheme is a fully-funded defined contribution scheme managed by private institutions. It is statistically classified to the financial corporations sector, in line with the relevant Eurostat Decision on the classification of funded pension schemes in case of government responsibility or guarantee.

Until 1st May 2011 the Polish social security entity (ZUS) received all contributions (19.52%) for both the 1st and the 2nd pillars. One part of these contributions (7.3%) was then channelled to the 2nd pillar scheme.

The new scheme (from 1st May 2011)

The Polish parliament has recently approved an amendment to the pension system. Part of the 2nd pillar contributions (5% in the first year) are now diverted to the 1st pillar, to be entered on so-called "sub-accounts" that will be subject to indexation by the rate of nominal GDP growth. ZUS acknowledges the accumulation of future pension rights in the name of the individual participants. The rights accumulated by the individuals may be inherited by their heirs in the case of death.

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The "sub-accounts" are not actually funded – the contributions are not ring-fenced in financial instruments (deposits, equity, bonds). Moreover, ZUS will not show liabilities for the "sub-accounts" in its own financial statements and it will not show a corresponding claim on government for the resources to pay future pensions.

Methodological analysis

The amendment leaves the existing pension pillars in place, and the statistical recording of these pillars does not change. The main issue is to determine the appropriate statistical recording of the new "sub-accounts", notably whether they are to be considered as funded or unfunded (to decide whether or not liabilities/assets should be recorded for their pension entitlements), and how the relevant Eurostat decision on the classification of funded pension schemes in case of government responsibility or guarantee should be applied (to determine the sector classification of the sub-accounts).

The 2004 Eurostat Decision on the classification of funded pension schemes is quite specific on the definition of a funded scheme (this decision has been subsequently included in the 3rd edition of the Eurostat Manual on Government Deficit and Debt). A funded scheme is seen as "an arrangement where there is an accumulation of assets, mainly financial assets, from contributions, with the objective of ensuring all or a major part of payment of the future benefits from these assets".

Given that the sub-accounts do not invest contributions in a fund, the sub-accounts cannot be considered as "Defined Contribution funded schemes" in the context of the Eurostat Decision. These sub-accounts should therefore be classified with ZUS in the general government sector.

The main difference between funded and unfunded schemes is how the schemes will meet their commitments vis-à-vis the scheme members: on the basis of current resources (with the involvement of a "sponsor" if insufficient), in the case of unfunded schemes, or by drawing on specific assets, in the case of defined contribution funded schemes, the risk being taken by the individual members of the scheme.

Unfunded schemes do not normally explicitly recognise a liability vis-à-vis the individual scheme members in their balance sheets and do not depend on the accumulation of reserves for paying future social benefits. Nevertheless, unfunded schemes often hold some assets (called "buffer funds", with a short term purpose, or "reserve funds" for longer term purposes). However, what is relevant is whether the assets involved are intended to be the majority, if not the only, source for honouring pension commitments.

According to Annex III of ESA 95 the assets that might exist in social security funds always belong to the government and not to the scheme members, as the latter are not the economic owners of social security assets which are held on a collective and not individual basis. Therefore, for all pension schemes classified in social security no liabilities should be recorded in the accounts.

As the contributions to the sub-accounts are immediately used to meet the current pensions in the 1st pillar pay-as-you-go scheme, rather than held in a specific fund to meet future pension payments, the new sub-accounts should be considered as an unfunded scheme. Whilst the individual members bear some risk that the uprating factor (nominal GDP growth) may not be sufficient to ensure a sufficient pension, this risk cannot be considered to be of the same scale with that of a defined contribution scheme with dedicated assets whose value and return may fluctuate substantially with markets. In addition this risk is not borne by individuals but government which may take some measures to mitigate it.

Therefore, the new 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.

This classification as an unfunded social security scheme (within the government sector) would have the following recording implications:

- social security contributions received by the government will be increased by the amounts of contributions (5% of the salary) that are now transferred to ZUS;
- however, in the future, the government will have to pay more benefits as the level of global future pension payments will include the pensions related to the "sub-accounts".

Applicable rules

- Eurostat Decision on the classification of funded pension schemes in case of government responsibility or guarantee;
- ESA 95, Annex III, social security schemes of government;
- Manual on Government Deficit and Debt (MGDD), definitions of funded and unfunded schemes;
- SNA 2008, chapter 17 J "Accounting for pension contributions and pensions".

Conclusion

From our discussions — and the clear guidance in the MGDD on "funded defined contribution schemes" — it is Eurostat's preliminary view that the sub-accounts should be **classified within the general government sector and no liabilities should be recorded**.

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.

In this context, we would like to remind you that Eurostat is committed to adopt a fully transparent framework for its decisions on debt and deficit matters in line with Council Regulation 479/2009 and the note on ex-ante advice, which has been presented to the CMFB and cleared by the Commission and the EFC. Eurostat is therefore publishing all official methodological advice (ex-ante and ex-post) given to Member States on the Eurostat website. In case you have objections concerning this specific case, we would appreciate if you let us know before 23rd May 2011.

Yours sincerely,

Francois Lequiller
Director