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The story of the Open Pension Funds and the Employee Capital Plans in Poland. Will it succeed this time?

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Abstract

Poland's new Employee Capital Plans (PPK) scheme, which is mandatory for employers, started to be implemented in July 2019. The article looks at the systemic solutions applied in the programme from the perspective of the concept of the simultaneous reconstruction of the retirement pension system. The aim is to present arguments for and against the project from the point of view of various actors, and to assess the chances of success for the new system. The article offers a detailed study of legal solutions, an analysis of the literature on the subject, and reports of institutions that supervise pension funds. The results of this analysis point to the lack of cohesion between certain solutions of the 1999 pension reform and expose a lack of consistency in how the reform was carried out, which led to the eventual removal of the capital part of the pension system. The study shows that additional saving for old age is advisable in the country's current demographic situation and necessary for both economic and social reasons. However, the systemic solutions offered by the government appear to be chiefly designated to serve short-term state interests and do not create sufficient incentives for pension plan participants to join the programme.

Introduction

The official start of the new private capital pension scheme, i.e. the Employee Capital Plans (PPKs), that was for a long time in the works began in July 1, 2019. According to the initial declarations of its authors, the plan was designed to achieve one of the main goals announced in the Strategy for Responsible Development of February 2016, i.e. to increase the level of domestic savings and to build domestic capital, and thus to create the conditions for achieving a higher level of investment to support economic growth[1]. As the concept of the PPKs took shape, more attention was being attached to its importance as a supplement to employees' future pension security in the face of the expected low replacement rate (the percentage of annual employment income replaced by retirement income after retirement) in the system that was reformed twenty years earlier.

The PPK is compulsory for employers – unlike other institutions of individual capital saving, i.e. the Employee Pension Schemes (PPEs), the Individual Retirement Accounts (IKEs), and the Individual Retirement Security Accounts (IKZEs), that have been around for several years – and due to certain special mechanisms applied it is supposed to be a universal and mass institution. It differs from the aforementioned fully voluntary forms of saving in that its introduction is correlated in time with the planned final liquidation of the second pension pillar of the Open Pension Funds (OFEs), and with the transfer of the OFE assets to private pension accounts in investment funds of the third pillar or to the Social Insurance Institution (ZUS) – depending on the choice of former OFE participants. Together, both changes are a large-scale undertaking with serious economic and significant social impact, and their determinants and possible effects are not entirely clear at the moment.

The aims of the present article are to analyse the systemic solutions applied in the PPK in light of the concept of a simultaneous reform of the pension system, to present arguments for and against these undertakings from the point of view of various actors, and to attempt to assess the chances of success of the changes that are currently being introduced. The success of these changes might be measured in the future by the level

1 This goal was also mentioned in the Explanatory Memorandum to the Act, and was even officially referenced to as the "Capital Building Programme." This aspect of saving in PPKs, however, is not often emphasized in government statements.

and stability of employee participation in the PPK. Universal participation would require active participation (i.e. the systematic payment of contributions) of at least 50–60% of those eligible after five years of the program. The article focuses primarily on the capital part of the pension system and on problems thereof. However, the analysis cannot disregard the entire pension system that includes the capital part. Therefore, before I proceed to the main topic of the article, it will be necessary to outline the underlying historical context, i.e. the pension system as it was shaped in Poland after 1999, including its practical verification and its changes over the next twenty years. These gradually introduced changes have led to the current situation that necessitates further decisions on the future shape of the system. The article consists of six sections. The first section briefly describes the structure of the 1999 pension reform in Poland and some problems related to its implementation; the second section discusses the withdrawal from the capital pillar part of the reform; the third section describes the period in which the fate of the capital pillar was weighted in the balance; the fourth section outlines the ideas of new solutions in regards of the capital pillar and PPK architecture; the fifth section discusses the rationale and significance for various social actors of the solutions that are being introduced; and the sixth section is a conclusion for the article.

1. Historical context. The architecture of the pension reform of 1999 and its implementation

Twenty years ago, in January 1999, the pension reform began in Poland. It fundamentally changed the system of securing the Polish citizens in their old age. The work on the concept of the reform lasted for over four years, and its basic shape was agreed upon by all the major forces in the political scene at the time. It so happened that during the middle of this period the scheme was being prepared and partly proceeded by the ruling leftist party Democratic Left Alliance (SLD), and then in the second half the control over it was taken over by the centre coalition of Solidarity Electoral Action and Freedom Union (AWS-UW) which completed the legislative work. The scheme was also approved by the Tripartite Commission for Social and Economic Affairs, including trade unions and employers' associations, and enjoyed great support from public opinion[2]. Far-reaching rationalization of the pension system was necessary both due to the need to regain control over its finances in the short term, and due to the long-term demographic trend of the increasingly unfavourable ratio of the number of employed persons to the number of non-working age persons,[3] which would otherwise made impossible a simple continuation of the pay-as-you-go system in which contributions of employed persons were supposed to successfully finance the benefits of retired persons. In previous years, rapid changes in the labour market during the transformation period and high unemployment forced Polish policymakers to significantly simplify the access to early old-age pensions and pensions due to inability to work. At the time the replacement rate remained high (it went as far as about 70 percent). In addition, a generous system of inflation indexation of pensions was introduced and a remnant of special retirement privileges for certain social groups was maintained[4]. The need for pension reform started to become urgent for politicians

2 A detailed description of the discussions preceding the reform, of its successive concepts and of positions of different parties can be found in: Golinowska, Hausner 1998: pp. 10–26.

3 Because of the rapid decline in birth rate on the one hand, and increase in the average life expectancy on the other.

4 The financial consequences of facilitating access to old-age and disability pensions combined with generous valorization and group privileges are presented extensively in Czepulis-Rutkowska [1997]: p. 147; Golinowska, Hausner [1998]: p. 11.

only after retirement spending increased in 1990–1994 from 8.5 percent to astronomical 15.6 percent of GDP, thus threatening a collapse of state finances [Czepulis-Rutkowska 1997].

Under the influence of the then existing political climate conducive to economically liberal solutions and averse to egalitarian solutions that evoked memories of the political system of the People's Republic of Poland (PRL),[5] a scheme was chosen from the various proposals that was a compromise, yet one that still radically changed the existing pension system[6]. It assumed maintaining the pay-as-you-go system in the first pillar, though in heavily modified form (a pre-existing defined benefit system was replaced with defined nominal contribution system,) and adding a second mandatory capital pillar and a legal framework for creating institutions that would accumulate voluntary private savings for old-age pensions in the third pillar [Security Through Diversity 1997]. The far-reaching vision of the reform assumed that the system should finance itself in the long term, i.e. it ultimately assumed cessation of financing from sources other than contributions paid by the insured and the employers. Therefore, the leitmotif of the new pension system was that the size of the future pension both in the first and in the second pillar was to depend primarily on the individual contributions of its participants during the entire period of their professional work. This solution was to encourage a long-term participation in the labour market [Żukowski 2014]. A minimum pension (subsidized by the state budget) equal to 25% of the average salary was planned for the low-wage earners who would not earn sufficient savings, while the contributions of high-wage earners were capped at 250%[7] of the average salary in Poland to prevent the formation of excessive pensions in the future. The retirement age for women was set at 60 and at 65 for men[8]. The new, second (capital) pillar was mandatory for persons under 30 and voluntary for persons between 30 and 50 (they could choose between either the capital system or contribution to ZUS), while it did not include persons older than 50 who remained in the reformed pay-as-you-go system. The contribution to capital pillar was removed and dissociated from the total contribution to pensions (at 7.3% of gross salary, while remaining 12.2% contributed to ZUS), so it did not constitute an additional burden for the participants of the system. However, this sepa-

5 According to Stanisława Golinowska [Golinowska, Hausner 1998: p. 15], the concept of state pension being as an equal and low universal benefit was at that time alien in terms of how the Polish public perceived justice (as evidenced by all opinion polls). Meanwhile, just (deserved) differentiation of pensions has been gaining much more acceptance.

6 Marek Góra, one of the creators of the new system, claims currently that what happened was not a mere pension reform, but a complete replacement of one pension system by another one that was adapted to the changed demographic structure of the population [Góra 2018: p. 6].

7 This limit has been recalculated to thirty times the contribution calculation basis. Governmental work is underway at present to abolish it (more on this below).

8 The first proposal assumed an equal retirement age of 62 years for both sexes.

ration reduced potential income of Social Insurance Fund (FUS),[9] thus creating a possibility of deficit – at least in the transition period. The issue was supposed to be solved by transferring proceeds from privatization of still numerous at the time state-owned enterprises to support the pension reform. It was hoped that these proceeds added to the savings resulting from the assumed liquidation of retirement privileges of selected social groups will allow for the entire system to balance out. A number of new institutions have been established by a relevant Act to implement this reform. The OFEs, aided by their managing General Pension Societies (PTEs), were supposed to collect the pension savings under the mandatory second capital pillar. In the voluntary third pillar, initially, the employee company pension funds were supposed be responsible for accumulating savings, and were soon replaced by external pension funds. A special state regulator, the Superintendency of Pension Funds (UNFE), was created to supervise all funds, and in later years it was integrated with other regulators into the Polish Financial Supervision Authority (KNF). Maximum fees for management by the PTEs and rather stringent regulations for investing assets accumulated in the OFEs have also been set by law[10]. The ZUS, as an institution with long traditions and a nationwide administrative apparatus, has been authorised (in addition to its existing functions) to collect contributions from both systems and to transfer the applicable part on an ongoing basis to the capital pillar, i.e. to OFE. It was also assumed that after the end of one's professional career the retirement savings accumulated in the capital pillar were to be distributed in separation from the pension calculated by ZUS. For this purpose private pension institutions were to be created. The pensioner would entrust them with their savings for distribution in the next years of their life (as so-called annuities) provided they did not decide to collect them once. In the end, however, these institutions were never established by law[11]. The Act also allowed contributions collected n OFEs to be inherited by the immediate family in the event of death of the pensioner. A legal framework was also created for the third pillar, i.e. for the private pension savings in pension funds (more on this below).

When trying to reconstruct the deeper intention of the 1999 pension reform on the basis of its basic assumptions, one has to agree that the reform in its concept completely withdrew from intergenerational redistribution (of income) of the pension system [Bugaj

9 The FUS is the most important of the funds managed by the ZUS.

10 The OFEs could only invest up to 40% of their assets in shares of listed companies, and only in Polish companies at that, as the OFEs were allowed to invest only up to 5% of assets in foreign securities. The result was that the funds invested most of their assets in safe securities of the Polish Treasury. This meant that the funds were not exposed to global competition, but at the same time they were not allowed to earn more for their participants. Restrictions on investing abroad were to be gradually reduced, but the limit was raised to 30% only at the time when the limitations on OFEs started in 2013.

11 The draft act on Lifetime Capital Pension Funds was prepared in 2008 and vetoed by President Lech Kaczyński.

2018]. The essence of the reform was that the amount of future pensions from both pillars must be based on participant's individual work. However, the concept included some significant intergenerational redistribution [Golinowska 1997][12] or, as Marek Góra puts it, balancing the interests of the working generation and the pensioner generation [Góra 2018]. The partial transfer of contributions to OFE meant abandonment of their consumption in the present by a generation of current retirees; it was assumed that the situation of young persons after the end of their professional work will be much more difficult than at present, primarily due to rapidly changing demographic conditions[13]. Thus, the (then and now) unjustified thought stereotype that pensioners are the most impoverished of all the social groups was rejected (in my opinion, rightly so)[14]. In public discussions on the concept of the reform and in the first period of its implementation, great importance was attached to the positive aspects of individual saving for old age and to the responsibility associated with it, but little was said about what would be the amount of a pension earned in the system. Optimistic expectations prevailed.

An important assumption of the reform that encouraged the introduction of the capital pension pillar was the belief that in all probability the capital market would significantly increase pension savings. This belief that was shared by the authors of the reform stemmed from the post-war experience of Western countries, with their capital markets characterized by strong and lasting growth trends that significantly exceeded wage and GDP growth rates[15]. Thus, capital pillar gains from growing capital markets were to provide additional protection against the risk of the ZUS pay-as-you-go system that was guaranteed by the state, but dependent on future economic growth and political decisions. Thus, the risks for future pensions were to be diversified with two different pillars. Hence the name of the new system: "Security Through Diversity."

There were high hopes that the creation of the capital pillar would support the development of the capital market and accelerate the creation of domestic capital. Not without significance was that the architecture of reformed pension systems based in part on capi-

12 Golinowska, 1997a: p. 37. At that time, Golinowska attached great importance to the intergenerational redistribution as a way of a fair kind of distributing costs across generations.

13 ZUS demographic forecasts indicated following changes between 2007 and 2060: the working-age population would decrease from around 24.5 million (64% of the population) to 14.8 million (48.3%), or by nearly 10 million persons, and the share of persons in non-working age would increase from 16% to 37.3% [Żukowski 2014: p. 51]. Marek Góra uses a term "positive demographic dividend" to describe a situation in which the next generations are more numerous than the previous ones, whereby pensioners are easily supported with contributions of working persons; this has definitively ended in Poland in the 21st century [Góra 2018: p. 7].

14 Data presented by Żukowski clearly indicates that the relative level of income of pensioners in Poland (in comparison with the other social groups) is higher than that in developed EU countries [Żukowski 2014: p. 46].

15 Representative of many analyses on this topic is KNF [2016]: p. 25.

tal pillars was quite a common at that time, and was recommended by international organizations, most of all by the World Bank that supported such efforts with technical advice and financial resources [Orenstein 2013[16]; Chłoń, Góra, Rutkowski 1999].

The pension reform brought some expected effects, for example a successful shift from the defined benefit system to the defined contribution system, and many unexpected effects; but some of its assumptions were not met.

Firstly, at the beginning of the OFEs' operation, it turned out that the ZUS and its IT system were completely unprepared for the reform and could not deal with individual records and allocation of contributions to OFEs. For the first few years the ZUS has not transferred any contributions of OFE participants, which resulted in a debt with increasing interest, and then the contributions were not transferred to the appropriate accounts, and the OFE participants could not confirm their account balances. This organizational chaos strongly alienated the public from the reform, even though over time the technical and financial assistance of the World Bank allowed for improvements in the administration of the system and in its IT support [Orenstein 2013; Chłoń-Domińczak 2002]. These obstacles were not enough, however, to stop the majority of eligible citizens (those who had a choice) from joining the OFE system.

Secondly, the legal limits on PTEs' fees on contributions and management fees calculated as the interest rate on OFE assets made operating costs of the capital pillar too high. At first, this did not discourage OFE participants who expected that OFE investments would make high profits in the long run – all the more so because the inflated fees were significantly reduced later on[17]. However, after the intense turmoil in the financial markets in 2008, the disparity between the PTEs' high earnings and the OFEs' low returns put the funds' financial results in a negative light (even though the OFEs were objectively not at fault[18]), thus undermining the participants' confidence in the capital pillar. It called into question the very rules of the PTE s' remuneration: the suitable amount of fees was not as problematic as the structure of incentives, specifically the lack of a good mechanism

16 Orenstein [2013] describes these reforms as "privatization of pensions," which in Poland is a rather imprecise term, since privatization may fully refer only to the third pillar, while only partially to the second. Poles were primarily dealing with individualization of pensions, rationalization of the first pillar and private management of the second pillar (but not with its privatization). The fact that the system remained public despite the introduction of private management of its capital part is also emphasized by Marek Góra [Góra 2018: p. 14].

17 Initially, this fee was set at a high level of 10% of the contribution, but in 2003 it was corrected by law to 7%, with a target reduction to 3.5% by 2014. In 2009, the fee was adjusted again, and the target of 3.5% was moved to the beginning of 2010. In 2013, the fee was reduced to a maximum of 1.7% of the contribution. Similarly, PTEs' remuneration for managing assets originating in OFE was significantly reduced. See also KNF [2016]: pp. 11–12.

18 After high positive rates of returns in previous years (between 6% and 15%), the rate of return in 2008 amounted to –14.26%. The reason was the collapse in the global financial markets. As for the PTEs' remuneration, it was based on statutory regulations [KNF as above].

for making remuneration dependent on the financial results of investments. In case of the OFE, the assessment criterion used was the mechanism of minimum rate of return with overage of possible shortages by the PTEs. The result was "herd" behaviour in the investment policy of funds, which tried to minimize deviations from the average rate of return instead of seeking to achieve the maximum rate of return [KNF 2016: p. 28].

The aforementioned three types of deficiencies of the reformed pension system can be classified as such that by correcting earlier regulations could be overcome given some conceptual effort and political goodwill. In general, however, it can be noted that regulations regarding the (mandatory) rules of joining OFEs or of suitable fees, the limits of OFEs' investments in various types of assets, and the periodic assessments of the achieved rate of return did not encourage funds to compete intensively by offering better conditions to its participants and to seek more effective investment methods. The funds operated within the institutional framework and adapted their actions accordingly. However, in my evaluation neither state supervision nor the legislator went to enough trouble to systematically rationalize and improve this framework by monitoring the process meticulously and by drawing conclusions from the experience that in Polish environment was, after all, completely experimental. Instead, in the subsequent years the capital sector was being gradually limited, more on which below.

The impossibility of the assumed long-run balancing of the missing contributions in the FUS with the help of income from privatization turned out to be the worst pitfall. After record-breaking year 2000[19], the income from privatization began to decline sharply in result of slowdown in the privatization process due to political reasons. After 2002, the item "funding social security reform with income from privatization" disappeared as a separate item in the budget implementation report[20].

The suspension of privatization after 2001 cannot be justified by the lack of state-owned enterprises and companies eligible for privatization at the time, since there were still 1137 such active entities at the end of 2005 [Błaszczyk, Nawrot 2007a: p. 82]. In the 2006–2007 period during the first Law and Justice (PiS) government the income from almost completely halted privatization was negligible. After 2008, the income from renewed privatization

19 Thanks to the sale of Telekomunikacja Polska SA.

20 In 2000, when income from privatization amounted to over PLN 27 billion, the amount allocated to support social security reforms was PLN 11 billion. At the same time, PLN 3.4 billion was paid to pensioners as compensation for unrealized outstanding indexation of pensions. In 2001, just over PLN 4 billion was allocated to support the insurance reform, PLN 2.4 billion for the repayment of compensations, while income from privatization reached PLN 6.8 billion. In the following years, such separate item disappeared from the state budget, enumerating only amounts of incomes from privatization allocated for financing budget deficit in 2002, 2003, 2004, and 2005, amounting respectively to PLN 1.9 billion, PLN 2.9 billion, PLN 7.4 billion, and PLN 2.7 billion (rounded up). [Błaszczyk, Nawrot 2007: pp. 95–96].

process once more reached high levels[21]. Although in the entire period from the introduction of the pension reform until its radical reversal (between 1999 and 2013) the income from privatization was much smaller than planned and for most of the period it ended up in the state budget – where it could be used for purposes other than balancing the retirement system – according to some calculations this income has significantly offset the costs of refunding contributions transferred to OFE to ZUS. According to the above report by KNF [2016: p. 38], the income from privatization in the years 1999–2013 amounted to PLN 127.3 billion, and the amount of refunds due to transfers of contributions to OFEs amounted to PLN 189.8 billion. This means that privatization paid for more than 67% of the refund. Nevertheless, even assuming that a robust policy would result in systematic and high income from privatization, this income source is finite. It was supposed to provide financial security for a transitional period after which the pension system should balance out internally. However, this did not happen, so the assumptions of the policymakers proved to be overly optimistic.

However, the biggest problem of the reformed pension system – one that caused its inability to balance out – was not the deducted contribution for OFEs, but the failure to permanently liquidate the expensive retirement privileges of some social and professional groups, including harmonization of early retirement regulations, due to political reasons. These privileges applied above all to farmers (whose pension contributions covered expenses only to a minimal extent), miners, uniformed workers, and some other professional groups that were not included in the common pension system at all or were included for a short time and later (in 2003–2005) withdrawn from it[22]. According to the KNF, while the amount of refunds due to the transfer of contributions to the OFEs was less than PLN 190 billion in the entire discussed period, the amount allocated to subsidies to pension systems administered by the ZUS and the Agricultural Social Security Fund (KRUS) (without OFE) was three times that, i.e. as much as PLN 587 billion[23]. These were the costs of negligence during the reforms of the pension system[24]. Thus, the new pension system was out of balance from the very start[25]; this necessitated constant high subsidies to the FUS (there were various other reasons which are not di-

21 This income was PLN 45 billion during the privatization in 2008–2011. [Patena, Błaszczyk 2016: p. 203].

22 For details see Bugaj [2018]: pp. 83, 125–127; Góra [2018]: p. 9; KNF [2016]: pp. 13, 37–39.

23 The KNF [2016: pp. 37–38] report refers to the *Statistical Yearbooks of Social Insurance for 1999–2011 and to the Important Information in Social Insurance for 2012 and 2013*, www.zus.pl.

24 Szumlicz writes that such cases of negligence were the main symptom of improper implementation of the pension system reform [Szumlicz 2014].

25 See Chłoń-Domińczak [2006: pp. 150–153] for discussion of the reasons for the system's imbalance in the first years of its existence, including growing subsidies to the FUS due to the privileges of certain social groups and the lack of uniform regulations regarding early retirement.

cussed here due to article size constraints). From the entire repertoire of changes in the 1999 pension reform package that were pending further implementation, only bridging pensions[26] were successfully adopted and implemented in 2008. While the aforementioned reforms of the pension system turned out to be unrealistic due to political reasons, the capital part of the pension system (to which a certain part of the contribution was constantly allocated, requiring state budget funding to the ZUS[27]) was a thorn in many politicians' side.

Over time, OFE became a permanent and important element of the Polish capital market. Due to investment limits imposed for prudential reasons, the OFEs invested mainly in Polish sovereign bonds and shares listed on the Warsaw Stock Exchange (GPW)[28]. This contributed to the significant development of the GPW, as OFE investments created a constant demand for new publicly offered shares. In the first years of the new century, the stock market boomed and prices of shares rose steadily, giving rise to hopes of substantial OFE investment results. A gradual rationalization of the ZUS part of the pension system was also being conducted, and the IT systems began to operate efficiently. However, this part of the pension system has not been balanced for the reasons described above.

26 Regulations on (partially paid) early retirement in some professions that require work in particularly difficult conditions.

27 According to the FUS and Ministry of Finance data the refund of contributions to the OFEs in the 2003–2011 period ranged from 1.03% to 1.90% of GDP [Golinowska 2014].

28 Only up to 40% of risky securities (shares) were allowed in the OFE investment portfolio.

2. Withdrawal from the reform in the capital pillar

As a result of the country's economic situation that deteriorated due to the global financial crisis at the end of the first decade of the 21st century, the capital pillar of the pension system in Poland came under strong pressure. On the one hand, the results of investing in capital markets during the crisis of the entire financial sector could not be satisfactory as stock prices were falling sharply. By September 2008, OFE assets began to dwindle for the first time [Osiecki 2013] and it came to view that high earnings of the funds are not permanent. On the other hand, due to reduced earnings resulting from the economic downturn, the need to co-finance EU projects and the lack of more thorough reforms in public finances, the state budget deficit was high and ever-increasing, thus steadily approaching statutory prudential limits. One of the causes was the ZUS deficit, only partially (as mentioned above) caused by the transfers of contributions to OFE[29]. Nevertheless, these contributions constituted one of the largest items in the state budget expenditure.

Already at the turn of 2008 and 2009, the then Minister of Labor Jolanta Fedak initiated the first propositions to reduce the OFE contributions and fees on contributions of clients, and in 2009 a project to halve the OFE contributions was initiated – this time with the participation of the Ministry of Finance[30]. In 2010, the Economic Council to the Prime Minister led by Jan Krzysztof Bielecki began its analysis of the costs of the capital pillar. As in the case of analyses conducted by the Minister of Finance, the Economic Council's analyses focused mainly on the accumulation of debt due to transfers to the OFEs and its servicing costs; the validity of macroeconomic assumptions of the pension reform of 1999

29 In addition, during the crisis the ZUS's revenues from enterprises experiencing financial problems also collapsed strongly, as such enterprises often stopped paying their contributions to ZUS. According to Dec [2018: pp. 188–192], the indebtedness of enterprises in the ZUS due to unpaid contributions has been growing constantly since 2004. In 2004 this debt amounted to PLN 734 million, in 2008 it was PLN 1.2 billion, and in 2011 it exceeded PLN 2 billion. In 2014 (i.e. during the introduction of statutory changes in OFE), it amounted to PLN 2.7 billion, and in 2017 it amounted to as much as PLN 3.9 billion. The majority (over 70%) of the debt is the arrears towards the FUS (i.e. towards the pensions fund). According to Dec, public aid granted to enterprises by the ZUS in the 2004–2017 period totaled PLN 3.6 billion, most of which accrued in 2004 (PLN 2.7 billion) and in 2008 (PLN 379 million).

30 The entire history of the gradual limitation of OFE has been described in detail in *Dziennik – Gazeta Prawna* [Osiecki 2013].

was being verified as well. In addition, proponents of curtailing the capital pillar pointed to the excessive share of state bonds in the investment portfolio of the OFEs.

The government's position on this matter was initially inconclusive. While the main promoters of restrictions or even liquidation of OFE were the ministers of labor and finance, the Minister of the Treasury and the President of the Stock Exchange strongly opposed them, judging that such actions would lead to degradation of the Polish capital market. The latter pointed out that without OFE there would be no stable domestic investors on the capital market, nor any new privatizations. On the contrary, the result would be a partial nationalization of private companies in which the OFEs hold large chunks of shares[31] [Nawacki 2013a, 2013b]. Minister Michał Boni – a supporter of maintaining the capital pillar – was tasked as well with modernizing the OFE sector by proposing a new incentive system and by changing other regulations. These discussions polarized the economic community in regards of its assessment of the capital pension system[32] and created a climate of growing uncertainty around OFE. At the same time, government tried to persuade the European Commission and Eurostat not to include pension liabilities of the OFEs in the public debt statistics, but the result of these efforts was a failure.

Additionally, the first pessimistic forecasts of the amounts of pensions in the new system began to surface around 2011. According to these forecasts, the replacement rate was expected to fall from 50–60% in 2011 to 30% in 2050 [Wiktorow 2011]. All these circumstances caused the government to become more and more critical towards the reformed pension system, and in particular towards its capital pillar that was made the main culprit of the rapid increase in the budget deficit. This prompted a search for ways to radically correct the system. Moreover, the new Hungarian government led by Viktor Orban started an unannounced liquidation of the second pension pillar in 2010, thus setting an example of a radical way of resolving budgetary difficulties – at least in the short run[33]. The Polish government did not immediately decide on such radical action, but from the end of 2010 it was looking for a way to reduce the budget deficit by gradually reducing the OFE sector.

31 By April 2013, OFE invested over PLN 101 billion in shares of GPW companies, and over PLN 30 billion in corporate bonds [Nawacki 2013b]. They also bought the National Road Fund bonds for PLN 17.8 billion and held PLN 1.46 billion in municipal bonds [Nawacki 2013 c].

32 This critical standpoint of the part of government and of the then Economic Council to the Prime Minister was strengthened by harsh statements of some economists who called into question the legitimacy of the entire pensions reform of 1999. An extreme example were publications and statements by Leokadia Oręziak in which she described the introduction of the OFE as the cause of the "catastrophe" of the alleged privatization of pensions in Poland. [Oręziak 2014].

33 In all three Baltic countries facing the severity of the 2009 financial crisis funding for the capital pillar contributions was also partially suspended, while retirement benefits were reduced [Golinowska 2014].

In the first step, the contribution to the OFEs was reduced in 2011[34] to only 2.3%[35] of gross remuneration (instead of the initial 7.3%). The remaining part of the contribution (that previously was to be allocated in the OFEs) was to be transferred to special sub-accounts at the ZUS subject to inheritance rights and indexed by the GDP growth rate in the last 5 years. The decision has been made as well to gradually raise the limit of OFE investment in shares[36]. A ban on acquisitions by OFEs was also introduced, and new contracts were to be concluded only by correspondence. The limits on contributions strongly curtailed increases in savings on OFE accounts, but it did not wipe them out completely; meanwhile, the ban on acquisitions caused a significant decrease in costs [KNF, 2016].

In order to raise replacement rate for future pensioners, the government decided next to extend the period of saving for pensions by raising the minimum retirement age and by equalizing this age for men and women to 67 years. The reform was supposed to be implemented gradually over almost 30 years[37]. The raise of retirement age introduced by law in 2012 was acclaimed by the majority of economists and people aware of demographic trends in our country, but was met with violent criticism of the opposition and a large part of the public.

In the second step of limiting the OFE sector, a public debate based of a study prepared by the government[38] was held in Autumn of 2013 on the review of hitherto functioning of the pension system and on proposals for its changes. The debate resulted in the decision of the parliament[39] in December of the same year to further "partition" the OFE sector. This partitioning consisted of overtaking by the state of about half of OFEs' assets worth PLN 153.15 billion in government bonds and other government or government-guaranteed securities, and then their remission. In result of this step, the formal debt of the state decreased by the equal amount[40]. In accordance with the Act, on February 3, 2014, 51.5% of accredited units in the accounts of OFE participants were remitted, and the corre-

34 The Act of 25 March 2011 on amendments of certain Acts related to functioning of the social security system, Journal of Laws of 2011 No 75, item 398.

35 It was successively raised to 2.8%, and the target increase to 3.5% in 2017 was announced in the bill.

36 From initial 40% to 90% in 2034.

37 Until 2020 for men, and until 2040 for women. The Act of 11 May 2012 to amend Act on Old-Age and Disability Pensions from the Social Insurance Fund and some other Acts (Text. No. 637).

38 "Security through sustainability" [2013].

39 The Act of 6 December 2013 on the amendment of certain acts in connection with the determination of the rules for payment of pension from resources collected in the open pension funds, Journal of Laws of 2013, item 1717.

40 According to Bugaj [2018: p. 105], this operation resulted in reduction of government formal debt by 8 percentage points, from 55% to around 47% of GDP.

sponding assets were transferred to ZUS. The equivalents of the remitted accredited units were allocated in the previously established sub-accounts of pensioners' virtual accounts in the ZUS, so instead of dues that were previously covered by specific treasury securities, the OFE participants were left with of future pension promises.

The Act also set a new level of contribution to the OFEs at 2.92% of gross salary. In addition, it was decided that all OFE participants must once again choose whether they want to continue to contribute to OFE, or if they prefer from now on to transfer the entire contribution to the ZUS sub-account. The default option was to transfer future contributions to the ZUS, so the option to contribute to OFE involved overcoming additional formalities[41]. The first 'transfer window' was open from March 1 until July 31, 2014, and the next ones were announced after two years and after four years. Moreover, all OFE advertising was banned in periods preceding the transfer windows. Over 2.5 million persons out of 16.7 million OFE participants (15.4%) decided to continue to contribute to the OFEs[42], which under such rules may indicate their great determination. The decision to transfer future contributions did not involve the transfer of previously accumulated capital, which continued to be managed by OFE.

In addition, the allowed mode of investing has been changed by law. From then on, the OFEs have been banned from investing in government bonds and other instruments issued or guaranteed by the State Treasury. At the same time, the OFEs were mandated to invest at least 75% of their assets in shares (which automatically meant a large increase in risk). In addition, as a result of the judgment of the Court of Justice of the EU investing in foreign assets was liberalized, setting a target limit of 30% of assets denominated in foreign currencies. Subsequently, the required minimum rate of return was abolished removing the resulting consequences of coverage of deficits by the OFEs. The PTEs fee paid by the OFE participants based on their contributions was again reduced to the maximum level of 1.75% of the contributions.

The question of persons nearing retirement age who were leaving the capital system was also regulated. Instead of establishing a legal framework for the creation of previously planned private pension institutions it was decided that benefits from the capital system would be paid by the ZUS – including benefits from the pay-as-you-go system. In addition, to make the payments of benefits independent of the risk of recessions on financial markets, a "safety zipper" mechanism was established, under which ten years before reaching retirement age the assets accumulated on the account of each OFE participant were to be gradually transferred to his sub-account at the ZUS. This meant

41 Submission of an applicable statement in the ZUS.

42 According to the statement of the ZUS spokesman Jacek Dziekan of August 18, 2014, tvn24bis / Economic news.

that on the day of retirement, the employee would no longer have any savings on the OFE account.

Resistance of OFE participants and of part of the public against the reduction of contributions, nationalization of half of OFE assets, and the introduction of the “zipper” was very strong. The arguments used by the then government, and in particular by Minister of Finance J. Rostowski, were viewed as unfair and demagogic because (for example) they targeted OFEs for being profit-seeking capitalist institutions that allegedly charged excessive high fees and unfairly profiteered on state bonds which the government was obliged to buy back anyway[43]. And yet it was the state legislator and regulator that imposed earlier the obligation on the OFEs to invest a large part of assets in these bonds and set high limits on fees, which were later reduced. Other accusation against the OFEs was that contributions to OFE were the main reason for the accumulation of public debt; when this criticism was itself criticized, no irrefutable figures supporting these allegations were presented.

When these arguments were not taken for granted, the government began to rationalize its policies by the dramatic situation of the budget and the urgent need to balance it in order to avoid financial crisis of the state. The critics[44] of the nationalization of the capital system by the government pointed out that the situation is by no means as dramatic. They said that the budget problems could have been solved by other means, without violating the private pensions accounts of citizens and without the devastation of the capital market, that the government’s actions violated the law and citizens’ trust in the state, and that the real motive of the government was the desire to “patch up” public finances in the short run. This, they stressed, would be detrimental to the country’s well-being in the long run, because it would fail to fix deeper causes of the public finance crisis, merely delaying their effects at the expense of citizens’ savings and country’s economic development. Another point was that nationalization and remission of OFEs’ state bonds will fail to reduce state debt, and only succeed at converting turn it into hidden debt that would have to be repaid in the future[45]. Moreover, it soon turned out that the whole operation fail to show to the EU that Poland improved its financial discipline, because according to the new ESA 2010 methodology, converting explicit debt into hidden debt did not reduce the sum of public debt.

43 A bizarre criticism was raised that the OFEs’ investment in government bonds is a “cancer,” and thus it has to be taken away from the OFEs.

44 For a representative example see: Balcerowicz [2013].

45 Specialists dealing with pension systems pay attention, however, not to treat hidden debt on an equal footing with explicit debt, because these are different economic categories. [Barr, Diamond 2009: p. 16].

The protests against the bill dismantling the second pillar lasted from the introduction of the bill until the last minute preceding it's adoption in December 2013. OFEs was defended by many prominent economists and lawyers[46] who appealed to all possible instances to stop the bill. At the turn of November and December the press issued a statement by a large group of Polish economists "against the dismantling of the pension reform" and a statement by lawyers assessing that the proposed changes are unconstitutional and institute unjustified expropriation. Recognized foreign economic magazines (e.g. the Financial Times and the Wall Street Journal) have published critical articles about the new Polish pension reform calling it a "pension swindle" and warning that the Polish government is playing with fire by threatening capital markets and by setting a bad example to other countries[47].

Only after passing the bill in January 2014 did President Komorowski question the Constitutional Tribunal (TK) whether the imposition of an investment profile on funds, prohibition of advertising, and abolition of the minimum rate of return by the bill are in compliance with the Constitution. Additionally, the Polish Ombudsman issued further questions to the TK on (1) the constitutionality of transferring half of future pensioners' savings from OFEs to ZUS without their consent, and on (2) justification for making ZUS the default choice for contributions in spite of their earlier decision in favor of OFEs. Essentially, these inquiries pertained to the nature of the assets collected in OFE. Most OFE participants were convinced (guided by the previous exegeses of the 1999 reform), that the assets accumulated in their individual and inheritable accounts of the capital system were their private property, to which they would gain access after reaching retirement age. However, in November 2015 the TK ruled that all statutory provisions (except for the ban on advertising) were justified, and that the assets accumulated in OFE are to be considered public assets, as they originate in compulsory and universal pension contributions, which constitute a public tribute[48]. According to the TK, as the state is responsible for the payment of pensions, it can govern such assets for the public good in accordance with changing socio-economic conditions. The ruling greatly disappointed OFE participants who favoured individual capital saving. Moreover, it undermined public trust in state institutions that first promised particular benefits to encourage citizens to take specific actions, only to renege all these promises after ten years by changing the

46 Most prominently by Leszek Balcerowicz and Jerzy Stępień. Stanisław Gomułka, Mirosław Gronicki, Andrzej Wojtyna and many others were also among the critics. The protesters among politicians included Jerzy Buzek and Jerzy Hausner. The Citizens' Committee for Pension Security (KOBE) consisting of eminent economists and lawyers was appointed to defend the pension system. See interview with L. Balcerowicz, Rzeczpospolita, 2/12/2013.

47 See Poland's Pension Swindle [2013] and Atkins [2014].

48 Judgment of the Constitutional Tribunal of 4 November 2015.

rules and taking away both current and potential future benefits. In my opinion the long-term undermining of confidence in the state is the biggest loss brought by the "OFE experiment" in Poland.

However, after the passage of time, when political emotions subsided somewhat, one can ask a number of questions about the very structure of the second pension pillar in Poland and about the manner of its implementation. It is reasonable, for example, to ask whether the distribution of risk did not conflict with the mandatory nature of the contributions or why the authors of the reform allow it to be designed in such a manner that the contribution to the OFE was ambiguous in character. The most fundamental question in relation to the solutions proposed at the time is whether mere division of the contribution between the insurance and the capital segments (without increasing it) substantiated expectations of long-term positive results. However, it can be assumed that in the late 1990s the establishment of an additional contribution for the capital segment could be considered politically unrealistic. But also allocating such a large part of the contribution[49] to the capital pillar turned out to be a very risky decision with serious consequences for public finances. In addition, overly optimistic predictions regarding the coverage of the systemic deficit of ZUS contributed to the final failure of the capital system [Szumlicz 2014]. The initial large overshoot of the fee on the contributions transferred to the funds should be particularly emphasized regarding the technical and organizational issues related to the capital segment of the reform of 1999[50]. The misfortune of OFEs and the capital pillar failing to take root in its original form in the pension system were exacerbated by the ineffectiveness of the supervisory institution [Golinowska 2014], and by the lack of responsiveness to feedback regarding erroneous statutory corrections to regulations.

49 According to T. Szumlicz, there was a clear "over-shooting" of the contribution; Szumlicz's opinion was based on examples such as the one of Sweden, where the contribution to the capital pillar amounted to 2.5% of the 18.5% contribution [Szumlicz 2014]. S. Golinowska holds a similar view [Golinowska 2014].

50 This was not the first case in the history of Polish transformation of excessive generous remuneration by the state of financial institutions without providing an adequate motivation system. The same happened in relation to funds' managers in the NFI (National Investment Fund) Program in the mid-1990s.[Błaszczyk at al 2003, p.162].

3. The "transitory" period and the fate of the OFEs

By 2014, the OFEs, which until recently managed assets worth over PLN 300 billion, have lost their former status. However, the shrunk OFE sector in fact still operated and invested. Its assets decreased every year because asset outflows to ZUS outweighed inflows in result of the operation of the "safety zipper", and because of low operating contributions due to overtaking the contributions of most participants by the ZUS and reducing them to 2.9% of salary. The inflow of contributions to the OFEs decreased as a result of 2014 changes by about 70% and already in 2015 there was a slight negative balance of OFE's cash inflows and outflows [KNF 2016: p. 34]. Due to small positive returns this meant that OFE assets remained frozen at the same level instead of growing dynamically as until 2013. So there was awareness that something must be done with the OFE system, because after the 2011–2014 changes the OFE were in a transitory state "between being and non-being", deprived of normal conditions for business activity in terms of a long-term perspective of planning and development. If this state of the matter was maintained without any changes, the OFE sector would inevitably continue to shrink and erode. In addition, investment *modus operandi* specific to high-risk funds which is unsuitable for pension funds and possibly harmful to its participants has been imposed by law. And yet the OFE sector still plays a large part in the financial market and can potentially be a source of substantial profits and benefits for its participants. The OFEs alone currently have PLN 162 billion of capital and have over 16 million participants [*Rzeczpospolita*, July 2019].

Since the introduction of changes in the OFE system the situation on the Warsaw Stock Exchange (GPW) has deteriorated significantly; the GPW was denied such significant improvement as all the foreign capital markets enjoyed after the crisis. Every once in a while, the Warsaw Stock Exchange Index (WIG) return rates were negative[51]. Until then, pension funds have been the main buyers of shares from new public offers and held substantial shares of companies listed on the GPW. The decision to partially expropriate funds and cut them off from new cash due to the changes described above resulted in the

51 According to the KNF, in the period from December 30, 2013 to December 30, 2015, the rates of return on selected stock markets were: WIG: –9.4%, WIG20: –22.6%, BUX :28.9%, DAX: 12.5%, S&P500: 12.1%, CAC40: 9.4%, FT-SE100: –6.8% [KNF 2016: p.5].

end of OFE's role as strategic, long-term investors on the GPW. This has led to an initial decrease in prices of shares of funds followed by a systematic decrease or stagnation in the value of shares of other companies listed on GPW, which was accompanied by an inhibition of new public offers.

Uncertainty about the future of OFE and the fate of companies whose shares were held by the OFEs increased even more at the end of 2015 when PiS won the elections; one could expect that the OFEs will be completely nationalized, which meant nationalization of significant blocks of shares of a large number of domestic and foreign companies listed on the GPW[52]. For quite some time, the government was considering two options for the transformation. Some participants of the government supported first option that boiled down simply to a full takeover of the OFE assets by the ZUS. This meant that the entire mandatory capital pillar of the pension system would be abolished. Experts warned that such a provision would cause a collapse on the stock market; the investment funds would vanish, and the confidence in the entire financial system would be undermined [DGP Editorial Discussion 2017]. Much less was said about the opinions of citizens about this state of affairs.

The further nationalization of open pension funds would lead to a partial nationalization of successful market-listed companies that were initially private and in which pension funds had large shares. What's more, the OFEs held shares in companies listed on global stock exchanges.[53] Dismantling the OFE sector would nationalize another large fragment of the private economy and ruin the capital market in Poland, further undermining confidence in the state. Thus, it was ultimately decided against it.

Finance minister (later prime minister) Morawiecki and his supporters promoted the second option, under which a third, completely private (and now inviolable, as it was proclaimed) pension pillar was to be created, and the individual savings accounts of current OFE participants were to be moved there. But not before transferring part of the savings[54] to the account of the state-controlled Guaranteed Employee Benefits Fund (FGŚP)[55]. Pension savings accumulated in the employee capital plans advocated by Morawiecki would add up to the private pillar.

52 According to the Explanatory Memorandum to the draft of the "Transfer" Act of May 2019 (p. 2), the OFE assets invested in companies listed on the GPW were valued at about PLN 126 billion.

53 In mid-2016, the OFE held shares in 300 companies; the shares were valued at about PLN 9 billion [Chądzyński, Kwiatkowska 2016].

54 The initial suggestion was 25%.

55 This was the first idea, probably designed to neutralize the resistance against this provision.

The concept immediately raised many questions. One pertained to question of how to quickly create 16 million accounts to which the savings were to be transferred, since most Poles did not yet have such accounts – even assuming that the transfer of retirement savings from "semi-public,"[56] as it were, OFE accounts to private IKE accounts would be legally feasible.

One solution instead of liquidating OFEs was transforming them into private investment funds while leaving the existing assets untouched. This would mean that the hitherto capital pillar would remain unchanged organizationally and personally, and that it would merely start to act in a different legal framework with slightly different operating rules. This idea was obviously enthusiastically welcomed by the existing PTEs, which for several years were waiting for a verdict as to their tentative existence, and the obligatory tribute to the state fund was accepted by them as a necessary sacrifice. In the election year 2019, a decision was announced in favour of capital path for the OFEs, and at the end of May 2019 the government presented the draft act on the transformation of OFEs as "giving back savings to the Poles"; the draft is currently in the consultation phase[57].

In parallel, although a little earlier, actions were initiated to activate mass savings in the third pillar by creating a new retirement scheme, i.e. the PPK. In October 2018, the Sejm enacted the corresponding act, which entered into force in July 2019[58]. In the remainder of the article, these two schemes will be analysed side by side as they constitute a joint program based on a uniform concept.

At this point, the discussed issues should be supplemented with a reminder of the fact that immediately after taking over the government the PiS government, in accordance with its electoral program, started to reverse the reform of 2012 that raised the retirement age. Beginning in 1 October 2017 the government reduced the retirement age to pre-reform level of 60 for women and 65 for men[59]. This of course has affected the entire financial architecture of the pension system, both in its pay-as-you-go (ZUS) and capital part. In short, the effect of this change is that the period of saving for pensions has been shortened and the period of receiving them has been significantly extended, which necessarily has a negative impact on the amount of benefits, especially for women[60]. In addition,

56 According to the Ruling of the Constitutional Tribunal of November 2015.

57 The act that liquidates OFE was adopted on February 13, 2020, during editorial work on the present article.

58 Act of 4 October 2018 on employee capital plans (Journal of laws of 2018 item 2215 as amended).

59 The Act of 16 November 2016 to amend the Act on Old-Age and Disability Pensions from the Social Insurance Fund and some other Acts (Journal of Laws 2017, item 38).

60 According to the latest OECD calculations, the net replacement rate for 20-year-olds starting their careers in 2016 will amount to a mere 30% of their last salary after their retirement and to 40% for low earners. [OECD 2017].

the government intends to abolish the limit of 30 times the projected average salary, above which pension contribution is no longer deducted. In the future the contribution is to be calculated using total income. This change was adopted by the Sejm on December 15, 2017[61] and was to enter into force from the beginning of 2019, but was temporarily[62] suspended by the President's *veto*. Its implementation will have negative consequences now and in the future, as it will take over the surplus cash of high earners that could be allocated to voluntary retirement savings in private funds, and will significantly increase the obligations of the ZUS system towards this group in the future, while excessively widening range of pensions. The announcement of this change has already been applied to the Act on Employee Capital Plans, as the PPK contribution will be calculated using entire gross salary without the 30-fold limit[63]. However, the announced change in the liquidation of "30-foldness" was criticized severely by organizations of entrepreneurs who are afraid of the leakage of best professionals and specialists from the labour market. Due to dis-agreements about this decision in the ruling coalition, the change was temporarily suspended after the 2019 elections.

61 The Act of 15 December 2017 amending the Act on the Social Security System and certain other acts.

62 The veto concerned only the procedure of passing this change in the Senate, not its merits and was later confirmed by a ruling of the TK.

63 This change was introduced by the amendment of 16 May 2019 to the PPK Act.

4. Overview of the concept of ‘reanimation” of Open Pension Funds, and the architecture of the Employee Capital Plans

4.1. Transfer from the Open Pension Funds to Specialized Open Investment Funds

Before I discuss the planned changes, it is worth briefly characterizing the OFE sector in its current form. On June 28, 2019, ten PTEs and ten OFEs operated on the market, and had 15,783,387 participants [KNF 2019b]. The three largest (Nationale Nederlanden, Aviva Santander, and OFE PZU Złota Jesień) each had over 2 million participants and held over 60% of the assets of all OFEs[64]. The assets of all OFEs slightly increased since the transfer of half of their assets to ZUS in 2014, as they exceeded PLN 160 billion. This means that the average account balance of each OFE participant is about PLN 10 thousand. According to the annual bulletin of KNF for 2018, several of the existing ten PTEs also manage seven Voluntary Pension Funds (DFEs), but their economic significance is marginal compared to OFEs in terms of both the number of participants and the value of assets[65]. Polish companies are the dominant shareholders in PTEs today (69.5% share), and there are also notable Dutch and French shareholders. All OFEs are currently in a relatively good economic and financial condition: they have equity at a level higher than required by law, they finance their assets mainly with equity and they achieve profits allowing for the payment of dividends. However, their situation is unstable because, as it was said earlier, there is a negative balance of settlements between OFEs and ZUS, because due to the so-called safety zipper the outflow of assets from OFEs to ZUS outweighs the inflow of contributions from ZUS to OFEs[66]. Also the rate of return on investment

64 The reduction in the number of OFEs from 20 to 10 was a result of previous mergers, the last of which took place in 2018, when PTE PZU Złota Jesień took over the management of PeKaO OFE because of the merger of both PTEs’ owners.

65 At the end of 2018, DFEs had 105.5 thousand participants and PLN 381.8 million in assets, and the revenues from DFE management accounted for only 1% of total PTE revenues.

66 For example, in 2018, the amount transferred due to the safety zipper amounted to PLN 8 billion, and the amount of contributions received by OFE from ZUS was PLN 3.3 billion [KNF 2019: p. 21].

(ROI) of all OFEs for 2018 was negative and extremely low[67], while in previous years ROI rates were positive. This can be attributed to the unstable situation of funds on the market. As KNF suggested in its annual report on PTEs for 2018, "from the point of view of further ... development of the PTE market, the most important factor is the continuing uncertainty regarding the further operation of OFEs" [KNF 2019a].

This uncertainty was stopped at the end of May 2019, when the government announced the draft amendment to the Act on Transferring Funds from Open Pension Funds to Individual Retirement Accounts[68], which will be further referred to here as the "Transfer" Act. According to the draft, in February 2020 all OFEs will be converted top-down into Specialized Open Investment Funds (SFIOs)[69] with separate pension sub-funds, and OFE members will automatically become participants of SFIOs in which IKEs will be created for them. And the PTEs that currently manage the OFEs will be transformed into Investment Fund Companies (TFI). OFE assets and liabilities will become SFIO assets and liabilities. These funds will operate on the basis of the amended Act on Individual Retirement Accounts; its draft includes amendments to several dozen acts related to the functioning of the funds and the social insurance system. It is no wonder that the draft "Transfer" Act is very extensive[70] and unintelligible to an ordinary reader. The Act not only regulates the basic principles of the planned transformation and its institutional shape, but specifies in detail all its subsequent steps, including dates (to the day) of carrying out successive stages by particular entities. As a side note, it is regrettable to note this new way of legislating that assumes that the laws should plan for and regulate all the smallest details, which of course is false and leads to enormous opacity of law.

OFE participants have the option of assuming an account in SFIO, which is a continuation of the OFE, or to transfer all of their saved contributions to ZUS. The first choice (which I call here the capital option) is the default selection: the choosers do not have to do anything except to acknowledge that they will become owners of individual accounts from which a transformation fee amounting to 15% of accumulated assets will be deducted in two instalments for the Demographic Reserve Fund (FRD). According to the authors of the Act, this fee is to compensate for future income tax, which will no longer be collected

67 According to the KNF, the average rate of return for 2018 was a negative 9.6 percent while in the previous year it reached a positive 18.8 percent, and in 2016 a positive 10.2 percent [KNF 2019: page 23].

68 Published in the Bulletin of Public Information (BIP) of the Council of Ministers and the Chancellery of the Prime Minister on 22 June 2019.

69 According to the Act of 27 May 2004 on Investment Funds and Management of Alternative Investment Funds.

70 Including the accompanying amendments to other acts, explanatory memorandum, and regulatory impact assessments, the draft has over 300 pages. In the description of the provisions of the Act I mainly used its extensive explanatory memorandum.

on receipt of assets. After the transfer of savings from OFEs to individual accounts in SFIOs, no retirement contributions will be transferred to these accounts anymore except for voluntary contributions of their participants. Such payments may be made by an SFIO participant on the basis of a separate agreement. The previous part of the pension contribution that was transferred to OFE will now be transferred in full to sub-accounts in ZUS[71]. Assets accumulated in SFIO and accrued returns on investing these assets will be paid to participants after reaching retirement age in full or in several instalments, excluding tax. These assets are subject to inheritance. The owners will not be able to access these assets earlier, except for the case of inheritance. The Act does not specify methods or deadlines for paying these assets.

Restrictions on investing in foreign assets (with a ceiling of 30%) and other prudential regulations were imposed on the TFIs that manage these assets. Asset management fees may represent at most 0.45% of the managed assets[72]. SFIOs will also be obliged to pursue an investment policy suitable to the age of its participants by creating pre-retirement sub-funds with a greater share of debt instruments and gradually transferring assets to them as the participants approach retirement age. This provision will perform a similar function to the current safety zipper, except that these assets will not be transferred to ZUS, but will remain in the capital pillar until the participants reach retirement age.

In the second case (further referred to as the insurance option), by 10 January 2020[73] former OFE participants must submit to the OFE a declaration on the transfer of assets accumulated in their accounts to the Demographic Reserve Fund (FRD), which is administered by ZUS. This decision will be final. If a decision is made to transfer savings from OFE to ZUS, there will be no transformation fee nor right of inheritance; the appropriate amounts will be recorded in the pension accounts, and the assets will be transferred to the FRD. A tax will be levied at the time of collection of the pension by the participant.

The draft law also includes a provision according to which assets accumulated on individual capital accounts (previously in OFE) of participants who did not transfer their savings to ZUS are to be taken into account when calculating minimum pension from ZUS. At present the pension supplement (that allows the pension to reach the level of the statutory minimum) is due until the end of life in situations when a participant (who has a minimal

71 According to the elucidation of the Minister of Investment and Economic Development Jerzy Kwieciński [Dziennik *Gazeta Prawna* of 28 May 2019], the entire former 7.3% OFE contribution of the capital option choosers will be transferred to an inheritable ZUS sub-account that will be subject to another (more favorable) way of indexation than in case of the basic account. The choosers of the insurance option will have their entire contribution transferred to the main account in ZUS.

72 The fee may amount to a maximum of 0.2% in case of the pre-retirement sub-funds.

73 This deadline must be adjusted in accordance with the postponement of the date of the Act's resolution.

seniority) has not saved sufficient capital only on their retirement account, whereas in the future this pension supplement will be calculated on the basis of the sum of contributions in ZUS and in the capital account. This has already been criticized as a worsening of the situation of the participants [Kostrzewski 2019]. However, this provision can be logically justified by the fact that contributions to OFEs in the past reduced the inflow of contributions to ZUS, so they should be fully taken into account when calculating pensions.

A novelty in the draft Act is the proposed regulation that specifies that the assets in the FRD (a fund separated from the FUS) will not be solely managed by the ZUS, but by a TFI whose sole shareholder is the Polish Development Fund (PFR). However, according to the draft Act ZUS will act in a supervisory role. According to the proponents of the draft, the Act should enter into force on November 1, 2019. However, due to the electoral break in the work of the parliament the act was not passed on time, so its implementation is expected to be delayed by several months[74].

During the consultations on the draft, first and foremost a postulate was emphatically voiced that in order to prevent concerns about the possibility of nationalization it should be explicitly written into the Act this time, in analogue with the PPK Act, that assets accumulated in IKEs under the SFIOs are the exclusive private property of account owners[75]. Another aspect was also being pointed out: in the absence of institutional provisions that allow capital saved in private accounts to be converted into lifetime pensions, said capital may be expended in the first years of retirement, leaving participants only with low ZUS benefits in their last years of life. Other doubts about the draft "Transfer" Act reported during the consultations related primarily to the short decision time, restriction of freedom on entering the system (the default option), and, given such parameters, to profitability of choosing IKEs over transferring all contributions to ZUS. As the ROI of the funds or the level of the indexation of ZUS contributions are not known in advance, it is difficult to assess which option is more profitable for the employee. Based on recent years of relatively high pension valorisation, there is a high probability that the insurance option will prove to be superior, but this may change depending on political decisions regarding the valorisation level[76]. Thus, the relevant choice will be a kind of lottery. There will be also

74 With the exception of Article 26i, which provides for the possibility of merging an IKE created from a transfer from OFE with another IKE owned by the participant; Article 26i is to enter into force 24 months after the date of the Act entering into force.

75 This proposition was issued by both trade union and business representatives. [DGP Editorial Discussion 2019].

76 The simulation presented by the Rzeczpospolita gazette shows that the transfer of the same amount of PLN 10 thousand by a 40-year-old person to ZUS and to IKE, assuming that the rate of return on capital and valorisation in ZUS will be equal (5%), will provide the participant who will retire after 25 years of work with a higher monthly supplement to the pension in ZUS than in IKE (respectively PLN 134 and PLN 122). [Skwirowski 2019a].

little time to decide (only two months) and the choice of transferring assets to ZUS will be irreversible.

There are also numerous reservations raised as to whether it is justified and expedient to charge the OFE participants with the 15% conversion fee for the FRD. Participants choosing the government-supported capital option (as more favourable to economic development) that theoretically has a higher probability of being profitable will, however, be exposed to higher risk (due to uncertainty of the capital market), so they should be particularly incentivized in favour of this option. But the draft Act lacks such incentives.

Also raised in the discussion is the fact that should the participants opt for SFIO instead of ZUS the state budget will obviously benefit (due to the transformation fee of possibly as much as PLN 19.3 billion), [Kostrzewski 2019] which means that the government is not selfless in its nudging in favour of the capital option. If the government was guided solely by the lofty intentions enumerated in the Explanatory Memorandum to the Act (e.g. higher future pensions, higher savings bringing about higher investment and economic development), instead of its own immediate budgetary interest, then rather than charging the fee upfront, at the start of the new system, the government should either delay charging the fee until the moment of collection of savings[77] along the lines of regulations of ZUS pensions, or waive its collection completely thus creating a strong incentive to choose the capital option[78].

The statutory proposal of ZUS handing over the responsibility of managing the FRD to the aforementioned TFI whose sole shareholder is the state-owned PFR also met with strong criticism of trade unions and some experts. FRD currently manages PLN 40 billion and will additionally receive contributions from OFEs transferred to ZUS. Critics believe that the ZUS is effective in managing the fund in its role of a special purpose fund designed to ensure increased security of the solvency of contributions from FUS. They stress that comparisons of international stable growth funds confirm this and that the proposed change is unnecessary and even harmful. It may undermine the system's

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77 Such a proposal was presented in consultations by the Polish Confederation Lewiatan [Skwirowski 2019].

78 Such government representatives as PFR's Vice President Bartosz Marczuk (voiced in an interview on Radio TOKFM) claim that the fee is neutral relative to the amount of savings, because it would have to be paid either now or on pension collection, and 15% corresponds to the effective rate of pensions tax . This is demonstrably false, as the result of multiplying the total amount of savings by interest will be greater than interest on smaller amount of savings reduced by the fee. Marczuk also suggests that we should agree on the fee as it is, as it were, a lesser evil, because the government abstains from taking all the funds from the OFEs even though according to the ruling of the TK it could have. The argument is simply cynical. In his interview Minister Kwieciński suggests similarly that "many of his colleagues in the government would be satisfied if 100% of OFE funds went to ZUS" [Kwieciński 2019].

integrity, leading to objectionable decisions such as investing in projects that do not ensure adequate ROI [Wiktorowska 2019; Skibińska, Kostrzewski 2019][79].

The authors of the draft assume that as much as 80% of OFE members will choose the capital option. This seems dubious given the government's undisguised intentions to profit from the transfer on the one hand, and the already undermined trust in the state due to its previous treatment of capital form of pension saving. OFE participants remember well that five years ago they were also faced with a default option of an opposite transfer; back then, the ZUS was suggested as the "better" option, while the name of investment funds was dragged through muck and mire. The individual savings of the participants in the OFEs were halved on the occasion. How can they trust now that this time it will be different? Moreover, in fact none of the options offered to the OFE participants by the government is favourable for the former, so the participants will have to choose a subjectively lesser evil. It can be assumed, however, that a significant part of persons with assets in OFE will risk staying in the capital pillar, provided that the act clearly states that the content of the account will stay private.

At this point it is worth considering what will happen in the economy if the majority of OFE members will choose the insurance option. This would result in the OFE assets being taken over in cash and in shares of private enterprises by the state ZUS. According to the latest data, the OFEs still hold shares of domestic companies worth PLN 114 billion [DGP Editorial Discussion 2019b]. This would mean an increase in the state sector by a value comparable to the current value of the State Treasury shares in the public companies, so it would mean nationalization of the economy at a large scale with all its well-known negative effects.

There is yet another aspect of the matter. Transferring the entire pension insurance contributions to the ZUS raises a question: How will the savings on the individual capital accounts of SFIO members increase? After all, one of the main shortcomings of OFE after 2014 cuts was the insufficient inflow of new contributions. Is all this organizational effort to be put into funds that cannot possibly develop? Judging by the side threads in statements of policymakers that drafted the reform and by certain statutory backdoors[80], to ensure the inflow of new capital there are plans for some kind of coupling of PPKs that are currently being created with assets accumulated in the OFEs and managed by the new TFI. This is because it seems unlikely that individual, voluntary contributions from participants could fill this gap. Thus, the idea of actually increasing the pension contribution for the capital

79 Besides trade union representatives, the president of the Pension Institute Antoni Kołek voiced critical arguments as well.

80 I am referring to the Article 26i of the "Transfer" Act, which provides for the possibility of coupling an IKE created by the transfer from OFE with another IKE owned by a given person; the Article is to enter into force 24 months after the Act will enter into force.

pillar would be implemented indirectly, which was not done in 1999. This may be an explanation for the mysterious silence regarding the relationship between the two enterprises.

Even if there will be no direct link between the PPK and the "new OFE", both programs remain clearly connected in public consciousness. The way in which the government will ultimately divide and redirect the material legacy of OFE will significantly affect the public trust in the new PPK program and will strengthen or weaken public faith regarding the advisability of additional saving for retirement. To restore this trust and reverse social losses caused by the "partitioning" of the OFE in 2011–2014, it would be advisable not only to abandon the transformation fee, as was suggested above, but to do more to actually rebuild the capital pillar.

One such proposals posited by Andrzej Rzońca [Rzońca 2018] is to allow to transfer back the assets in ZUS' sub-accounts of OFE participants (corresponding to the contribution "taken" from OFE) to their individual retirement accounts in treasury bonds after a prior guarantee that these accounts are private. According to the Rzońca's proposal such bonds could be converted in the future into the shares of State Treasury companies. In addition, bonus shares could be obtained to reward work lasting many years or working after retirement age. Given that by April 24, 2019 almost PLN 400 billion was held in ZUS sub-accounts [Chądzyński, Osiecki 2019], it is hard to imagine that the current government would take such an initiative. However, this proposal is well-worth considering in the future.

4.2. Existing voluntary, private pension saving schemes and their limitations

It is necessary to briefly describe here the history and the condition of voluntary institutions of the third pension pillar in Poland. When the pension reform was introduced in 1999, a legal framework was created to enable and encourage the accumulation of additional voluntary pension savings, in addition to savings from contributions for the first and second pillars. The PPEs established in firms were supposed to perform the role of the institutions collecting these funds. The initial idea was that employees were to pay contributions, and the employers were to organize the entire scheme. But after a year the idea was abandoned in favour of the employers paying contributions, with possible voluntary contributions of employees. The minimum contribution amount is currently 3.5% of the gross salary of each employee (the maximum is 7%), and the condition for registering a PPE is for the minimum of 25% of employees of a given firm to subscribe to it[81]. The PPEs are usually managed by external financial institutions such as investment funds, insurance companies, or (rarely) employee pension societies in companies. Each PPE must be created with the active participation of employee representatives and with their approval; this also requires registration at the Office of the Polish Financial Supervision Authority (UKNF) and is subject to its supervision. Few employers decided on such voluntary schemes in the first years of the 21st century, when high unemployment made it unnecessary to solicit employees with special bonuses. However, the number of the schemes gradually increased, especially in larger, wealthy businesses that were interested in finding skilled professionals and were able to afford them. The number of the schemes plateaued over the past few years. According to the KNF, at the end of 2018 1230 schemes accumulated PLN 12.7 billion in assets and had 425 thousand participants [KNF 2019: p.26; KNF 2018]. It was obviously a small percentage of the market compared to the OFE sector with 16 million participants and assets worth PLN 160 billion. However, interest in PPEs increased immeasurably after October 4, 2018, when the specific shape of the Act on Employee Capital Plans that makes PPKs mandatory was made known. For various reasons, many employers preferred PPEs, which exempt them from participating in the PPKs. According to the KNF, at the turn of the year the number of applications to the PPE register swelled: 254 applications were submitted and 108 decisions on entry in the register were issued from October 2018 to February 2019[82]. By mid-July 2019 the number increased to 1551 PPEs (usually in large businesses), and is expected to continue to increase. But why would businesses get involved in the PPEs in spite of its larger costs for the employer in comparison with the PPKs?[83] One of the reasons is that PPEs shed a positive light on businesses of ones that fight for skilled employees on the labor market. The employees perceive the PPEs as advantageous, because the contributions are paid by the employer and any additional contributions of the employees are voluntary. What's more, the employee has the right to co-decide on the selection of the sub-fund in which their contributions will be collected (unlike in the PPKs). In addition, the total amount of the ZUS contribution paid by the employer is not included in the PPE contribution calculation basis, and investment profits and withdrawals from PPEs are exempt from capi-

81 The Act of 20 April 2004 on Employee Pension Schemes, Journal of Laws of 2004 No 116, item 1207, amended by the Act of 4 October 2018 on Employee Capital Plans is the legal basis for the PPE.

82 In 2018 alone, 292 applications were submitted, 206 new PPEs were entered into the register, 64 employers subscribed to the inter-company schemes registered in KNF, and the amount of accumulated assets increased by PLN 92 million during the year. For comparison, in the entire 2017, 48 PPE were entered in the register and 77 applications were submitted. [KNF 2019: pp. 26, 121; Skwirowski 2019c].

83 According to some calculations, the payment of the PPE contribution of 25% of employees is the equivalent of the payment of the PPK contribution of 78% of employees. [Skwirowski 2019c].

tal gains tax (similarly to the case of PPKs). PPE participants have complete control of their assets after retirement: unlike in the case of the PPKs, they can make a cash withdrawal or invest the assets freely. There are also several important advantages of PPE for the employer: Firstly, in contrast to the upstart PPK, the concept has been well-known and proven for many years. Secondly, a PPE is quite simple and easy in terms of financial reporting, and thus constitutes a much lower administrative burden on the entrepreneur resulting in lower costs. Thirdly, in case of a PPE, if oversights or failures to meet deadlines are not removed within a specified period, the financial penalty imposed by the UKNF is small (up to PLN 50 thousand), while in case of a PPK the penalties for the same infringements are draconian (up to PLN 1 million or 1.5% of the firm's remuneration fund). What's more, in contrast with the PPK contributions, PPE contributions can be temporarily suspended or reduced in the event of temporary difficulties experienced by the company. Generally speaking, PPEs are built from the bottom up and tailored to the individual needs of companies, and are thus more flexible and intelligible; the resulting lower risk for the employers makes businesses more eager to prefer PPEs. However, PPEs are not widespread enough to be a serious source of protection for larger sections of society in their old age.

IKEs (introduced in 2004) and IKZEs (introduced in 2012) are another form of private pension saving – an individual form. As the PPEs did not develop well at the beginning, other options were introduced; one such option allowed citizens to set up individual accounts for pension saving and to receive capital gains tax exemption for their annually-capped contributions. The accounts were managed by insurance companies, investment funds, brokerage houses, banks, and DFEs. At the end of December 2018, there were 995.6 thousand IKEs and 730.4 thousand IKZEs, with respective asset value of PLN 8.7 billion (IKEs) and PLN 2.3 billion (IKZEs) [KNF 2019: p. 28]. In 2018, there were four times more owners of these accounts than the PPE participants (1.7 million and 425 thousand, respectively); collectively, both groups held about the same amount of assets (PLN 11 billion and PLN 12.7 billion, respectively).

Given the recent rapid development of the PPE sector, it can be assumed that the number of the PPE participants will double[84], further increasing the amount of the assets in the scheme. However, according to the KNF, most PPE, IKE, and IKZE participants are wealthy persons in the last income deciles[85], which means that this version of the third

84 However, the entities that are required to introduce the PPK (in consecutive installments) can no longer set up new PPE programs.

85 According to the KNF, 90% of IKZE contributions deducted from tax for 2012 were paid by participants in the last two income deciles (i.e. 20% of the highest-earners). [KNF 2016: p. 62]. The authors of the cited report suggest that the tax reliefs adopted here do not contribute to the new savings, but rather shift the allocation of existing or planned savings wherever these reliefs apply.

pillar does not solve the problem of poverty of retired low-wage earners. As I noted earlier, the solution it is also not a sufficiently widespread.

4.3. Employee Capital Plans: the concept and the instruments

The 2018 Act on Employee Capital Plans[86] is designed to be universal and to cover all persons of a certain age that work in the country and contribute to ZUS. The Article 3 of the Act states that the PPK is created for the purpose of systematic accumulation of savings by the PPK participants to be repaid upon their reaching the age of 60 (and for other purposes specified in the Act), and that assets held by PPKs are private property of PPK participants[87].

Participation of employees in PPKs is voluntary but default, meaning that an employee unwilling to participate must declare it in a statement within certain time limit, and renew it every four years. In absence of the statement, the employee enters the scheme automatically.

On the other hand, participation in PPKs is compulsory for employers, and within two years starting from July 2019 subsequent tranches of companies (from the largest to the smallest) are to participate in the scheme, except for public finance sector entities (regardless of their size) that will enter the scheme in 2021[88]. In the first tranche, businesses with more than 250 employees are to enter the program between July 1, 2019 and January 2020. It is estimated that this tranche includes about 4100 largest companies[89].

Subject to the automatic subscription to the scheme are employees working under not only contracts of employment, but also under civil law contracts, provided they have worked for their company for three months (in total during the year) and have reached the age of 55[90]. Contributions to PPK will flow from three sources: employees contributing at least 2% of their net salary[91] per month, employers contributing 1.5% of each

86 The Act of 4 October 2018 on Employee Capital Plans, Journal of Laws 2018, item 2215.

87 With the condition that in the event of earlier withdrawal of the assets the part funded by the state will be returned.

88 The smallest companies with up to 10 employees may be excluded if all their employees submit a declaration that they do not wish to subscribe to the PPKs. All companies with PPEs that meeting PPE conditions on an ongoing basis (contribution of 3.5% of the salary of each participant and 25% of employees participating in a scheme) are also excluded.

89 After deduction of approximately 1,500 companies that opted for the PPE.

90 Persons aged 55–70 can participate in the program at their own request.

91 There is a slight confusion about the contribution calculation basis, because according to law the contributions will be charged on net remuneration, i.e. after taxes. In spite of that, they will be calculated on gross remuneration, after deducting ZUS contributions.

employee's salary each month, and the state budget[92] contributing a one-time welcoming payment of PLN 250 and an annual contribution of PLN 240 for each PPK participant. The employer and the employee may additionally declare higher contributions (up to 3% and up to 4%, espectively). Employees earning less than 1.2 times the minimum wage may be periodically exempt from the full 2% contribution and pay 0.5% of the salary. The employee may resign from participation in PPK at any time, which will result in suspension of payment of further contributions by the employer. The participant's account will, however, remain in the system, unless they request an earlier withdrawal (see below). The employer is obliged to prepare employees for the introduction of PPK by providing them with objective information and agreeing upon detailed rules of the scheme with the employee representatives; it is worth to mention that discouraging employees from subscribing to the program is highly penalized.

The contributed assets will be managed by specialized financial institutions (TFIs or insurance fund companies) registered in the relevant records and fulfilling quite demanding requirements regarding their financial resources and past experience on financial markets. Employers are required to choose a specific financial institution within a statutory deadline, to sign a PPK management contract with the institution (with the participation of employee representatives), and then again to sign a PPK administration contract being a detailed continuation of the former agreement[93]. If the employer ultimately fails to enter into a contract with the financial institution of his choice, said institution may be designated by the PFR overseeing the entire program, provided that PFR holds over 50% of its shares.

Financial institutions that administrate PPKs must create a certain number of *defined date sub-funds* (most often it will be eight to nine funds) to operate a PPK in a given business. Employees of a similar age will be assigned to individual sub-funds so that different investment risk policies can be applied to them. The Act details proportions by which individual defined date sub-funds are to allocate their funds into various types of asset investments[94]. The Act specifies methods of communication between PPK participants and financial institutions running PPKs; the communication is to be predominantly electronic. It is forbidden under the threat of high financial penalties for the financial institutions to use unreliable advertising and provide misleading information. PPK management costs were set at a low level: the management fee may not exceed 0.5% of a fund's net asset value, the performance fee may not be exceed 0.1% of net value of the fund assets, and the performance fee may be charged only provided that an annual rate of return exceeds

92 More specifically from the Labor Fund.

93 Failure to enter into contract on time and to perform other obligations under the Act are subject to penalty of 1.5% of the remuneration fund or PLN 1 million.

94 The Act devotes as many as seven pages to the investment policy of the PPKs.

the reference rate determined by the relevant minister[95]. The Act sets out in detail what types of costs in addition to management costs can be covered with a PPK's assets. Supervision over PPK's compliance with the law and the interests of PPK participants in its operations is to continue to be formally exercised by the official supervisory body (i.e. the KNF); the scope of the required reporting of financial institutions is to be particularly comprehensive and detailed. The Employee Capital Plans Registry is to be kept by the PFR. The Registry includes four types of records: of financial institutions managing the PPKs, of enterprises that have contracts with the PPKs, of PPK management contracts, and of individual PPK participants. In general, legal solutions ensure that the PFR will have detailed information on all aspects of the implementation of the scheme and will have effective control over it. The PFR's decision regarding an entry to the registry (e.g. an entry of a financial institution) is not a mere formality; PFR's assent is required. PFR's approval is required as well in case of data on company pension schemes and on cash flows on participants' accounts. Therefore, the PFR is the central "commanding" unit of the PPK, and it materially benefits because of this. Financial institutions are required to pay a monthly fee to the PFR account for the upkeep of the Registry and other PFR's duties. The fee, however, may not exceed 0.01% of the annual net value of assets of all funds of the defined date sub-funds managed by a particular financial institution. In addition, the Act announces the creation of a PPK information portal at PFR, to which financial institutions are to pay a welcome and annual fees.

The disposal of the assets deposited in the PPKs by the participants may take various forms. After 60 years of age the participant may collect 25% of the assets in cash, and the remaining 75% will be spread into at least 120 monthly installments. Such participant may also make a transfer withdrawal to an account in another PPK, in an insurance institution, or to a term deposit in a bank, provided that any cash withdrawal will be carried out by these institutions in similar installments and schedule as in case of cash withdrawals from PPKs. The participant may demand the withdrawal in fewer installments, but this, however, will involve certain costs. Similarly, if a participant decides to cease their participation before the age of 60 and requests cash withdrawal, they will have to reimburse all payments made by the state to the Labor Fund account, transfer an equivalent of 30% of the assets received from the employer on behalf of their IKE to the ZUS, and pay the capital gains tax on the remaining amount. At the request of a PPK participant before the age of 60

95 Pursuant to the Article 49 of the Act (paragraphs 11 and 13), the reference rate is determined taking into account relevant objective economic factors, in particular the rate of return on securities issued by the State Treasury. The method of determining the reference rate and the detailed method of calculating the remuneration for the result will be determined by an ordinance issued by the minister competent for financial institutions, taking into account the effectiveness of the investments made.

in the event of their or their close family members' serious illness, the participant may withdraw up to 25% of the assets accumulated in their account. Another option is a withdrawal of up to 100% of the assets in case of participant building a house or buying a flat, provided the participant is under 45 years old. Moreover, the nominal value of the assets must be transferred back to the account within 20 years. The Act also specifies in detail withdrawals by family members in the event of the death of a PPK participant. The Act also provides a possibility of combining benefits of a participant and their spouse in the form of a marital benefit until the exhaustion of assets in both accounts. The PPK Act, similarly to the previously discussed draft "transfer" Act, is very detailed and tries to regulate all possible states of reality, which does not seem to be the best solution from the point of view of legal transparency. The Act itself has 75 pages, and together with the explanatory memorandum and accompanying documents the number swells to 455 pages.

5. Pros and cons

The intention of the PPK Act is to force the part of society that consumes all its income immediately and has no habit or does not perceive any possibility of saving its part for later consumption into saving for old age. While saving with intention to purchase flats or other durable goods is quite common in Poland today, pension saving remains an uncommon thought for most of the population, especially among young persons. 2016 research by J. Czapiński and M. Góra showed that only 21.5% of working Poles saves for old age and these are high-earners at that. The lowest-earners (within the two first deciles of income) have no income surpluses for such a purpose, but other low- or medium-earners are able to save and even declare such readiness provided that their savings would be partially subsidized by employers or by the state budget [Czapiński , Góra 2016]. The preexisting lack of providence probably stems to a large extent from the lack of economic education and disregard for disturbing demographic data about trends of dependency ratios for the next 20–30 years in our country. It seems that the additional reason is the faith in the state somehow solving the problem in the same way as it has always done. In contrast to societies in many of the other formerly socialist countries (in particular of post-Soviet ones), Polish society lacks examples of the ZUS suddenly interrupting payment of pensions for months or years; in the last few decades it was also never necessary to reduce pensions by half or more (as it happened in Greece or in the Baltic States after the 2008 crisis). Even in the period of high inflation at the beginning of the transformation period in Poland efforts were made to secure the basic pension indexation. Currently, the replacement rate exceeds 50%. Therefore, many citizens probably assume that at present there is no need to worry, as in the future the government will make some redistributive actions in favor of pensioners or that it will otherwise prevent the system from collapsing, e.g. by raising taxes. In spite of that, some young people hold an opposite view that neither the ZUS system nor the capital system can withstand the expected demographic trends, and as such is unable to provide financial security for old age. This is why, the thinking goes, each individual has to privately secure oneself by avoiding or minimalizing paying contributions to these systems today [Kolany 2019]. Both attitudes have a destructive effect on the motivation to save for old age.

And yet the reality is implacable: if the ratio of pensioners to employees falls to 1:1.5 or 1:2, as suggested above, then the contributions cannot possibly finance pensions. The principle of the defined contribution in the pay-as-you-go system means the amount of pensions received depend on the amount of paid contributions; and according to estimations in 20–30 years the replacement rate will not exceed 30% [OECD 2017: p. 29], in contrast with the current 50–60%. Same OECD study shows that in countries where voluntary pension saving schemes have been widespread for years (e.g. USA, UK, Ireland, Canada, Japan) there is a very large gap between the replacement rate in the compulsory pension system and the replacement rate in both systems (e.g. rises from 20–30% to 60 and even 80%). All this leads to the conclusion that further saving for old age in addition to the mandatory ZUS system is necessary to prevent relative poverty in old age. This is why an attempt to solve this problem by law and in a universal manner is reasonable. Even assuming that it may not be possible to include the lowest-earning part of the population in this saving scheme because of its voluntary nature, and consequently that this group will have to accept its reliance on the minimum pension, it remains a good idea to include in the scheme the remainder of society (with a large share of middle and low income groups).

The question arises, however, whether the particular solution that was applied is appropriate and whether it will be effective not only in terms of the adequacy of the institutional solutions used to the goals set, but whether it accounts for machinery of human action, which is not always rational in the colloquial sense of the term. A deeper consideration is whether the solutions designed in this way are honest in their intentions towards the persons they concern and whether they hide some other goals of their designers not discussed here.

One of the first issues coming to mind is the default principle applied by both the PPK Act and the draft "Transfer" Act. The point is that the participant in the emerging SFIO or PPK does not consciously and voluntarily decide to join these programs, but is automatically enrolled in them. The option of unsubscribing has a cost of making some intellectual and organizational effort on his part. This is based on the nudge theory formulated by an American behavioral economist and the 2017 Nobel laureate Richard Thaler [Thaler 2018]. The theory is based on a conviction that instead of using negative stimuli or regulations, it is easier to encourage people to behave as expected by creating a better *choice architecture*, i.e. to set circumstances encouraging them to make certain decisions.

The reason for automatic enrollment in the PPK plan is to encourage as many people as possible to start saving for old age. Many foreign studies show examples (cited by the popular portal *wynagrodzenia.pl*) [Kulikowski 2019] of introduction of automatic enrollment significantly increasing the number of participants in pension programs and seemingly having stronger positive effect on the rate of savers than the tax reliefs on saving. In result, numerous arguments exist in support of the idea that such default provisions mobilize the so-called "passive savers," and thus have a much greater probability of increasing the percentage of savers. Conclusions made by the authors of both TEP (Towarzystwo Ekonomistów Polskich) reports on the additional pension system in Poland [TEP 2014 and 2016] are similar.

However, one may wonder of the extent of the ability of the creators of Polish pension saving schemes to predict the consequences of these decisions that are in fact taken for the persons concerned. Can it be assumed with a high degree of probability that capital programs designed in such a way will provide future pensioners with a significantly increased benefits and is the risk of investing capital in them somehow guaranteed by the government[96]? Finally, one may ask whether the information about these schemes is transparent enough to give participants any chance of choosing alternative ways of saving[97]. Thaler's theory assumes that the designers of public policy are guided by the public good and are only concerned with improving the functioning of society and the state. While analyzing the principles of the PPK as well as the draft "transfer" Act, it is difficult not to notice that in both cases the default provisions nudge into behaviors that are aligned with the running interests of the government [Skibińska, Kostrzewski 2019][98]. Moreover, both schemes are strongly associated with the interests of their originator and patron (PFR). Besides presenting the arguments regarding the need to save for old age, the explanatory Memorandum to the Act strongly emphasizes the role of the PPKs in the Capital Building Programme (CBP) as a factor in increasing the savings rate in order to accumulate investment assets. There is no certainty, however, as to whether the intended goal is to support the development of the entire capital market that would allocate assets in the most effective uses in the economy, or whether PPK is designed primarily as a "short cut" to provide asset inflow into a governmental investment vehicle with great ambitions, i.e. the PFR, which is also to exercise control over the entire PPK. In this context, it is worth mentioning that at present (early November 2019)[99] we already have data on the kind of financial institutions that have signed the most contracts on PPK administration with large

96 One of the critics of the default choice of capital provisions is Piotr Kuczyński [2019]. Restrictive regulations of the investment portfolio of future funds raise many doubts among other authors as well. Such regulations force the PPKs to invest mainly in Polish shares and treasury bonds, thus significantly limiting the possibility of receiving high returns on these investments [Kolany 2019].

97 Sebastian Stodolak voiced these and other doubts in his article ["Poszturchiwani"] "the Nudged" in June 2019 in the Dziennik Gazeta Prawna, and in the same pages the discussion is continued by Agnieszka Wincewicz-Price and Paweł Śliwowski in their article "Wspierać, a nie poszturchiwać" ["To Support, not to Nudge"].

98 Besides, similar default solution was used in 2014 in order to transfer funds from OFE to ZUS.

99 The article was written between July and August 2019, but it's editorial work was conducted in late 2019 and in the beginning of 2020.

enterprises. It turns out that half of the large enterprises in the first tranche (2,541 enterprises) have signed contracts with PKOTFI, TFIPZU and Pekao TFI [Skibińska 2019], which are owned by state banks. Not to doubt the professional capacity of these companies in managing funds, one can be concerned though about the criteria for allocating their investments in future.

Another important issue that needs to be addressed in this context is the rather unreliable agitation by the government and by the PFR. Rarely are the presentations on the benefits of both schemes accompanied by a remark that PPK or the new SFIO are not full pension schemes but only supplementary saving schemes for old age. The latter do not provide pension benefits until death, but only until the funds are exhausted; what's more, they are not guaranteed by the state or indexed as in case of ZUS pensions. As the payment of these funds after reaching the age of 60 is to be spread over 10 years, after that the PPK participants will find themselves in a much worse financial situation and this should be countered. Given the lack of clear information, the expectations of the future participants of these schemes may be excessive and will thus fail to encourage an increase in the pool of additional private pension savings (other than the existing schemes). Gradual increase of such savings should be suggested. Painting an inflated image of contributions by the employers and by the state as a source of some extraordinary benefits seems somewhat misguided as well. The compulsory employer contribution will usually replace a salary rise, and the state contribution subsidy comes indirectly from taxes.

What may be surprising in this context is how small in reality are the benefits that the participants of both schemes (SFIO and PPK) can actually expect. As discussed above, in the case of the conversion of OFE into SFIO neither of the two proposed solutions is financially beneficial for the participants. The state, in turn, will receive from each potential member of SFIO a 15% transformation fee that constitutes a quasi tax with an estimated total value of over PLN 19 billion (which have already been taken into account in the future budget for 2020)! Abandoning this peculiar 15% fee that in fact constitutes a tax on partaking in the capital program would encourage choosing this option, which is not even considered in the discussion. Therefore, income tax at the exit (at receiving pension at retirement) should be seriously considered as the solution, as is applied in most foreign voluntary pension programs and in the same way as the tax is collected on ZUS pension. Firstly of all, the tax collected on entry is discouraging. Second of all, it is unfair, because it robs future generations of future taxes. In addition, avoiding naming it a tax is ambiguous and dishonest. This solution brings to mind prepayment for cars in a "rightly past" communist system, which we would like to forget about.

Similarly, in the PPK program the employee contributions should be exempt from income tax at least at the entrance to the system (in whole or in part), as is practiced in most countries that have introduced semi-mandatory pension savings (e.g. in the UK, which was taken as an example in the development of the Polish PPK). Meanwhile, in the PPK program, the employee's is supposed to pay his 2% contribution on the wage after tax (but it is calculated on the basis of gross wage), and the payment by the employer on behalf of the employee must also be taxed first before it reaches the employee's account. The subsidy from the state budget (PLN 20 per month) is minuscule next to payments of employees and employers, so its role is not as important as it is being portrayed. Combining the default principle with the tax relief and possibly a slightly more generous state subsidy would be a much more motivating solution than the current one. It would prove that the government really cares for the accumulation of the savings and that it wants to bear a part of its cost[100]. An analysis of existing provisions, however, leads to the conclusion that the government puts too little effort into encouraging pension savings, and when it does, it is mainly at someone else's expense. As for the employers, however, instead of incentives, coercion and penalties were applied[101].

It is rarely discussed how much of a challenge for employers is the PPK imposed on them. Top-down and rigid and regulated in detail systemic provisions that do not match the specific conditions of each company are always worse than those built from the bottom up. In addition to the partial payment of contributions by employers, which from their point of view constitute an additional tax, they will have to bear enormous organizational effort and high administrative costs[102]. This will be a particularly heavy burden for smaller companies. Designating PPK costs as tax-deductible is not enough to create a sufficient incentive. Draconian penalties for untimely or improper performance of duties are inconsistent with the provisions of the scheme. The option of transferring some of the obligations to financial institutions does not relieve the companies of their responsibilities, but rather generates costs. There is a striking asymmetry in the PPK Act between the entrepreneurs and all other PPK parties in that the incentives for entrepreneurs are greatly outweighed by their obligations and responsibilities in comparison to those of other parties. Why are entrepreneurs forced to bear the entire burden of saving for old age? There is no comment on that in either the Act or in the government statements.

100 The budgetary cost of supporting additional pension savings in countries with developed systems (e.g. Sweden, Finland, New Zealand, or the United Kingdom) ranges from 0.4 to 1.5% of GDP [TEP 2016].

101 Without coercion, participation in the PPK program would be rather unprofitable for entrepreneurs given regulatory conditions, because a fiscal cost of one zloty spent on the scheme exceeds that of one zloty spent on salary. The zloty in the pension fund is always "worse" than the net salary zloty, so it must cost less [Wiśniewski 1997].

102 According to recent estimates the introduction of PPK will increase the payroll fund in enterprises from 0.5% to 3%. Additional costs include selection of the managing institution and adaptation of the IT systems [Skwirowski 2019]. Businesses will also have to repeatedly register the status of employees on civil law contracts according to their total annual seniority in the company and the number of employees in separate age groups that subscribe to different sub-funds.

But what is the reason for lack of criticism on the part of the businesses? It seems that the entrepreneurs understand and accept the two objectives of the program: the urgent need to increase the savings rate in the economy, and the need to increase savings for old age. This induces them to take part in achieving these goals.

To recapitulate, I believe that the goals of introducing an institution of additional savings for old age are legitimate and worthy of support, both for social and economic reasons. But the particular solutions offered by the state are inadequate and subordinated mainly to the current interests of the government; as such, they do not allow for optimism as to the success of their implementation measured by broad and permanent employee participation in the PPK.

Conclusion

The aims of the present article was to analyse the systemic solutions applied in the PPK in light of the concept of a simultaneous reconstruction of the OFE sector, to present arguments for and against these undertakings from the point of view of various actors, and to attempt to assess the chances of success of the changes that are currently being introduced.

Above, I tried to present the factors that, in my opinion, will have an impact on the behaviour of the main participants of the system in their decisions to join and to remain in the PPK. In my opinion the analysis shows that the systemic solutions designed by the government fail to create sufficient incentives for potential participants to encourage their participation, which will result in significant rate of resignations (after the automatic enrolment). The rate of resignations will probably continue to increase in the next tranches of the program along with the gradual decrease in the size of entering enterprises, in which earnings are lower and for which the PPK will constitute a high financial and administrative burden.

Finally, I reexamine the issues raised in the first part of the article from a perspective of the entire pension security system, and conclude by formulating several postulates on the basis of the ideas contained therein. Firstly, consider the lessons learned from the mistakes of the 1999 reform.

The lack of consistency and firmness in implementing the reform (in particular the parts that required the abolition of privileges of some groups) led to a failure to balance out its fiscal effects; this, in turn, has led to a gradual reduction of the capital part of the system.

Too optimistic assumptions as to the financing of the pay-as-you-go part of the system have allowed the premium for the capital pillar to be set on an excessively high level, which further destabilized the system. The failure to clearly define the nature of the OFE premium ownership (i.e. whether it was private or public) incentivized OFE participants to lose their confidence in the system.

Very high limits on fund management rewards and inadequate evaluation mechanisms resulted in disincentives and superfluous costs. The drastic reduction of possibilities for investment in foreign markets forced the funds to depend on comfortable though less profitable domestic investments.

The increase in retirement age that was necessary for demographic reasons was carried out in a way that failed to gain the acceptance of the bulk of society, which allowed the next government to reverse it.To add insult to injury, the 1999 reform marginalized the so-called third pillar, i.e. the (individual and group) voluntary capital pension saving, failing to provide sufficient incentives for their development [Szumlicz 2014].

One evident and major achievement of the 1999 reform was the successful transition from the defined benefit system to the defined contribution system, which reduced the risk of future insolvency of the pension system.

However, I cannot agree with the view currently expressed by some authors of the reform that this transition alone is enough to fully prove the success of the reform, and that the second capital pillar (in an ongoing liquidation) or the private pension funds are negligible and insignificant supplements to the public system, as such not worthy of a discussion [Góra, Rutkowski 2019]. It is perplexing to see such utter disregard among outstanding experts for the capital pillar, which is vital in its role of development and stabilization of the capital market and of creation of domestic capital. Furthermore, the experience of other countries shows that saving in private voluntary pension funds is an important positive element of security for old age in countries with a low replacement rate. Therefore, in my opinion, these forms of individual and collective prudence should be propagated as widely as possible, and the public participation should be promoted by all possible means.

Considering the context and objectives of the systemic solutions described in the present article which are currently being introduced by the government, it must be acknowledged that they constitute an attempt to carry on the pension reform of 1999 in its capital segment, as they are trying to replace the solutions that for some reason failed with new ones. In place of the former obligatory participation in the capital system, the current solutions aim at encouraging the professionally active part of the Polish society to make additional savings for old age and to multiply them by investing in the capital market.

In my opinion, the fact that the current contribution for additional savings in the capital system is a supplementary contribution instead of being a separate part of the public contribution deserves praise, because it is clear solution, even though more expensive for the participants. Another advantage of this solution is the fact that participation is voluntary (despite automatic enrolment). While agreeing with the motivation for these changes, however, one needs to consider their effectiveness.

As mentioned above, one can be sceptical about the success of the PPK program in terms of widespread and permanent participation of Polish employees, especially low- and medium-earners. The program fails to sufficiently incentivize long-term saving and changes in habits in general. Citizens should be persuaded clearly that saving pays off; the incentives should result in an increase in voluntary and permanent participation in the program of the automatically-enrolled employees. A total or partial tax exemption of income allocated in the voluntary contribution would provide such an incentive[103].

The solution regarding the transformation of OFEs also fails to provide clear incentives to leave capital held in the OFE account in voluntary capital pension funds; the main obstacle here is the 15% fee substituting for tax, on which I wrote above. Transferring all saved capital to private accounts and delaying income tax collection to the moment of benefit reception (as in case of ZUS benefits) would be much more conducive to such decisions. Such a solution would indicate that the state has no myopic interest in urging citizens to save and would build trust in these institutions. The next step in building trust could be to allow for voluntary transfers of savings from ZUS sub-accounts back to individual private savings accounts (i.e. the proposal of A. Rzońca discussed above).

In conclusion, I formulate a few more social engineering postulates regarding such changes as the reforms discussed above:

Firstly, pension reforms have a very long time horizon, and therefore their solutions should be extremely durable, thus inspiring public trust. Of course, constant adaptations to changing environment are necessary, but these should be changes in parameters rather than in the basic principles of the pension system. The pension system is a form of social contract according to which every citizen should be able to form expectations regarding their future. Frequent changes undermine citizens' trust in the pension system and can encourage them to avoid contributing. The extreme changes to the systemic rules described above that occurred every couple of years over the past two decades prove that this basic principle has not been followed.

Secondly, the memory of the previous declarations and changes introduced by governments and their effects, i.e. path dependency, is of great importance to the public perception of such fundamental systemic changes affecting their lives. In the case of the transformation of OFE, the memory of events from five years ago may dominate today's decisions. Therefore, it is very important to explain the changes and their goals, and to argue and persuade that they are indeed justified. Unfortunately, there is still an absence in Poland in this regard. Social dialogue remains a scarce resource, and the institutions established for this very purpose are lacking. All the more a serious effort is needed in informing and persuading to obtain a social mandate for such important undertakings.

103 There are many indirect solutions with varying fiscal costs to the state budget, e.g. a degressive contribution (decreasing in rate with the increase in income) [TEP 2014; TEP 2016].

Finally, of great importance is the conduct toward the present and future citizens. The citizens must be supplied with full and honest information on what they both can and cannot expect from the reformed system. This requires transparency of the solutions proposed on the one hand and constant education on the other. All attempts to manipulate or use “default” solutions to achieve short-term benefits by the government and various interest groups undermine trust in pension systems and in state institutions, which results in long-lasting negative effects. Regardless of whether and to what extent the main goal of the PPK program succeeds, it is my conclusion that the Polish citizens should be further strongly encouraged to choose various voluntary forms of pension saving (both individual and collective), including participation in employee company capital programs, which were not mentioned in the present article [Błaszczyk 2014].

Postscriptum

After submitting the article for printing and before its publication, several important events took place that were a continuation of the decisions and actions delineated in the article. I will enumerate these events below:

1. On November 7, 2019, at the last cabinet meeting before the parliamentary elections the government decided to pass the aforementioned “Transfer” Act (i.e. the draft amendment to the Act on Transferring Funds from Open Pension Funds to Individual Retirement Accounts). The government assumed that 75% of OFE account holders will choose the capital option, and that the planned transformation fee of 15% will amount to PLN 19.3 billion and will be paid to the FUS in two installments in 2020 and in 2021. The stipulated amount of the first payment was as much as PLN 13.5 billion; and this amount was entered into the state budget. The government took into account that for each month before the enforcement of the Act, the OFEs had to transfer PLN 550–600 million to ZUS under the “safety zipper”; this is why the administration wanted to delay the passage of the Act, which was ready by July 2019.

2. On February 13, 2020, shortly after the elections, the Act was passed by the Sejm by a majority of 13 votes (with the entire opposition voting against it).
   Pursuant to the Article 50 paragraph 1 of the Act, funds transferred from OFE to OKE are private property. The Act was almost identical to the draft, but for all the deadlines which were postponed by six months.
   The date of its entry into force (20.06.2020) and the dates of the “transfer window” (the two months for the decision of OFE participants to either remain in the capital option or to transfer their funds to ZUS) were changed. The transfer window was set for the holiday period (June and July 2020), which greatly reduces the likelihood of participants choosing the option less desired by the government (i.e. transition to ZUS). The PFR (Polish Development Fund) became the managing entity of the FRD (Demographic Reserve Fund).

3. After the elections, the government finally withdrew the draft Act on abolishing the so-called 30-fold limit, i.e. the current upper limit of salary, above which pension contribution is no longer deducted.
   It happened because of the strong resistance by one of the coalition partners of the PiS.

4. At the end of December 2019, the PFR reported that in the first tranche of recruitment to the PPK (that included the largest employers) 39% of employees (1.3 million people) agreed to participate.

5. At the end of March and after the outbreak of the COVID-19 pandemic, the government announced as part of its "Anti-Crisis Shield" some changes in the implementation of the PPK project. The first change is to postpone the deadline for concluding management contracts in medium-sized enterprises until the end of the year instead of the end of July.

6. Another change under consideration is to postpone the implementation of the "transfer" Act (regarding the liquidation of OFE), but this change still awaits its concrete formulation.

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