OVERVIEW OF THE PENSION REFORM IN THE REPUBLIC OF CROATIA AND FUTURE PERSPECTIVES

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SSCSSR - IPA 2008
Old pension system

PAY-AS-YOU GO defined benefit system based on Bismarckian tradition with broad coverage characterized by following features:

- demographic problems (aging of population, low birth rates)
- pension system as a refuge for unemployment problems
- drastic decrease of dependency ratio
- low retirement age (old-age pension 60/55, early retirement 55/50)
- too generous replacement rates due to calculation of benefits on the basis of 10 best years
- too broad definition of invalidity and related pension rights
Pension reform

Pension reform objectives were:

- higher level of pensions,
- introduction of different ways of financing,
- reduction of public system expenditures,
- re-establishment of long-term sustainability,
- harmonization of pension system with economic and demographic tendencies,
- increasing of individual responsibility for one’s own social security,
Pension reform

- The reform was divided into two steps:

  PARAMETRIC REFORM and SYSTEMIC REFORM

- Parametric reform had started with changes in the I pillar - *Pension Insurance Act* past the procedure and entered into force from the beginning of 1999, as well as *Act on Maximum Pension*

- Systemic reform had started with modelling of the II and III pillar

- *Act on Compulsory and Voluntary Pension Funds*

- *Act on Pension Insurance Companies and Pensions Based on Individual Capitalized Savings*
Outline of current pension system

From the beginning of 1999

Mixed public-private system based on 3 pillars:

DB scheme – PAY-AS-YOU-GO – I pillar (from 1 January 1999)

DC scheme – funded – II pillar (from 1 January 2002) compulsory

DC scheme – funded – III pillar (from 1 January 2002) voluntary
Outline of current pension system

- **II pillar – Mandatory, Funded, DC**
  - mandatory for individuals under 40 years of age
  - individuals between 40-50 can choose
  - individuals over 50 remain in I pillar
  - membership only within one MPF

- **III pillar - Voluntary, Funded, DC**
  - no age limit
  - membership within several VPF
  - open-end pension funds
  - closed-end pension funds (employers, TU)
Outline of current DB system

- Pensioners: 1,203,564
- Insurees: 1,463,418
- Dependancy ratio: 1.22
  (in January 2011 according to CPII data)
- Big number of special categories (war veterans, Croatian army, Police and Judiciary officials, representatives in Croatian Parliament and those who are working in dangerous jobs)
- Replacement rate 39.68%, but in case of 40 years of insurance 59.00%
# Population of the Republic of Croatia

## Population in 2008

<table>
<thead>
<tr>
<th>Population</th>
<th>MEN</th>
<th>WOMEN</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>between 20 and 64</td>
<td>1,349,291</td>
<td>1,360,818</td>
<td>2,710,109</td>
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<tr>
<td>over 65</td>
<td>297,319</td>
<td>465,588</td>
<td>762,907</td>
</tr>
</tbody>
</table>
Organizational structure of DB system

- **Croatian Pension Insurance Institute**
  (public institution with the status of legal person with public authority in respect of giving pension insurance decisions)

- **Ministry of the Economy, Labour and Entrepreneurship**
  (supervises the implementation of laws and other legal regulations, responsible for legislation proposals)

- **Ministry of Finance**
  (tasks related to analyses and forecast of macroeconomics trends, monitoring of trends in pension insurance system)
Financing of DB system

- Employee pays the contribution rate of 20% of the wage (if he/she is insured only under the I pillar)
- Or 15% of wage if additionally insured under the II pillar
- Employer allocates the contribution rate on his/her behalf
- Tax authority collects the contributions
Contribution paying scheme within PAY-GO system

- **EMPLOYEES**
  - Contribution rate: 20%

- **TAX AUTHORITY**

- **CROATIAN PENSION INSURANCE INSTITUTE**
  - Contribution rate: 15%

- **CURRENT PENSIONERS**
**PAY-GO system**

**Insured persons**
- Employees and other deemed as such
- Salaried civil servants
- Full time volunteers and apprentices
- Unemployed persons according to the employment laws
- Top sportsmen
- Monks, priests, other clerics
- Members of management boards
- Croatian citizens employed abroad
- Foreign citizens and stateless persons
PAY-GO system

Types of pension:

- **Old-age pension** (65/60 years of age and 15 years of qualifying period)
- **Anticipatory pension** (60/55 years of age and 35/30 years of qualifying period)
- **Disability pension** (based on total or occupational disability)
- **Survivors’ pension** (widow, widower, children)
- **First pillar basic pension** (in case that person is entitled also to the II pillar pension)
PAY-GO system

- **Minimum pension** (entitlement if regularly determined pension is lower; defined in a value per year and multiplied by the number of years of the qualifying period completed)

- **Maximum pension** (regulated by special law, per year determined as 3.8 of average value point per year)

- **Indexation of pensions** (twice a year according to the Swiss formula – 50% of the average cost of living/ and 50% of average gross salary)

- **Pension formula** (point system – personal points x pension factor x actual pension value)
Outline of current compulsory DC system

4 compulsory pension funds

- Raiffeisen OMF 30.87%
- PBZ/CO OMF 17.78%
- Erste Plavi OMF 15.38%
- AZ OMF 35.97%
Outline of current compulsory DC system

**Membership/net asset**
- 1,561,454 members of the funds
- contribution rate 5% of wage
- net assets 37.3 billion HRK

**Total assets investment structure**
- domestic assets 88.21%
- foreign assets 11.79%
Outline of current compulsory DC system

Investment structure within domestic assets

- Securities and deposits 86.97%
- Shares 16.77%
- Government bonds 62.69%
- Cash 0.57%
Outline of Voluntary DC system

- Raiffeisen ODMF 25.97%
- Erste Plavi Protect ODMF 4.67%
- Erste Plavi Expert ODMF 9.11%
- Croatia osiguranje ODMF 9.91%
- AZ profit ODMF 38.76%
- AZ benefit ODMF 11.58%
Outline of Voluntary DC system

6 open-end pension funds

- 170,859 members of the funds
- net assets 1.5 billion HRK

Total assets investment structure

- domestic assets 86.55% (securities and deposits 84.07%, shares 13.63%, government bonds 48.95%, cash 1.97%)
- foreign assets 13.45%
Outline of Voluntary DC system

Rates of return

(percentage difference between the value of its unit of account on the last day of the reporting period and this unit value of the last day of the previous period) annualized since start of business from 2.72% to 9.68%
Outline of Voluntary DC system

15 closed-end pension funds

- 17,577 members of the funds
- net assets 293 mil HRK
- investment policy limited
- rates of return (annualized since start of business) from 1.17% to 15.53%
Organizational structure of DC system

- Compulsory/voluntary pension funds
- Compulsory/voluntary pension companies
- Pension insurance companies
- Regulatory and supervisory body – **Croatian Financial Services Supervisory Agency**
- **Central Registry of Affiliates** (only for the compulsory system)
- **Tax Authority** (collects the contributions)
Outline of Voluntary DC system

Contribution paying scheme

- GROSS SALARY (WAGE)
- contributions 20% to the Tax Authority
- I PILLAR 15%
- II PILLAR 5%
- COMP/VOLUNTARY PENSION FUNDS
- CPII
- CRA
Outline of Voluntary DC system

- Steadily growing number
- No single organisation keeping records for III pillar schemes
- Tax preferential treatment for fund members:
  - Income tax relief (up to 6,000 HRK per year)
  - State subsidies (15% of total contribution per year)
- New: incentives for closed-end pension plan

sponsors (payments for voluntary savings below 6,000 HRK per year are exempt from paying taxes)
BROJ MIROVINSKIH FONDOVA / NUMBER OF PENSION FUNDS

- Obvezni mirovinski fondovi / Mandatory pension funds
- Otvoreni dobrovoljni mirovinski fondovi / Open-end voluntary pension funds
- Zatvoreni dobrovoljni mirovinski fondovi / Closed-end voluntary pension funds

<table>
<thead>
<tr>
<th>Year</th>
<th>Obligatory</th>
<th>Open-end</th>
<th>Closed-end</th>
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<td>7</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>2003</td>
<td>4</td>
<td>4</td>
<td>15</td>
</tr>
<tr>
<td>2004</td>
<td>4</td>
<td>4</td>
<td>15</td>
</tr>
<tr>
<td>2005</td>
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<td>6</td>
<td>12</td>
</tr>
<tr>
<td>2006</td>
<td>4</td>
<td>6</td>
<td>10</td>
</tr>
<tr>
<td>2007</td>
<td>4</td>
<td>6</td>
<td>12</td>
</tr>
<tr>
<td>2008</td>
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<td>15</td>
</tr>
<tr>
<td>2009</td>
<td>4</td>
<td>6</td>
<td>15</td>
</tr>
</tbody>
</table>
II Pillar Costs

- Centralization of the system with one institution for collecting of contributions – Tax Authority and one “clearing house” Central Registry of Affiliates, which keeps II pillar records
- Both central agencies are financed from the State budget
- Costs should be lower because of centralized system
Central Registry of Affiliates

Responsibilities:
- registration and change of membership
- accepting and processing of R-Sm Form,
- managing and maintaining the Register
- managing function of Central accounting
- recording data into the Register
- matching data to the related Pillar II payments
- delivering data to other institutions,
- communication with members of CPFs
II Pillar Costs

Centralization of records:

- allows easy access to records,
- reduces the need of moving records when contributors change providers,
- simplifies the calculation of the total pension (from the two pillars)
- there is no need for pension funds to know the individual details of their clients
II Pillar Costs

The types of fees and their upper limits to be charged by the pension companies administering the compulsory pension funds according to the law:

- **Entry fees** should not exceed 0.8% of the contributions paid.
- **Management fees** (net asset value fees) should not exceed 1.2 percent of the total assets per year according to the Act.
- By-laws of the Croatian Financial Services Supervisory Agency have set a lower rate (0.65% in 2011).
- **Exit fees** should be paid if a member switches from the fund within the first three years of membership: 0.8% of the total amount of the member’s personal account in the first year, 0.4% in the second year and 0.2% in the third year.
Government Economic Recovery Program

Regarding DB pension system

- Amendments to the Pension Insurance Act (1 November 2010) entitlements from DB scheme should be equal for men and women (Constitutional Court Decision) – 65 years of age (for old-age pension) gradually in 20 years
- Retirement age for early retirement also gradually increased for women (60 years of age gradually in 20 years)
Government Economic Recovery Program

- Pension amount for early retirement pension appropriately reduced in relation to years of insurance
- Changes in the pension scheme for special categories, decreasing the amount of pension for 10%
- Gradually suspension of “privileged” pensions
- Suspension of pension adjustment for 2010 and 2011
Government Economic Recovery Program

Regarding DC pension scheme

- Increasing the contribution rate for II pillar
- Reducing the administrative costs by reducing fees
- Changing of the basic pension formula
- Supplement on the pension (equal to the supplement on the pension acquired according to the Pension Insurance Act or pro-rata supplement)
Future perspectives in general

- Insure adequacy and sustainability
- Challenge for policy makers is to aim for a good balance between sustainability and adequacy
- Strengthen the awareness of available routes to adequate income in retirement
- Although the economic crisis and possible lower economic growth will make this harder
Future perspectives in general

- Reviewing the degree of financial market exposure and the design of risk sharing in funded pension systems
- Introducing special schemes according to the younger/older cohorts
- Achieving better balance for pension severs and pension providers between risks, security and returns
- Enhance public confidence in funded schemes
Thank you for your attention