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Original research article

Development of the state-contributory supplementary pension insurance in the Czech Republic

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ARTICLE INFO

Article history:
Received 31 October 2013
Received in revised form
10 March 2014
Accepted 3 June 2014
Available online 13 June 2014

Keywords:
Pension
Pension fund
Supplementary pension insurance
Participant's contribution
Amount of state contribution
State contribution
Participant to the supplementary pension insurance
Savings assessment
Supplementary pension savings

ABSTRACT

The state-contributory supplementary pension insurance is a popular product in the Czech Republic. According to the Association of Pension Funds of the Czech Republic, as at 31 December 2012 ca. there were 5.15 million registered participants in pension funds (as at 31 December 2011 it was ca. 4.60 million of participants) who had deposited ca. CZK 246.594 billion (as at 31 December 2011 it was ca. CZK 232.052 billion). Pension funds have been showing stable management, however, at the cost of low income. Since its reform was enforced by the government in 2013, supplementary pension insurance has remained a part of the pension scheme. It has become a so called "Pillar III" and the law describes it as *supplementary pension savings*. The Amendment to the State-Contributory Supplementary Pension Insurance Act, whose target is to reinforce the role of supplementary pension insurance in the creation of total savings for retirement age contains a number of positive elements. The question is whether the amendment will actually meet expectations, i.e. to make the supplementary pension insurance a functional "Pillar III" of the pension scheme as the state-contributory supplementary pension insurance does not fulfil its primary function yet and de facto it is not even capable of competing with life-cycle mutual funds or with other substitutes offered on the financial market without being significantly supported by the state.

Introduction

The amount provided by retirement pensions in the Czech Republic is considered to be adequate by 23% of citizens. On the other hand, 77% of citizens consider the amount to be inadequate and 45% of them regard the pension amount as "definitely" inadequate.

The state-contributory supplementary pension insurance implemented in the Czech Republic within the scope of the

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http://dx.doi.org/10.1016/j.kontakt.2014.06.001

voluntary private pillar, was to help citizens when they retire by adding a certain amount to the state pension. It is therefore completely understandable that high expectations were laid on pension funds created in the Czech Republic in 1994. The media were competing with each other in publishing various specialists' and analysts' commentaries predicting not only a quick development of this sector but also a tempting return of at least 2–3% above the inflation rate. Interesting supplementary pensions (necessary also due to the decrease of the pension value by ca. 15% caused by price liberalisation in 1992) were also expected within 20 years at the latest after the start of the pension funds. Therefore, it is not surprising that after the first licenses were awarded in November 1994, pension funds attracted the general public extraordinarily.

However, the reality is somewhat different. Although the state contribution and tax relief helped the product to be used by more than 5.15 million active participants (60% of citizens between 30 and 60 years of age are saving these days – more than 80% of all economically active citizens – which means that the Czech Republic is now among world's top countries for participation of its citizens in savings), the average monthly contribution of participants (excluding the state contribution) does not even amount to CZK 600. This situation has not been significantly improved even after it was made more advantageous for companies contributing to their employees' supplementary pension insurance. It is therefore quite logical that participants' savings are low and insufficient for the payment of a regular pension amount (the vast majority of participants receives a lump-sum settlement; a regular pension is exceptional).

In a way, the state-contributory supplementary pension insurance is a peculiar Czech phenomenon. Its characteristics are those of life insurance, but that is not what it is. It seems to be a regular investment, but it does not follow investment principles. It simply functions under completely special rules.

Materials and methods

The aim of this study is to present the development, issues and perspectives of the state-contributory supplementary pension insurance (supplementary pension savings) as Pillar III in the Czech Republic. The grounds for the development assessment were the data published by the Association of Pension Funds of the Czech Republic [1,2], by the Ministry of Finance of the Czech Republic [3,4] and by the Czech Statistical Office [5]. Time series obtained from these data were furthermore analysed and conclusions were made based on these analyses.

Results and discussion

State-contributory supplementary pension insurance was implemented in the Czech Republic under Act No. 42/1994 Coll. on State-Contributory Supplementary Pension Insurance and Amending Certain Acts Related to its Introduction, as amended [6].

Under the above mentioned Act, state-contributory supplementary pension insurance means the collection of financial contributions from participants in supplementary pension insurance and from the state as provided for the benefit of the participants, management of such financial contributions, and the payout of supplementary pension insurance benefits. Supplementary pension insurance cannot be carried on by any persons other than pension funds.

A natural person may become a participant if he is over 18 years of age and has permanent residence in the Czech Republic. Participation in the supplementary pension insurance is established by the execution of a **supplementary pension insurance policy**.

The State-Contributory Supplementary Pension Insurance Act stipulates the following two types of pension plan:

- contributory pension plan;
- benefit pension plan.

The pension plan can be conceived of as a defined-contribution pension plan where the size of pension benefits is dependent on the sum of the contributions remitted in the participant's favour, on the participant's share of the pension fund's revenues, and on the age from which the pension benefits are to be provided.

The nature of a defined-benefit plan is that the pension sum is pre-determined and is not bound directly to the contributions made (when stipulated terms and conditions are met, the pension fund guarantees the agreed pension sum).

Significant support to the supplementary pension insurance is provided by the state (excluding the state contribution) as it offers tax relief [7,8], for **employees** as well as for **employers**.

We may define the system, which may be referred to as Pillar III of the pension security scheme in accordance with a common world practice, by the following parameters [9]:

- voluntariness;
- state contribution;
- governed supervision.

State-contributory supplementary pension insurance in data

There are 10 pension funds operating actively in the Czech Republic (over time, the number of pension funds has decreased from the original 44 to the current 9 funds) where a foreign shareholder with high capital has gained a key position almost with all pension funds. Their basic economic characteristics and positions on the supplementary pension insurance are shown in Table 1 of selected indicators as at 31 December 2012.

At the end of 2012, the number of participants in the supplementary pension insurance reached 5.150 million. Supplementary pension insurance is, therefore, still expanding, despite its downward trend (Tables 2 and 3).

The reasons for the slackening of interest in supplementary pension insurance in the years 2009–2011, presented by a downward number of newly concluded contracts, may be that, apart from the stagnation in economical performance, the unemployment rate was high, income growth was low, and the state did not have a clear strategy of reform of the pension scheme. The market-saturation factor also played an

Table 1 – Selected characteristics and indicators of pension funds as at 31 December 2012.

Pension fund name	Number of active participants	Participants' funds (in CZK thousand)	Total assets (in CZK thousand)	Total liabilities (in CZK thousand)	Equity capital (in CZK thousand)	Profit (loss) for the accounting period after tax (in CZK thousand)
AEGON PF	101,387	4,593,330	5,370,781	5,370,781	740,282	112,854
Allianz PF	486,445	20,421,310	22,468,802	22,468,802	1,668,857	357,367
AXA PF	438,430	30,852,728	34,540,046	34,540,046	3,489,286	453,867
ČSOB PF Stabilita	732,428	28,854,957	32,308,661	32,308,661	2,642,177	607,236
Generali PF	76,399	3,575,870	3,960,991	3,960,991	330,678	45,466
ING PF	405,393	24,613,915	26,600,628	26,600,628	1,638,588	472,851
PF České pojišťovny	1,280,079	59,259,016	67,742,856	67,742,856	7,313,117	1,431,133
PF České spořitelny	1,058,852	42,521,479	45,446,219	45,446,219	2,590,657	756,800
PF Komerční banky	571,002	31,902,495	34,882,637	34,882,637	2,442,237	575,382
Total	5,150,415	246,595,100	273,321,621	273,321,621	22,855,879	4,812,956

Source: [1].

Table 2 – Total number of effective policies in years 2000–2012 (in millions of units).

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
2.372	2.534	2.622	2.74	2.964	3.28	3.594	3.936	4.207	4.395	4.528	4.566	5.15

Source: [3].

Table 3 – Number of new policies (in CZK thousand) and year-on-year development in years 2000–2012 (%).

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
595	408	347	372	436	544	559	586	590	525	495	457	1128
	−31.4	−14.9	7.1	17.1	24.9	2.6	5.0	0.7	−11.1	−5.6	−7.8	146.8

Source: [3].

indubitable role as did the low estimation of savings within pension funds in the past years (in particular in 2008). System changes which came into force in 1 January 2013 are without a doubt the reason for the enormous and unrepeatable growth in 2012.

Even companies which often contribute to their employees' pensions had restricted their scope of contribution to the supplementary pension insurance (Table 4).

The amount which is yearly paid out on state contributions also showed permanent growth in the supplementary pension insurance scheme as is described in Table 5.

Weaknesses of the state-contributory supplementary pension insurance

Despite the relatively positive development of the supplementary pension insurance scheme there are problems and weaknesses, particularly in the age structure of participants to the supplementary pension insurance which does not correspond with the population layout (Table 6).

The average age is 48 years which is substantially more than the average age in schemes of other developed countries. Younger workers (less than 40 years of age) are not insured

Table 4 – Number of new supplementary pension insurance policies with registered contributions.

Number of new supplementary pension insurance policies with employer's registered contributions (in thousands of units) and year-on-year development (%) in years 2000–2007

2000	2001	2002	2003	2004	2005	2006	2007
416.57	567.75	650.21	727.99	801.63	927.93	1028.85	1129.62
	36.3	14.5	12.0	10.1	15.8	10.9	9.8

Number of new supplementary pension insurance policies with employer's registered contributions (in thousands of units) and year-on-year development (%) in years 2008–2012

2008	2009	2010	2011	2012
1222.64	1261.52	1284.74	1271.93	1317.56
8.2	3.2	1.8	−1.0	3.6

Source: [3].

Table 5 – State contributions paid out in years 2000–2012 (CZK billions).

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
2.47	2.658	2.77	2.93	3.222	3.683	4.162	4.651	5.088	5.347	5.51	5.602	5.913

Source: [3].

Table 6 – Age structure of participants to the supplementary pension insurance.

Age	Age structure percentage (%)
18–19 years	0.5
20–29 years	12.1
30–39 years	21.1
40–49 years	19.2
50–59 years	22.9
60–69 years	16.6
70–79 years	6.1
80 years and more	1.5

Source: [4].

sufficiently which is why they present a considerable risk group; this generation will strongly feel the effects of the pension scheme reform (pension guaranteed by the state) and therefore these citizens will be dependent on supplementary sources of old-age pension. As regards the total number of participants, 47% of men and 53% women contribute to the pension scheme.

The **distorted age structure** in the system supplementary pension insurance is why specialists are concerned. The average age of the Czech population is actually 39 years and thus it is nine years younger than the age of participants to the supplementary pension insurance. If the current situation stays the same, it could cause a future major **disbalance** of the whole supplementary insurance scheme by the simple ageing of the population.

Average low contributions to the scheme

Average contributions to the scheme are low and this situation may be considered as the main weakness of the supplementary pension insurance (Table 7). They amount to less than 2% of the average gross wage and they show a downward trend (in 2000 the contribution share to the supplementary pension insurance against the gross wage amounted to 2.5%). Most of the participants (around 30%) save CZK 500–599 monthly so they gain the full state contribution and partially also a tax relief, however, they will not save much for their retirement.

The highlighted contributions of such a low level are insufficient to cover the life annuity of pensioners to allow them to maintain their life standard during retirement. It is therefore obvious that despite its popularity, the supplementary pension insurance does not fulfil its function, which contradicts its sense and primary mission.

Currently the average state pension amounts to approximately 52% of the average net income. To exaggerate its simplification, it means that in order to maintain his life standard, a pensioner should make such savings as would allow him to draw a monthly annuity amounting to several thousands of Czech crowns (the difference between an average net income and an average pension) and not just several hundreds, which describes the current situation. However, in order to draw such a life annuity, he would have to saved an amount of more than CZK 1.3 million.

According to Kamil Durčák, Product Manager of Rentia, AWD ČR division [10], people should generally save five to ten percent of their incomes and they should do so for their entire productive age. This would help them eliminate (although not completely) the downgrade of their life standard in retirement.

Low assessment of contributions

Low assessment of contributions is a fundamental issue of supplementary pension insurance and it does not contribute to its attractiveness (especially for younger generations), since the assessment interest rate awarded to clients scarcely covers inflation.

Contributions assessment shown by pension funds may be tempting at first sight which is supported by the following overview of the nominal assessment of contributions in years 1995–2012 (Tables 8a and 8b); pension funds often use this fact within their marketing activities (especially when "client-hunting").

This relatively favourable situation is significantly changed (unfortunately for the worse) by inflation. Its rate in the years 1995–2012 is shown in the following Table 9.

Table 7 – Development of participant's average contribution and of the state contribution in years 1995–2012.

Year	Participant's average contribution (in CZK) – excluding contributions paid by employers to their employees	Average monthly state contribution to participants (in CZK)
1995	262	93
1996	305	103
1997	333	97
1998	333	95
1999	324	92
2000	326	89
2001	340	90
2002	354	90
2003	384	96
2004	397	98
2005	408	99
2006	431	102
2007	450	104
2008	451	105
2009	444	105
2010	440	105
2011	442	105
2012	465	108

Source: [3].

Table 8a – Overview of nominal contributions assessment in years 1995–2003.

Pension fund	Nominal contributions assessment in years 1995–2003 (%)								
	1995	1996	1997	1998	1999	2000	2001	2002	2003
AEGON PF	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Allianz PF	–	–	8.90	9.10	6.00	3.80	4.36	3.71	3.00
AXA PF	12.80	11.45	11.20	10.10	6.50	4.10	4.25	3.41	3.36
ČSOB PF Progres	0.00	16.40	8.00	10.90	7.70	5.62	3.90	4.26	4.30
ČSOB PF Stabilita	10.40	10.90	10.30	10.02	6.10	4.20	3.20	3.00	2.30
Generali PF	10.30	10.61	14.60	11.40	5.30	3.60	4.60	4.10	3.00
ING PF	12.80	12.10	11.00	9.34	6.00	4.40	4.80	4.00	4.00
PF České pojišťovny	10.30	9.20	9.60	9.72	6.60	4.50	3.80	3.20	3.10
PF České spořitelny	4.00	8.10	9.05	8.33	4.40	4.20	3.80	3.50	2.64
PF Komerční banky	9.44	8.36	9.10	9.50	7.20	4.89	4.40	4.63	3.40

Source: [2].

Table 8b – Overview of nominal contributions assessment in years 2004–2012.

Pension fund	Nominal contributions assessment in years 2004–2012 (%)								
	2004	2005	2006	2007	2008	2009	2010	2011	2012
AEGON PF	0.00	0.00	0.00	4.50	3.50	2.10	2.11	1.60	2.50
Allianz PF	3.00	3.00	3.11	3.00	3.00	3.10	3.00	2.69	2.20
AXA PF	3.10	3.70	2.50	2.20	0.00	2.00	1.47	1.47	1.40
ČSOB PF Progres	5.30	5.00	2.30	2.40	0.02	1.00	1.03	1.71[a]	2.10
ČSOB PF Stabilita	4.30	4.00	2.80	2.40	0.05	1.37	1.49		
Generali PF	3.00	3.81	3.74	4.10	2.00	2.40	2.10	0.30	1.30
ING PF	2.50	4.20	3.60	2.50	0.04	0.10	2.10	2.10	2.10
PF České pojišťovny	3.50	3.80	3.30	2.40	0.20	1.20	2.00	1.50	2.50
PF České spořitelny	3.74	4.03	3.04	3.10	0.40	1.28	2.34	2.07	1.90
PF Komerční banky	3.50	4.00	3.00	2.30	0.58	0.24	2.23	2.00	1.80

Source: [2].
[a] Pension funds Progres and Stabilita were united in November 2011.

Table 9 – Inflation rate in years 1995–2012.

Inflation rate in years 1995–2003 (%)								
1995	1996	1997	1998	1999	2000	2001	2002	2003
9.1	8.8	8.5	10.7	2.1	3.9	4.7	1.8	0.1
Inflation rate in years 2004–2012 (%)								
2004	2005	2006	2007	2008	2009	2010	2011	2012
2.8	1.9	2.5	2.8	6.3	1.0	1.5	1.9	3.3

Source: [5].

The level of real contributions assessment (that is the assessment of contributions after adding the inflation rate) does not correspond with the parameters expected from a long-term investment (Table 10).

The rate of assessment of real contributions (taking inflation into account) shows a strong downward trend particularly in the first five years (quasihyperbolical functional dependence) where there is an inverse relationship between the amount of contributions and the rate of their real assessment. That means the higher yearly contributions are, the lower the rate of their real assessment (based on model projection we may estimate that after ca. 40 years of savings with a yearly contribution higher than CZK 6 thousand the rate of real assessment does not amount to even 1%).

According to Jiří Rusnok, the former President of the Association of Pension Funds, the low real assessment of funds within pension funds justly faces criticism, but it is the price paid for maintaining system stability (according to the law pension funds must adhere to at least zero nominal assessment).

A low contributions assessment is largely influenced by the Act on Supplementary Pension Insurance which regulates the manner of pension funds' management and it restricts pension funds in many ways. A fundamental barrier consists in the funds' duty to gain a positive economic result within a period of a year.

A strongly conservative investment strategy did not allow younger participants, with a longer investment period, to choose a **more aggressive strategy**, with an emphasis on

Table 10 – Real contributions assessment in years 1995–2012.

Pension fund	Real assessment of participants' funds in years 1995–2003 (%)								
	1995	1996	1997	1998	1999	2000	2001	2002	2003
AEGON PF									
Allianz PF			0.40	−1.60	3.90	−1.10	−0.34	1.91	2.90
AXA PF	3.70	2.65	2.70	−0.60	4.40	0.20	−0.45	1.61	3.26
ČSOB PF Progres		7.60	−0.50	0.20	5.60	1.72	−0.80	2.46	4.20
ČSOB PF Stabilita	1.30	2.10	1.80	−0.68	4.00	0.30	−1.50	1.20	2.20
Generali PF	1.20	1.81	6.10	0.70	3.20	−0.30	−0.10	2.30	2.90
ING PF	3.70	3.30	2.50	−1.36	3.90	0.50	0.10	2.20	3.90
PF České pojišťovny	1.20	0.40	1.10	−0.98	4.50	0.60	−0.90	1.40	3.00
PF České spořitelny	−5.10	−0.70	0.55	−2.37	2.30	0.30	−0.90	1.70	2.54
PF Komerční banky	0.34	−0.44	0.60	−1.20	5.10	0.99	−0.30	2.83	3.30
Pension fund	Real assessment of participants' funds in years 2004–2012 (%)								
	2004	2005	2006	2007	2008	2009	2010	2011	2012
AEGON PF				1.70	−2.80	1.10	0.61	−0.30	−0.80
Allianz PF	0.20	1.10	0.61	0.20	−3.30	2.10	1.50	0.79	−1.10
AXA PF	0.30	1.80	0.00	−0.60	−6.30	1.00	−0.03	−0.43	−1.90
ČSOB PF Progres	2.50	3.10	−0.20	−0.40	−6.28	0.00	−0.47	−0.19[a]	−1.20
ČSOB PF Stabilita	1.50	2.10	0.30	−0.40	−6.25	0.37	−0.01		
Generali PF	0.20	1.91	1.24	1.30	−4.30	1.40	0.60	−1.60	−2.00
ING PF	−0.30	2.30	1.10	−0.30	−6.26	−0.90	0.60	0.20	−1.20
PF České pojišťovny	0.70	1.90	0.80	−0.40	−6.10	0.20	0.50	−0.40	−0.80
PF České spořitelny	0.94	2.13	0.54	0.30	−5.90	0.28	0.84	0.17	−1.40
PF Komerční banky	0.70	2.10	0.50	−0.50	−5.72	−0.76	0.73	0.10	−1.50

Source: Author's calculation based on the data of the Association of Pension Funds [2] and the Czech Statistical Office [3].
[a] Pension funds Progres and Stabilita were united in November 2011.

shares which could be gradually transformed to a more conservative strategy where gained profit would be "protected".

The key factor influencing the rate of contributions assessment is **costs** (in the long run the trend of costs together with inflation is to absorb the biggest share of clients' profits).

Operating costs of private pension funds are high. According to economists from the scientific centre IDEA of the Economics Institute of the Academy of Sciences of the Czech Republic this is the reason why Czech pension funds are the least profitable in Central Europe.

Although the rate of average operating costs towards total assets shows a downward trend, its level is still intolerable (considering foreign experience, the costs amounting to 1% of assets mean consumption of 15–20% from collected contributions). According to Jan Švejnar, professor of University of Michigan [11], the best world's biggest pension funds have fees of 0.1% of a contributed amount.

The highest cost items are generally costs of "client hunting" as all funds take clients of other funds over and this is systematically done by financial advisors (they get a lucrative commission upon bringing a client to the company). It is quite logical that pension funds want someone to pay for that, and it should of course be the clients (at the expense of their contributions assessment).

Low number of pensions

Another significant weakness of supplementary pension insurance during its entire existence has been the fact that participants usually terminate their legal relations by a lump-sum settlement and the number of retirement pensions from the scheme is very low (supplementary pension insurance acts de facto as a kind of "state-contributory savings" and it therefore does not fulfil its sense and mission).

There are a number of causes of this alarming state. Despite a generous state contribution, our benevolent legislation does not force participants to the supplementary pension insurance to use it for their life annuity payment which is why pension funds are successful in gaining so many clients by emphasising the short-term advantageousness of supplementary pension insurance in their marketing strategies (i.e. the preference of having insurance with a lump-sum payment against an insurance of life annuity).

Supplementary pension insurance (supplementary pensions savings) since 2013

Since the government's reforms in 2013, the supplementary pension insurance has remained a part of the pension scheme. It has become a so called "Pillar III" and the law describes it as the **supplementary pension savings**. In comparison with the previous situation, by enforcing the Act No. 426/2011 Coll., on Retirement Savings [12], and Act No. 427/2011 Coll. on Supplementary Pension Savings [13], the following significant changes are implemented:

- *The original pensions funds are transformed to pension management companies*

  The original pensions funds are transformed to pension management companies and they cannot be obliged to secure a non-negative income. The assets of pension funds (shareholders) and participants' funds (contributions) are

separated. Not only does this make this profit distribution among shareholders and participants more transparent, but it also limits the area of drawing sources of participants to the supplementary pension insurance. It also allows a clear definition of the administration fee for participants' funds. These are limited to 0.4–0.8% (0.4 for so called "conservative funds" whose creation is obligatory, and 0.8% for all other participants funds) plus a 10% assessment share (so called success fee).

- *Existing participants are "transferred" to "transformed funds"*

  Participants who have entered into a contract before 31 December 2012 are transferred to so called "transformed funds" and they keep all benefits they have had before (e.g. annual guarantee of contributions returnability, etc.).

- *New participants may enter into "participants funds"*

  Participants entering into a contract after 31 December 2012 may not enter into "transformed funds" but only into "participants funds". These funds do not guarantee a non-negative assessment (profit) any more and they get a bigger chance for investment which creates potential prerequisites not only for gaining a higher profit than before, but a risk of savings' depreciation (the risk shall be carried by participants). Participants to "transformed funds" may enter into "participants funds" (a transfer from "participants funds" to "transformed funds" is not possible). Participants may choose from several investment strategies. All pension management companies offer a conservative fund for participants where it is possible to use a dynamic investment strategy.

Conservative lifecycle strategy

This strategy may be recommended to people at the age of approximately 55 who will not enter into pension savings because the conservative fund for participants will invest in bonds with a strictly determined risk. These types of savings should ensure that participants will get their savings back with a state contribution evaluated at 2% in total.

Balanced lifecycle strategy

A balanced lifecycle strategy is recommended for people aged 45–55. Within the scope of this strategy the saved funds fluctuate more (in certain years they may be slightly in deficit, on the other hand, others may reach growth of up to 6%). Despite the fact that participants' funds will be invested mainly in bonds, a certain percentage will also be invested in shares, cash and real estate. The assessment should overcome the conservative lifecycle strategy and it should most likely reach the amount of 1–5%.

Growth lifecycle strategy

A growth lifecycle strategy is most suitable for participants younger than 45 years. It brings the best results in the long run as participants funds will be mainly invested in stock markets and in real estate. It is the most risky strategy since the assessment percentage (or depreciation percentage) may reach up to double-digit numbers.

- *Rules for granting state contribution are tightening up*

  The amount of minimum monthly participants' contribution to which a state contribution is made is increased from current CZK 100 to CZK 300. Participants to supplementary pension insurance may therefore gain a state contribution of CZK 2760 per year (at the end of 2012 it was CZK 1800). The new amount of state contributions concerns all policies on supplementary pension insurance which means even those concluded years ago and to which participants gain contributions of the original amount (CZK 50 state contribution to CZK 100 saved). The change which was reinforced as at 1 January 2013 is clearly described in the following Table 11.

  Before an amendment to the law was enforced in 2000, the maximum state contribution in the first two years of savings was only CZK 150 per month, after that it was only CZK 120. The lower state contribution was compensated for in a way by the lower age of participants (50 years of age) where it was possible to receive saved funds.

  According to the information gained from sources of pension management companies, more than a million participants save less than CZK 300 monthly (and therefore they do not gain a state contribution).

- *The boundaries of tax relief are moved*

  Participants to supplementary pension insurance will still be allowed to deduct their paid contribution to pension savings (to the amount of CZK 12,000 a year at maximum)

Table 11 – State contribution.

Individual monthly contribution (in CZK)	Monthly state contribution before 31 December 2012 (in CZK)	Monthly state contribution as at 1 January 2013 (in CZK)
100–199	50 + 40% of amount higher than 100	0
200–299	90 + 30% of amount higher than 200	0
300–399	120 + 20% of amount higher than 300	90
400–499	140 + 10% of amount higher than 400	110
500–599	150	130
600–699	150	150
700–799	150	170
800–899	150	190
900–999	150	210
1000 and more	150	230

Source: [6,12,13].

from the income tax base. However, the boundaries from which these contributions may be deducted, are changed. Whereas by the end of 2012 it was possible to deduct contributions exceeding CZK 6000, after the amendment (since 1 January 2013) this boundary is doubled to CZK 12,000 (it is connected with a change in the minimum monthly contribution with a maximum amount of state contribution changed from CZK 500 to CZK 1000, and thus from CZK 6000 to 12,000 per year).

What are the payment choices in Pillar III?

If a participant saves in a **transformed fund** (and entered into a contract before 31 December 2012), he is entitled to all allowances under his pension plan). Participants are entitled to the payment of the following three types of allowances from the supplementary pension insurance:

- *Lump-sum settlement* – due to a participant on the conditions stipulated by a pension plan in lieu of a pension. It consist of the total amount which the participant has saved (contributions paid by the participant and his employer), of state contributions he is entitled to, and of the share of a pension fund's revenue from both of these amounts.
- *Termination settlement* – due to the participant to the supplementary pension insurance or the natural persons appointed in the policy by the participants. It consist of the total amount which the participant has saved (contributions paid by the participant and his employer), and of the share of a pension fund's revenue from this amount. Within the scope of the termination settlement, state contributions or pension funds' revenues from state contributions are not paid out.
- *Pension* – a lifetime, regular payment of a financial amount for a period determined by the pension plan (it is generally a life annuity). The following benefits shall be provided out of supplementary pension insurance (pension funds may not broaden the scope of benefits):
  - old-age pension;
  - early-retirement pension;
  - disability pension;
  - survivors' pension.

A participant saving in the **participants fund** may use saved up funds strictly for the payment of the following benefits:

- old-age pension for a fixed period;
- disability pension for a fixed period;
- lump-sum settlement;
- termination settlement;
- payment of a single premium for life annuity;
- payment of a single premium for pension for a fixed period with a fixed amount of pension.

Old-age pension payment for a fixed period and disability pension for a fixed period

Old-age pension for a fixed period or disability pension for a fixed period are paid either as benefits of a fixed amount or as a fixed number of benefits until all of the participant's funds are used, and these are paid regularly at least four times per calendar year if the benefit amount is at least CZK 500. Otherwise the pension management company may decrease the number of benefits to one per year. When applying for the payment of these benefits, a participant determines the period or amount of benefits in such manner that the expected period of benefit payments would last at least for 3 years. The pension management company shall initiate the benefit payment by the end of the calendar month immediately following the calendar month when the application for payments was handed in at the latest unless otherwise agreed by the participant and the pension management company.

Lump-sum settlement

A lump-sum settlement is due to a participant on the conditions stipulated by law and if the participant is not being paid another benefit (old-age pension for a fixed period, disability pension for a fixed period; payment of a single premium for life annuity or payment of a single premium for pension for a fixed period with a fixed amount of pension).

A lump-sum settlement is due to a person appointed by the participant in the event of a participant's death after the day he was entitled to a specific benefit (old-age pension for a fixed period, disability pension for a fixed period; lump-sum settlement; payment of a single premium for life annuity or payment of a single premium for pension for a fixed period with a fixed amount of pension) or in the event of a participant's death and his old-age or disability pension had already started being paid (in such a case the specified person is entitled to a lump-sum settlement amounting to a yet unpaid part of participant's funds).

A lump-sum settlement is subject of inheritance (unless an appointed person for a fixed period is determined by the participant concerning his disability pension).

If the appointed person or inheritors are entitled to a lump-sum settlement, the pension management company shall pay the lump-sum settlement within one month upon receiving a written application, should the participant's death be proclaimed.

Termination settlement

A participant is due a termination settlement if supplementary pension savings are terminated (upon a written agreement between the participant and the pension management company by notice), if the savings period was at least 24 calendar months and if the participant's funds have not been transferred to a different pension management company.

A participant is also due a termination settlement if the participant's fund is terminated unless his funds have been transferred to another participant's fund.

A termination settlement is due to a person appointed by the participant in the event of the participant's death and if he had not been entitled to one of the benefits (old-age pension for a fixed period or disability pension for a fixed period from all participant's funds; lump-sum settlement from all participant's funds; payment of a single premium for life annuity or payment of a single premium for pension for a fixed period

with a fixed amount of pension from all participant's funds; expiry of the notice period or the participant's death). Unless a person is appointed by the participant, the termination settlement is the subject of inheritance.

The amount of termination settlement constitutes of the value of the participant's funds up to the date the obligations arising out of the supplementary pension savings policy stipulated by agreement of the participant and the pension management company are terminated, or up to the date the notice is served, after the deduction of contributions provided by the state.

Termination settlement paid by the pension management company is paid within one month of the date the written application for its payment is served on an authorised person.

Payment of a single premium for life annuity and for pension for a fixed period with a fixed amount of pension

Upon receiving a written application for the payment of a single premium for life annuity and for pension for a fixed period with a fixed amount of pension, the pension management company is obliged to inform the participant in writing of the total amount of funds at the date of receiving the application and it is obliged to do so within 7 working days at the latest.

When arranging the life annuity, a pension payment must be stipulated in regular monetary benefits in a non-descending amount and they are to be paid life-long and at least four times per calendar year.

When arranging a pension for a fixed period with a fixed amount of the pension, the pension payment period of a fixed amount of the pension must last at least 3 years (on certain conditions the law allows the period to be at least 2 years).

A pension management company shall make a single premium payment upon submitting a concluded insurance policy which complies with the terms and conditions under Act No. 427/2011 Coll., on Supplementary Pension Savings [13], to the account stated in the insurance policy, and it shall do so by the end of the calendar month immediately following the calendar month in which the insurance policy was submitted at the latest. If the submitted insurance policy does not comply with the terms and conditions stipulated by this Act, the pension management company is obliged to inform the participant of this fact within 5 working days of the date of its submission. Any supplementary payment of the state contribution shall be paid upon receipt to the participant by the pension management company without any delay in the manner stated in the application for benefits.

Before an insurance policy is concluded, the insurance company shall inform the applicant in writing of the amount of pension which shall be guaranteed to him upon conclusion of the insurance policy (from the value of the participant's funds as of the date of the application delivery). The insurance company is legally bound to provide this information for a period of 6 months upon providing of the information.

Conclusion

Should the government, despite the conclusion of the World Bank recommending a so called Pan-European pension scheme [14,15], impose its vision of a pension reform, the supplementary pension savings may become a suitable product for those who for some reasons (mainly due to insufficient income) may not opt out from the public pillar in favour of the fund scheme (''opt-out'' scheme) or for those who may not find it trustworthy but who will want to save some funds to contribute to their pension.

The Amendment to the Act on Supplementary Pension Insurance aiming to strengthen the role of supplementary pension insurance in the creation of total savings for old age, brings a number of positive elements (separation of the assets of participants from those of a shareholder; stipulation of maximum fees for funds administration; a participant's option to select a strategy of more investment strategies which most suits his age and risk approach) and it is obvious that the main changes (including changes in the area of state contribution) were designed especially from the perspective of the participant. Therefore, most likely, participants as well as politicians (as they need to win favour of their voters) will be very content with this offer in the short run. The question is whether the amendment will actually meet expectations, i.e. to make the supplementary pension insurance a functional ''Pillar III'' of the pension scheme.

Reforms to the social security scheme (primarily the pension reform) are a very sensitive issue and they are often misapprehended which often leads to various protests of citizens, unions or interest groups. The start-up of these reforms is, however, also a factor which is taken into account when assessing the performance of the Maastricht fiscal convergence criteria and mitigation of penalties for non-compliance on grounds of reforms.

Conflict of interest

The author confirms that there are no known conflicts of interest associated with this publication.

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