



The opinion of Polish Chamber of Pension Funds about the proposed amendments of 31 January 2009 to Law on organisation and operation of pension funds

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In the opinion of Polish Chamber of Pension Funds, the association of 12 from 14 pension funds operating on the Polish market, the most important and urgent issues to deal with at the moment are changes to the law regulating investment policy of open pension funds in order to increase the diversification of assets and give the possibilities to differentiate the investment policy according to the age of pension fund members.

The main aim of the mentioned alterations should be the enhanced safety of pension fund investments and the opportunity to reach higher rates of return. This opinion is supported by many pension experts, both Polish and foreign ones. The Chamber has prepared many proposals regarding investment regulations and submitted them to Ministry of Finance, Ministry of Labour and Social Policy and The Polish Financial Supervisory Authority on the 6 February 2008.

On the request of Polish Chamber of Pension Funds, Minister of Finance has appointed a working group within the Council of Financial Market Development that has analysed proposals on changes in investment regulations and give initial recommendations. Most of the Chamber's proposals (8 of 9) got positive opinion of the group members.

At the same time Polish media have initiated the campaign to reduce fees charged by general pension societies. The action was conducted under the slogan „Struggle for higher pension”.

To show the factors that influence pension benefits, the Chamber prepared an appropriate simulation several months ago. It indicates that quicker decrease in upfront fee to the level of 3,5% from the year 2009 instead of 2014 (as written in the law), could increase the monthly pension benefit by 2.80 PLN. To give some comparison, if the average rate of return would be higher by 0,5 percentage point (with other conditions unchanged), it results in additional 70 PLN to monthly pension. These calculations stress the importance and urgency of changes in investment regulations. Very little benefits for future pensioners resulting from lowering the upfront fee are, of course, not the only argument against. In the discussion about the fee reduction, the consequences of such an amendment for general pension societies should be also taken into consideration. The Chamber's analysis gives the results that lower upfront fee would cause that only 3 of 14 societies would reach the positive return on capital. Proposed legislative action to reduce upfront fee will worsen the financial situation of all general pension societies and will postpone the possibilities for shareholders to get the return of invested capital. Moreover, the societies associated in the Chamber would understand the fee reduction as a serious interference in the rules of the public-private partnership that were agreed when building the pension system. It would be the significant change in conditions of running the pension business. In addition, it is worth underlining that proposals of reduction in fees are submitted although the first activity of this kind took place in 2003 and the amendments accepted then are still to be implemented in the following years. The introduced changes limited price competition between open pension funds. When participating in legislative process, the Chamber was warning of such a threat to the market. The next step in fees' reduction may result in pension funds not being competitive at all in terms of prices.

The other problem described frequently by market analysts is the so called „crowd“ or „herd“ effect that causes only a little differences in investment results achieved by pension funds. Building similar portfolios is a result of the minimum rate of return mechanism. Managers of pension funds are forced to build similar portfolios in order to avoid offsetting the deficit that could appear when the reported rate of return would significantly differ from the average weighted rate of return of all funds. Accepting more risk than average is automatically punished. This problem has to be solved while preparing the amendments to the law on organisation and operation of pension funds.

In the mean time, assumptions to the amendments of law on organisation and operation of pension funds pass over the changes in investment policy, except for introduction of three types of funds with the investment policy tailored to the age of members. Describing expected effects of the proposal, authors focus on the safety of pension assets before the moment of retirement by introducing conservative funds, not considering the problem of higher efficiency in the period of 40 years. The introduction of aggressively investing funds and fees' reduction does not solve the problem. Solely implementation of three investment funds managed by one society will be inefficient without necessary alterations in the allowed financial instruments, changes in investment limits and eliminating negative aspects of the mechanism of the minimum rate of return (MRR). Hence, the Chamber appeals for broadening the amendments by adding issues regarding investment policy and MRR modifications.

Assessing the range of proposed changes to the law on organisation and operations of pension funds, the Chamber has noticed inconsistency in the concept prepared by Ministry of Labour and Social Policy. One of the main goals is to enhance safety of the system by significant increase in contribution paid by the general societies to the Guarantee Fund (they are to be three times higher than today) with prospects of maintaining its high level also in the future. To meet this goal, shareholders of general societies would be forced to transfer additional capital to the societies, taking into consideration that the incomes of these legal entities would be reduced due to lower upfront and management fees.

Keeping in mind experiences of 2003, when the rules were changed for the first time, part of the shareholders could get to the point that pension business is not worth their troubles and involves excessive risk of frequent changes in business regulations. Consequently, they would seriously think of withdrawing from the market. Their decisions could negatively influence the competition on the market. The assumption that some new society will enter the market then and take over the members of withdrawing societies, seem to be illusory. Proposed fees' reduction and the fact that government interferes in fees' level for the second time, could effectively discourage them from entering the market. Eliminating one of the entrance barriers, i.e. the acquisition on the primeval market, and giving some privileges in the procedure of members' lottery, could not be a sufficient incentive when they would have to face high capital requirements and low fees. The period necessary to reach the break even point would be much longer for new societies than for those which entered the market in 1999. Consequently, the proposed amendments will not improve the market competition but would bring opposite effect.

The negative impact on competition could be also observed after changing the management fees. Introduction of management fee limit expressed in quota, not percentage of managed funds, could result in the situation that, from some point in time, attracting more members by general pension society would not make any sense from the economic point of view. On one hand there will be activities performed by general society in order to offer its members the best service and achieve the highest investment result and, on the other, there will be lack of any payment when more insured driven by excellent service and results will choose the society. Consequently, the aim of improving the fund's efficiency to attract more members lacks its economic sense. Such situation could lead to the long-term erosion of pension sector. Current times of crisis give the evidence of long-term perspective being of the utmost importance for pension systems to meet its goal.

The assumptions to the proposed amendments lack any calculations of financial results for both pension fund members and general pension societies. Such a situation is unacceptable, especially when significantly altering the regulations on open pension funds and general pension societies.

Considering the described situation, the Chamber has prepared own preliminary simulation of the possible influence of given amendments on financial situation of pension societies, both in the first year (2010) and four following years (2011-2014). Reduction of maximum upfront fee by a half and accepting the quota limit for management fee will result in lower incomes of societies by ca. 723 million PLN in 2010. That amounts to fall in societies' income by 1/3. In the next years the decrease in incomes will equal ca. 600-500 million PLN annually in order to reach 400 million PLN in 2014. In addition, the single costs of higher contribution to the Guarantee Fund will amount to ca. 1.680 billion PLN and pension societies would be obliged to transfer ca. 200-300 millions PLN every year to adjust the level of the Guarantee Fund to the increasing assets in management. As a result, all general pension societies would suffer losses. Hence, the Chamber expects the projected increase in contribution to the Guarantee Fund to be desisted.

The same importance as to discussion on results of described changes should be given to the assessment of costs appearing when introducing multifunds replacing the only one fund managed by pension society. The societies associated in the Chamber are of the opinion that it is possible to introduce subfunds when maintaining the current level of fees, although it needs additional expenditures from the society. But there should be no more than 3 subfunds and no obligation to carry several accounts for one member. Otherwise, it could multiply the costs of transfer agent, informative, accounting and reporting costs. The assumptions of changes in acquisition reflect inconsistency and lack of understanding for the agent's role in the pension system. The limited knowledge about the agent's abuses coming solely from not numerous complaints obtained by the supervisor should not lead to the conclusion that the system could operate properly without acquisition run by general societies. Fund members would become very passive, if nobody would supply them with necessary information for the decision to choose or change open pension fund. Pension fund agents play a relevant role in the system providing members with knowledge on operation of pension funds. Lack of alternative sources of such knowledge will not allow the direct electronic canals of distribution to become more common, as the authors of the project expect.

The second pillar of the new pension system was the first public-private partnership introduced in Poland on such a big scale. The cooperation of market institutions with government administration, set in good faith to meet public goals, can take place only on the conditions of consensus and mutual trust. Breaking the rules lead to abuse of parties' interests and may negatively influence the efforts to reach the defined aims. Polish Chamber of Pension Funds, supporting the idea of public-private partnership, thinks that both the preparation process of the amendments and part of its assumptions violate interests of General Pension Societies, not offering any equivalent benefits to the members of open pension funds. Public-private partnership is one of the well available forms to realize important economic and social goals in Poland at the moment, but the Chamber is afraid that negative experience of pension funds may have an impact on further undertakings that require such a kind of cooperation. The government expects private investors to set up pension companies. Bad experience of 2003 and presented proposals of amendments could discourage them from creating these institutions.