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SECOND PENSION PILLAR – OPORTUNITY FOR EMPLOYEES

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Abstract:
The middle and young aged people should save some share of their income for the third life period, when they will become the pensioners. We can assume that the state pensions won`t be sufficient for all expenses we`ll have in the pension. If we saving only 5 percent monthly of our income, after 40 years of saving the amount with the state pension will be sufficient for normal living and spending.

From January 2011 some pensioners in Slovenia are receiving their additional annuity from 2nd pension pillar. Their additional annuity is form 5 to 10 percent of their pension. In the other words this pensioners will receive in one year a thirteen pension. They can afford more the other pensioners who didn't` save any money in the 2nd or 3rd pension pillars.

Keywords: second pension pillar, demographic changes, annuity insurance.

1. INTRUDUCTION

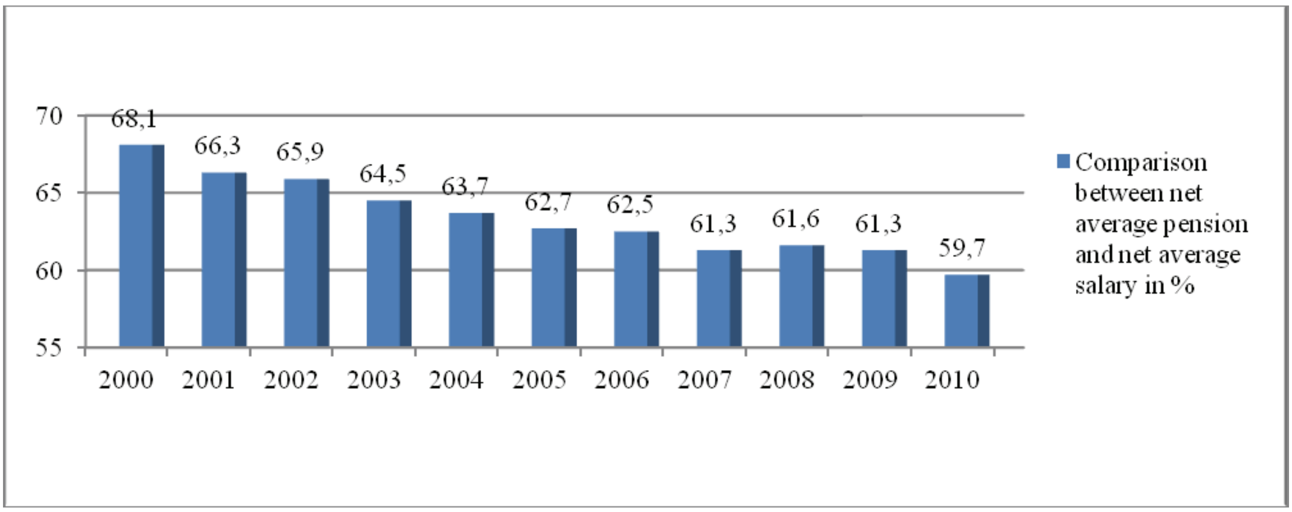
Slovenia had introduced so called 2nd pension pillar in the end of 1999. Until then, we had only one pension system based on mandatory pension insurance (pay as you go) called also 1st pillar. On the 1st of January 2000 the government introduced new pension system, which covers both mandatory pay-as-you-go system and additional funded system. After the 1st of January 2000 the Slovenian pension system covers three pillars:

- 1st pillar – mandatory pension insurance on pay as you go system,
- 2nd pillar – mandatory and voluntary additional pension insurance – funded system,
- 3rd pillar – voluntary additional insurance – funded system.

1st and 3rd pillar all employees in Slovenia know very well. 1st pillar is compulsory for all employees. Employers and employees have to pay the provisions on gross income of employees. The provision is 15,50 percent on gross salary which is paid by employee and 8,85 per cent above gross salary which is paid by employer (the sum of pension provisions is 24,35 per cent). The 3rd pillar bases on voluntary person savings and covers life insurance or similar insurance (funded insurance). This pillar has no restrictions, has no tax benefits and all persons can sign the insurance contract.

2nd pillar was new in Slovenia in 2000. It covers the difference between 85 percent and 72,5 percent of calculating pension after the year 2011. The bases for calculating the pension in 2000 was the 85 percent of average net income (salary) at the period of the best running 10 years. Now days the bases for calculating the pension is 72,5 percent of average net income at the period of the best running 18 years. Comparison between the average net salary and net pension in 2000 and 2010 is represented in the Graph 1.

Graph 1: Comparison between the average net salary and net pension between 2000 and 2010



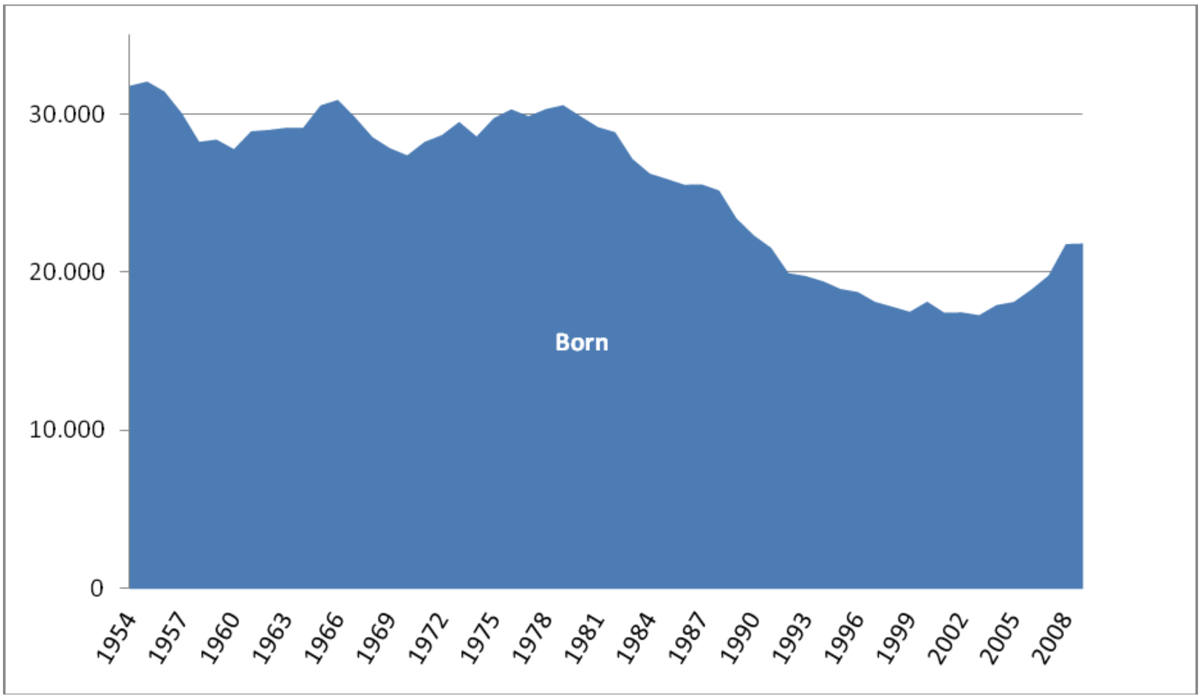
Source: ZPIZ, March 2011

We can conclude that the pensions from the state are falling and they will be falling also in the future. Middle and young aged employees can expect that their pension from the state will be between 30 and 50 percent of their net salary. The only way to avoid the poverty as the pensioner is to save for own pension. But unfortunately is a long way from knowing that to take action on that.

2. DEMOGRAFIC CHANGES AND THE EXPECTATIONS

Within last decade all counties in Europe reformed their pension systems. Reforms are necessary because of the growth of pensioners, growth of life period and low fertility. European Commission in its` Green paper (2010) acknowledge that the demographic ageing has been faster than previously expected and the recent financial and economic crisis had a dramatic impact on budgets, capital markets and companies. The number of born people was declining in Slovenia for the last more than 50 years what is presented in Graph 2.

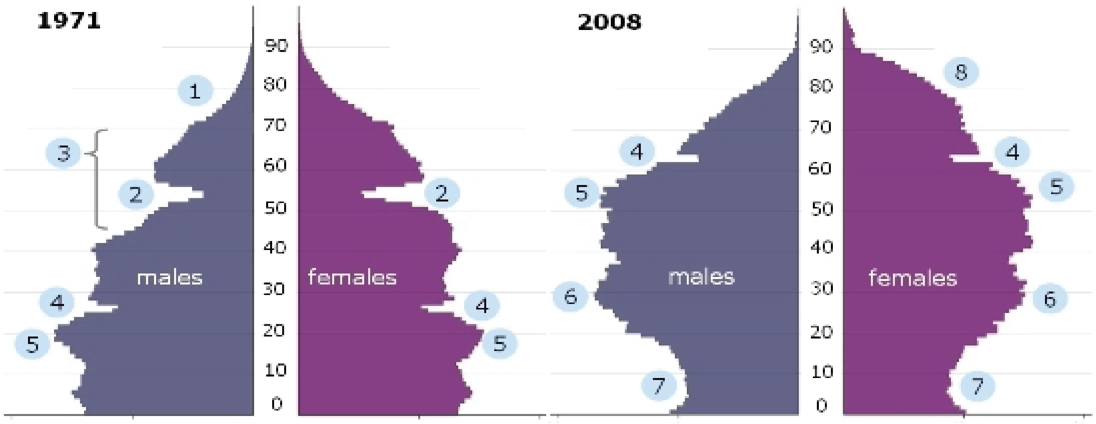
Graph 2: Born people in Slovenia form 1954 to 2009



Source: Statistical office of the Republic of Slovenia, March 2011

Demographic changes are presented also in population pyramid. When we compare population pyramids in different decades we can see the dramatic changes (see Picture 1). Pension system Pay-as-you-go was presented when the population pyramid had the shape of pyramid. The children were the most numerous group of the population, and the pyramid narrowed toward the top (Šnuderl & Žnidaršič, 2009). This pyramid is typical for young populations with short life expectancy. For older population, including Slovenia, the shape of pyramid is more like a vase. Due to a small number of births, prolonging of life and consequently higher share of older population, the pyramid peaks are more rounded, while the bottom parts are getting narrower (represents younger population).

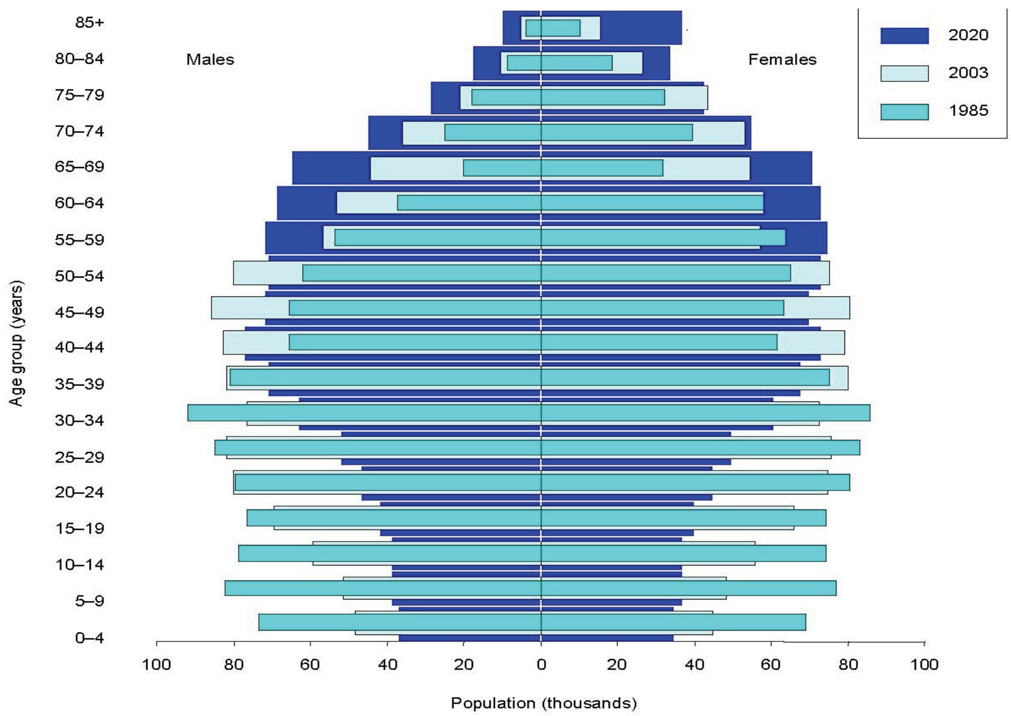
Picture 1: Comparison of the population pyramid for Slovenia in 1971 and 2008 (Šnuderl & Žnidaršič, 2009)



Legend: 1 – losses during the World War I, 2 – decrease in births during the World War I, 3 – losses during the World War II, 4 - decrease in births during the World War II, 5 – baby boom generation after the World War II, 6 – high fertility in the seventies, 7 – decrease in births, 8 – surplus of females

Very similar is comparison of population pyramid for Slovenia at Picture 2. In this pyramid we can observe changing the number of population among the years.

Picture 2: Aging pyramid for Slovenia in 1985, 2003 and 2020 (WHO for Europe, 2005)

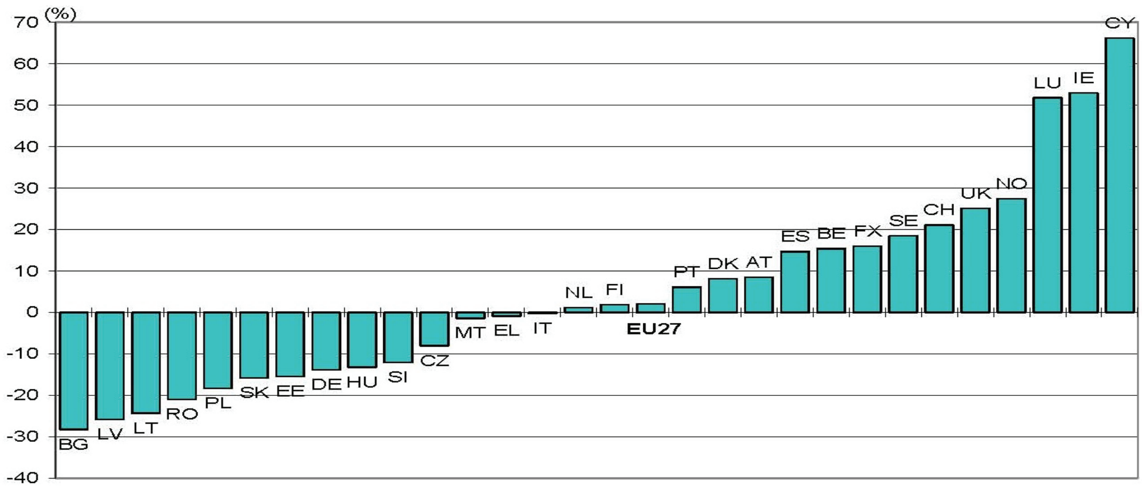


Source: WHO for Europe, 2005

From the Picture 2 we can conclude that in the year 1985 the younger population (between 0 and 39 years) was the largest. The middle aged population was narrowing and the oldest population (65 +) was the smallest one. If we look the year 2003 we can conclude, that the births decreased (more than 30 percent in the population between 0 and 9 years old), the largest population was between 25 an 54 years old, the share of oldest population increased (65 years and above). The projections for the year 2020 are not optimistic. The births will continue to decrease (more than 20 percent in the population between 0 and 9 years old if we compare the data with the year 2003 or around 50 percent if we compare data with the year 1985). The largest population will be between 40 and 69 years old. The share of oldest people (75 +) will increase for more than 30 percent if we compare data in the year 2020 and 2003.

Similar projections were made for Europe (Giannakouris, 72/2008). Ginnakouris (72/2008) assume that the population of EU27 will rising from 495,4 million in 2008, reaching 520,7 million in 2035 and declining to reach 505,7 million on 2060. The EU27 population is projected to become older with the median age projected to rise from 40,4 years in 2008 to 47,9 years in 2060. The share of people aged 65 years or over in total population is projected to increase from 17,1 percent to 30 percent of from 84,6 million in 2008 to 151,5 million in 2060. The number of people aged 80 years and over is projected to almost triple from 21,8 million in 2008 to 61,4 million in 2060. From the projections in the Graph 3 we can see that the Slovenian population will decrease for more than 10 percent between 2008 and 2060.

Graph 3: Projected total population change over the projection period 2008 – 2060 (2008=100) for EU Member States, Norway and Switzerland



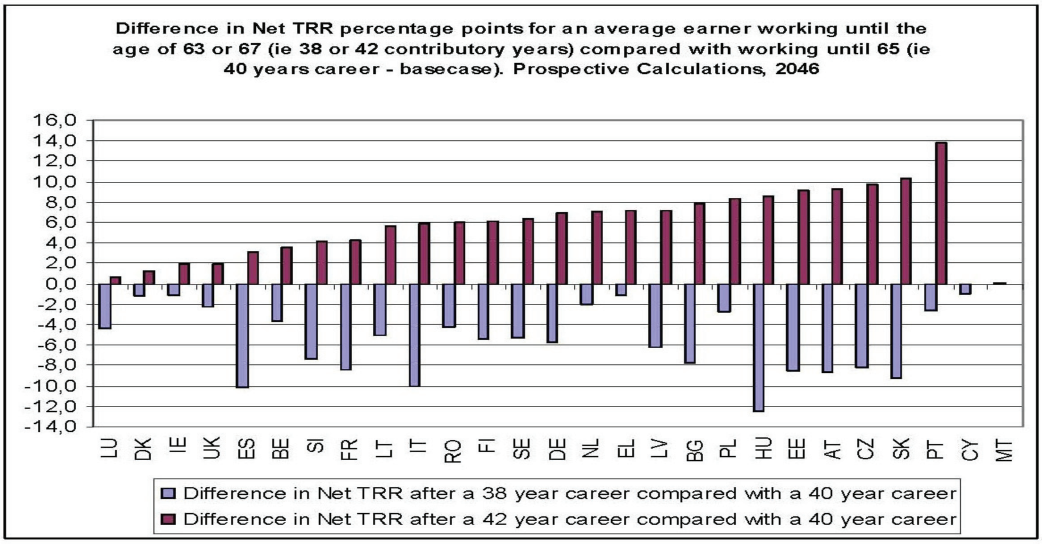
Source: Giannakouris, 72/2008

An enormous achievement is living longer than ever before (Green paper of EC, 2010, p. 4). Combine this with low fertility rates will lead to dramatic changes in the age composition of population. Unless people, as they live longer, also stay longer in employment, either pension adequacy is likely to suffer or an unsustainable rise in pension expenditure my occur. Member states of European Community changed their pension systems in the last decade (Green paper of EC, 2010, p. 5) and the key trends have been:

- Encouraging more people to work more and longer so as to obtain similar entitlements as before (see Graph 4),
- The move from largely single to multi-tiered systems (the role of PAYG system is decreasing, the role of prefunded private schemes, which are often of a Defined Contributions (DC) are increasing but they have a marginal role,
- Measures to address adequacy gaps (ease access to pensions for vulnerable groups and increase financial support for poorer pensioners etc.),
- Gender dimension: women tend to predominate among those with atypical contracts, they tend to earn less than men and tend to take career breaks for caring

responsibilities more often than men (their pension tend to be lower and the risk of poverty tends to be higher among older woman, also because they live longer).

Graph 4: Difference in Net TRR percentage points for an average earner working until the age of 63 or 67 compared with working until 65

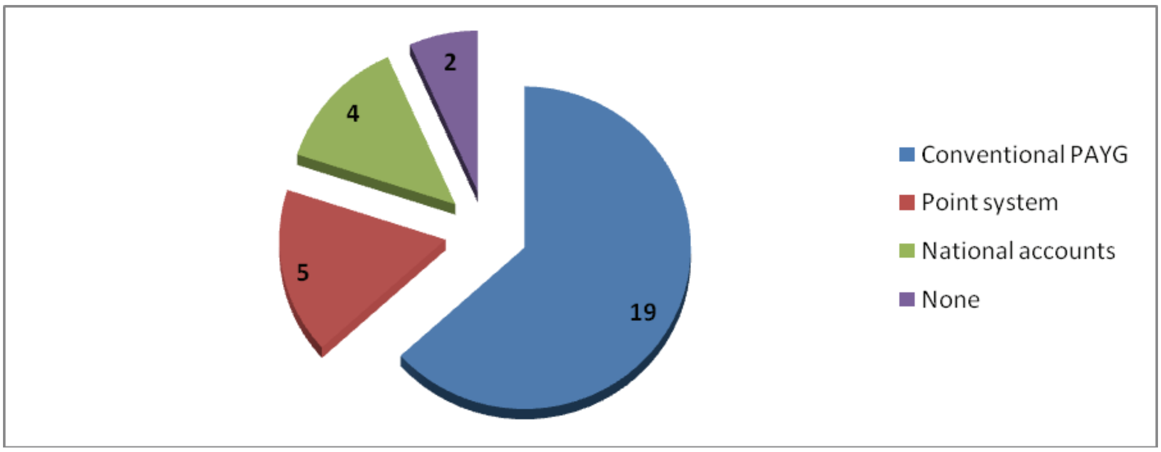


Source: Green paper of EC, 2010, p. 33

The financial and economic crises impacted PAYG and funded pension systems. Higher unemployment, lower growth, higher national debt levels and financial market volatility have made it harder for all systems to deliver on pension promises (Green paper of EC, 2010, p. 6). Private schemes can relive some of the pressure on public pension provision. However, increasing reliance on private schemes has fiscal costs, given the widespread practice of providing tax incentives during the accumulation phase.

If we look at the pension systems in the ECA (European and Central Asia) region their pension systems come in all shapes and sizes, and one of the key lessons from the crises is that no pension system is immune from the global financial and economic crises (World bank, 2009). Most countries in the region have three pillars in their pension system, a zero pillar, typically a first pillar, but sometimes a second and a third pillar. In the Graph 5 we can see the different types of first pillar.

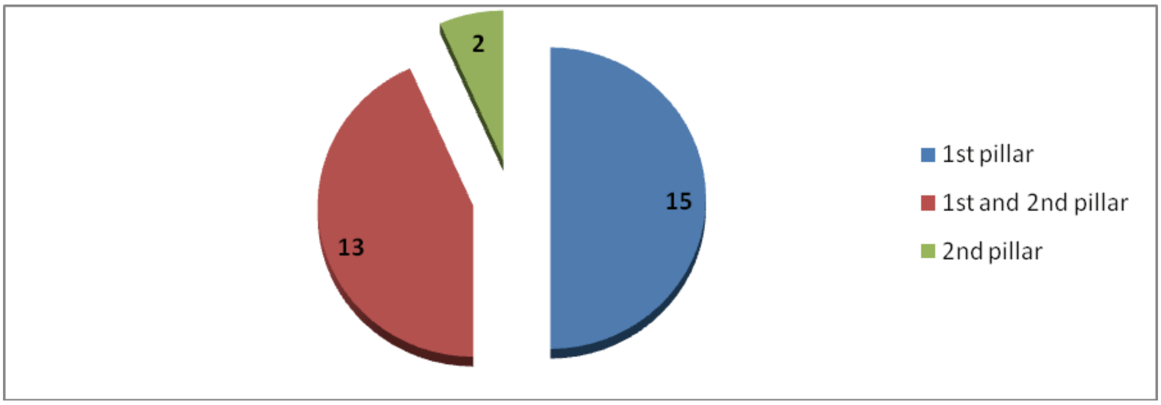
Graph 5: Number of countries of each type of PAYG pension systems in ECA



Source: World bank, December 2009

The largest share of types of PAYG pension systems in ECA region has the conventional PAYG system (see Graph 6). Most countries have the 1st pillar or unfunded pension system (World Bank, 2009) where contributions paid by current workers finance pensions for current retirees, and pensions for today's workers will be paid by contributions from future workers or children of today`s workers. The majority of ECA countries provide retirees with some percentage of their former salaries, however defined, per year of contribution. Only two countries (Kazakhstan and Kosovo) do not have a contribution-based managed PAYG system but flat pensions are provided to all elderly people from the budget.

Graph 6: Pillar configuration of ECA pension systems



Source: World bank, 2009-12-07

In addition, 13 of 30 countries gave adopted 2nd pillars or funded systems (World Bank, 2009). The major difference between 1st and 2nd pillar is where the contributions are kept. In the 2nd pillars the worker`s contributions are kept in individual saving accounts and actually invested in a variety of financial assets. In the 1st pillars the worker`s contributions are used to finance current pensions.

3. THE ISSUE OF 2ND PILLAR OF PENSION SYSTEM IN SLOVENIA

The voluntary supplementary pension insurance scheme represents collecting premiums (monthly or yearly) on personal accounts of insured person. The regulation of 2nd pillar was printed in Gazette of Republic of Slovenia no. 106/99, 72/00, 124/00 and 109/01. Only persons insured under 1st pillar (those who paid the pension contributions from their gross salary) can save premiums in the 2nd pillar.

In the theory of taxation we know four different tax regimes for investments:

- EEE (exempt – exempt – exempt),
- EET (exempt – exempt – taxable),
- ETE (exempt – taxable – exempt)
- ETT (exempt –taxable – taxable).

The first stage is investment (when somebody invests the money), the second stage is earning stage (when somebody gets benefits from investment such as interests, dividends, ect.) and the third stage is withdrawal stage (when somebody withdraw all the investment with benefits).

The tax regime for the 2nd pillar in Slovenia is EET. The investment of paid premiums are tax free or better the tax is deductible, the interests earned from collected premiums are tax free, the life annuity from the annuity insurance is taxable.

The tax deduction is 5,844 percent of gross salary of employee (if somebody earns gross average Slovenian salary around 1.500 Euros per month, the amount of maximum premium per month is 87,66 Euros). The premiums are upwards limited so the premiums above 223,61 Euros per month are fixed (this is for the year 2011). The employees have the tax deduction for social contributions and taxed on salaries and for tax on profit. The employers receive back some income tax which depend on their income grade (which can be 16 or 27 or 41 percent).

In Slovenia the 2nd pillar has the minimum guaranty. Paid premium after costs and the minimum profitability are guaranteed. The extra profitability belongs to insured person if he or she called of the contract.

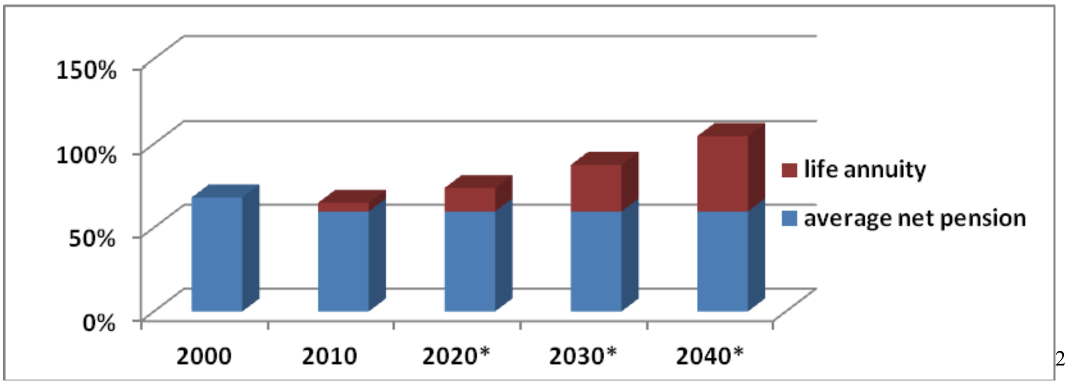
More than 95 percent of insured people in Slovenia are collective insured and the premiums are paid from their employees. More than 60 percent of employed people (or 541.464 people on 31st of December 2010) in Slovenia are insured in 2nd pension pillar.

In the 2011 some performers in the 2nd pillar (pensions companies and insurance companies) had introduced the new service. The first monthly (or quarterly or half-yearly or yearly) life annuities were paid on the accounts of life annuity insured pensioners.

If somebody with average Slovenian salary signed a voluntary supplementary insurance contract for collective or individual pension scheme and saved the maximum premiums for 10 years (average premium for 10 years is 72,34 Euros per month) he or she collected around 11.500[1] Euros premiums and additional earnings. The monthly annuity for man, 60 years old with 11.500 Euros on his account will be 52,75 Euros before taxes (annual annuity is 616,83 Euros before taxes). If we compare monthly annuity from the 2nd pillar in Slovenia with the net average pension we can find out that the savings in the 2nd pillar reached their goal. The average net pension in Slovenia for April 2011 is 579,73 Euros. More than 60 percent of pensioners have their pensions lower than 700 Euros. If somebody saved for 10 year maximum premium in the 2nd pillar, his pension is higher for 9 percent.

[1] The calculation was performed at the internet site of Moja naložba pension company d.d. with presumptions of 1,9 percent of entrance fee, 1,2 percent per year of management fee, 0,025 percent per year of custodian fee, tables of mortality are DAV 1994R, the calculated life annuity is before tax

Graph 7: Comparison gross average salary and maximum premium for the 2nd pension pillar



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In the Graph 7 we assumed that the proportion between pensions and salaries is unchanged. If we will save the same amount for 40 years, our additional monthly annuity will have the same share as our state pension. If we assume that the proportion between pensions and salaries will be falling, the share of additional annuity will rise. The fact is that demographic change, caused by a pronounced decline of fertility and a simultaneous rise in life expectancy, is leading to a declining and ageing population in both the European Union and in Slovenia (Domadenik, Ograjenšek & Redek, 2008, p. i).

From our opinion the pension reform from year 2000 was and wasn`t successful. Those employees who were insured and collected premiums for 10 years have some amounts on their personal accounts. Their state pension is higher for 5 per cent if we calculate their pensions today. Those employees who didn`t collect any premium, has or will have only the state pension. In other words, if there was an average net pension in Slovenia of 576,78 Euros per month in 2010, is the amount of additional pension within 5 percent around 50 Euros per month[3] or 600 Euros per year. If he will become a pensioner in the year 2021, he`s pension will be higher for 14 percent[4] or approximately 135 Euros per month or 1.620 Euros per year.

In the conclusion we can agree that for our pensions or better money inflows in the period of after retirement we have to save. The state pensions will be low or could also be equal for all pensioners. This statement has bases in the facts we know today:

- Demographic changes (living better and longer, low fertility, rising share of older people),
- Labor changes (reduction of share of employees, rising ratio of elder non-workers to workers),
- Increasing public debt (also because of financial and economic crises in 2008),
- Increasing public spending on pensions, health care, long-term care,
- Decreasing GDP growth etc.

The younger and middle aged populations have to save for their money inflows after retirement. They have to save in the 2nd and 3rd pillars. The savings have to be dispersing on investments and issuers or financial mediators.

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[2] The proportion between pensions and salaries is the same as in the year 2010, the monthly paid premium is 72,34 Euros and it doesn’t change throw the years

[3] the calculation is made for men, who will become a pensioner in April 2011, he collected around 11.500 Euros of premiums and earnings and he`s monthly annuity is for life with the guarantee of 15 years

[4] The proportion between pensions and salaries is the same as in the year 2010

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