

Problems with shifting  
from DB to DC  
...from the Polish experience

*Remigiusz Borowski*

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# Real shift only in PAYG the basic scheme

- From parametric DB scheme...
  - Legal formula of benefits
  - With parameters like years of military service or periods of higher education
- ...To national contribution scheme.
  - Similar to NDC scheme in e.g. Sweden
  - Benefit based on indexed contributions
  - Because social security requirements inside the scheme element of DB – minimum pension

# Spectrum of DC funded schemes – Open Pension Funds (OFE)

- Mandatory
- Individual accounts managed by private, separated institutions
- Based on Chilean and World Bank Concept
- Developed and change to local conditions
  - addition to minimum pensions - depends on incomes both PAYG and OFE schemes
- Very restricted regulation in compare to other financial institutions
  - investment policy
  - capital requirement

# SPECTRUM OF DC FUNDED SCHEMES —

## Occupational Pension Schemes (PPE)

- Similar to 401k
- Voluntary
- Occupational
- Sponsored by employers with possibility to add individual contribution
- Managed by many market financial institutions
- DC individual accounts
- Limited tax and social security contributions reliefs
- Role of representation of employees in creation and management

# Spectrum of DC funded schemes – Individual Pension Accounts (IKE)

- Similar to IRA
- Voluntary
- Individual
- Limited contribution
- Managed by many market financial institutions
- DC individual accounts
- Limited tax reliefs

## *Why DC ? - Argument I*

DB in long run always more expensive = less profitable than DC

- Management in finance = management of risk
- More risk you transfer more you pay
- Effect which explains ie.:
  - stock are in average more profitable than state bonds
  - insurance more expensive than pure investment products etc...

# *Why DC ? - Argument II*

In long run DB not clearly safer:

- Fluctuation of profitability in DC less important
- Risks in DB more important

*No financial institution or other company can deliver a watertight financial guarantee for the payment of occupational pensions, especially as they form a very long term obligation.*

*1-st point of Executive Summary*

*The protection of supplementary pensions... Rapport for the European Commission made by ESOFAC BELGIUM (Actuaries and Benefit Consultants) and EURACS (European actuarial consultancy services),  
24 May 2010*

# Why at all to choose DB funded products in this situation?

- Because we are ready to pay more money for transfer of more risk
- Risk is unacceptable for social security reasons
- We want to spread risk between the whole group of risk etc...

Versions of traditional argumentation which supports the idea of social-security-in-pensions („argument of myopia” ):

**Important majority of people are never able to make proper decisions about their retirement incomes**

## *Why DC ? - Argument III*

My „Weak” version of „ („argument of myopia” ” for occupational pensions:

**Almost all of people are ~~never~~ not able to make proper decisions about their retirement incomes because they don't care as long as they are near the age of being retired**

# The problem is not in lack of ability to learn - it is in motivation!

- Younger people maximise the economic effectiveness of their time by using it for other problems than pensions
- That explains why educational programs are so ineffective
- People at retirement age are well enough motivated for making proper decisions

# The danger of problems because of using DC less important because :

- Occupational pensions are driven by minority who (should) act in the interest of all employees
- In compare to the time the DB model of funded pensions was developed people are:
  - Better educated
  - In average richer
  - Covered by social security scheme which offer at least minimum pension
  - Security regulations are much better developed

# Conclusions:

- DB is better if you:
  - Take your benefits
    - Promises are not sure the real money is...
    - You take them on the cost of young participants or/and your employer
  - Are young but believe in promises of DB schemes and accept lower profitability
- For the rest - DC is better if you are so nice to agree with my:
  - Argument I and II - at least till the moment you are retire
  - All of my arguments - always

Thank you for your attention