ECONOMIC COMMENT

19 February 2018

Employees' Capital Plans (PPK)

On 15 February, the government representatives presented the main assumptions behind the Employees' Capital Plans (PPK), i.e. new element in the pension system. PPKs are set up to support domestic saving and to increase future pensions. PPKs will be introduced gradually – initially, only the biggest companies will be obliged to present PPKs to its employees; while smaller companies will join the scheme later. In the last phase, PPKs will also cover the public sector entities. According to the estimates of the Finance Ministry, PPK will be available to a total of 11.4mn employees. In our view, contributions to PPK will exceed PLN20bn in 2020, and will hamper the growth of gross disposable income and private consumption. At the same time they will trigger a higher saving rate and improvement of current account balance, and a higher demand for T-bonds.

Employer group	Employees (mn)	Introduction date
>250 persons	3.3	01.01.2019
50-249 persons	2,0	01.07.2019
20-49 persons	1.1	01.01.2020
other and GG	5.1	01.07.2020
Total	**11.4**	

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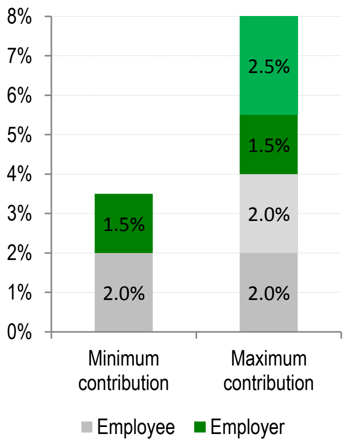
Contribution

Size of contribution to PPK



PPK contribution is to be equal to 2.0% of the pension contributions' taxing base (i.e. gross salary), paid by the employee with a possibility of a voluntary increase to 4.0%. This contribution will not be tax-deductive, so it will decrease the net salary. Additionally, 1.5% of gross salary will be paid by the employer with a possibility of a voluntary increase to 4.0% (employer decides whether to increase this part and contributions can be differentiated within one company but only based on experience with no impact on gross salary). In total, contribution may fall between 3.5% and 8.0% of gross salary. The central budget – with use of Labour Fund – will be adding PLN240 of annual premium to each PPK account provided that the holder saves more than 6 minimal contributions deducted from the minimal salary (i.e. about PLN450 per annum). Additionally, until end of 2020 the government will add PLN250 of "welcome premium", provided that the saver pays at least 3 contributions.

Pay-out

After reaching 60 years of age, the PPK-saver will be entitled to withdraw 25% of savings without the obligation to pay capital gains tax. The remaining part will be paid out in the form of at least 120 monthly instalments (the saver can declare a longer time) or transferred to an insurance company and paid out in as life annuity. In both cases the payment will not be subject

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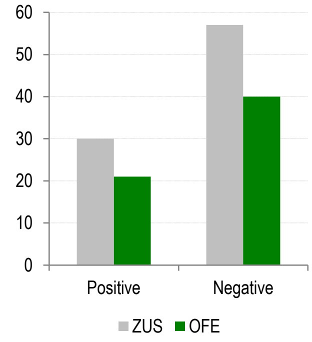
to capital gain tax. This part of savings can be also paid out earlier, but in this case, it will be taxed. The bill also allows a temporary use of PPK savings to finance own contribution in mortgage loan and a disbursement in case of a serious illness.

Financial institutions and investment policy

Employer will be obliged to choose a managing institutions (or a few) that will offer PPKs, consisting of at least 4 schemes with investment policies fitted to different age groups. Up to 30% of means can be invested abroad, with no other investment limits in the bill. The maximum annual management fee was set at 0.5% of assets under management (AuM) and would be suspended if a given managing institution wins more than 15% of the PPK market. Additionally, there is a possibility to introduce a performance fee up to 0.1% of AuM (with no suspension after exceeding concentration threshold). In 2016, in open pension funds (OFE), the average management fee was equal to 0.45% of AuM, while the initial fee was equal to 1.58% of new means. Fees in mutual funds (TFI) are clearly less competitive with management fee ranging from c1% of AuM for cash funds to 3-4% for equity funds.

Opinions about ZUS and OFE, CBOS survey, March 2014

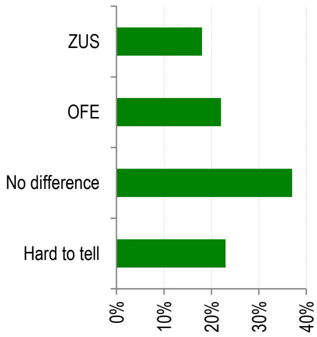


Pros and cons for a saver

We see the following incentives that should encourage participation:

- Contribution from the employer and the government. For an average salary in the corporate sector and assuming minimal contribution paid, the employee will cover only 51% of his or her total contribution. For a minimal salary – only 45%. Thus, the employee's contribution will be doubled "as a gift".
- Low fees, competitive compared to OFE and TFI
- No capital gain tax (similarly like in IKE – Individual Pension Accounts)
- Possibility to inherit PPK deposits and no obligation of withdrawal in form of life annuity

Which option will grant You a higher pension, CBOS survey, March 2014



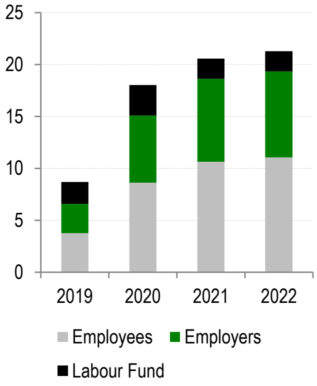
However, we also see some drawbacks:

- Lower net salary
- Limited investment product choice, presented by the employer
- Lost of freedom in managing own means
- Worries about inference of politicians in the saved capital

Participation

The Finance Ministry estimated the participation rate at 75%. In our view, such a high rate is quite probable. The architecture of choice put forward by the government, i.e. a default registration in the PPK with an option to file in an opt-out motion will result in a high participation rate in <55 age group. Additionally, even those, who choose to opt out, will be registered automatically again after two years. Actually, it will be quite wearisome to escape from saving within the PPK. Opt-out will be a bit easier for employees of smaller companies and for the self-employed, as they will be given an opportunity of one-time resignation. We do not rule out 80-90% participation rate for employees under 55 years of age in companies employing at least 10 (50-55% of the legitimate population). Let us compare this architecture of choice with 2014 OFE registration – at that time only 15.4% of savers chose OFE and others went for the default option, i.e. the Social Security Institution (ZUS), even though surveys pointed to a very bad perception of ZUS (and in particular worse than of OFE) and to a common belief that OFE stood for higher future pensions than ZUS. Especially, default option was chosen by those, who did not hold any strong views about advantage of any of these two schemes.

Estimated contributions to PPK, PLNbn

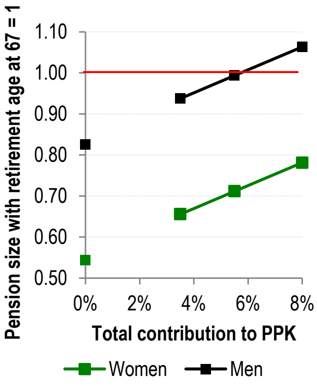


Active choice undermines the participation, and an explanation of such a phenomenon can be offered by Richard Thaler, Winner of Nobel Memorial Prize in Economic Sciences in 2017. This is why the participation rate in 55-69 age groups (about 18% of the entitled population), not registered automatically, will be considerably lower, in our view. On the other hand, automatic registration is less necessary in this group, as older people are more conscious of the need to save. For example, data on IKE and IKZE from 1H17 (completely voluntary and private elements of the pension system) show they were opened only by 7% of employees in 31-40 age group and by 13% of employees in 51-60 age group. We think that participation of 55+ age group in PPK is likely to be higher than in the case of IKE/IKZE given universality of the new scheme and financial incentives. In general, we estimate the participation rate at 70-85%.

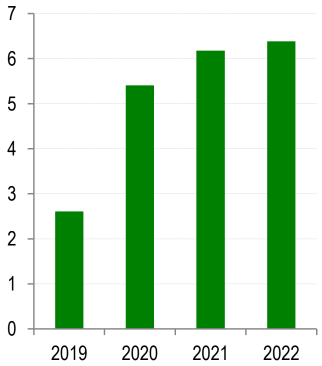
Our estimates

In order to estimate inflows to PPK we took our forecasts of wage and employment growth, assumed the lowest possible contribution, and participation rate of 80% among large companies, 55% in small companies, and 40% among the self-employed. In 2019, the inflow could be cPLN8.7bn, rising to PLN21.3bn by 2022. The estimates could be called conservative, in our view.

Will PPK offset the effect on pension of the lowered retirement age?



Estimated demand of PPK on Polish treasuries, PLNbn



Contributions paid by employees will be growing from PLN3.8bn in 2019 to PLN11bn in 2022 and gross disposable income will decline by this amount. In relation to GDP this will be 0.2% in 2019, up to 0.4% in 2022. The decrease of disposable income will weigh on private consumption, which in our view will grow 0.3pp less in 2019 and 2020, and 0.1pp less later. In the long term the negative impact of PPK on consumption decreases because it the programme strengthens purchasing power of retirees. In particular, our estimates indicate that with a total PPK contribution of 5.5%, men could make up for the decline of pensions caused by scrapping the reform that was gradually increasing the retirement age. The most that women could achieve with the help of PPK, under maximum 8% contribution, is to halve the loss in pension benefits. We expect that households saving rate will go up, by about 1.0-1.5pp (in 3Q17 it was equal to 2.4%), which will positively influence the current account balance by c0.3% GDP.

A consequence of the introduction of the employer's contribution means that labour costs will rise by cPLN3-8bn per year. It needs to be stressed that the introduction of PPK will coincide with the removal of the cap of annual pension contribution (30 times the average wage), which will raise labour costs by another cPLN1bn per year. We think that in an environment of scarcity of spare labour force and wage pressure it would be an extra factor compressing enterprise margins, which could lead to faster growth of inflation.

It is hard to guess what saving plan offer will be presented by the managing institutions taking part in the PPK programme. We think that a good proxy can be the investment policy of OFE from before their reform which transferred a part of their assets ZUS in 2014 – at that time c50% of funds were allocated in government bonds and c40-45% in equities. We assume that also in case of PPK there will be high allocation in Polish treasuries, albeit a bit smaller due to a development of the corporate debt market and covered bonds market in the recent years. In our view it should not be lower than 30%, which would translate to PPKs' demand for government bonds of cPLN2.5bn in 2019 and cPLN6.5bn in 2022. However, net inflows on the bond market would a bit lower as PPK contributions would decrease inflows into the banking system and thus banks' demand for bonds. With time, PPK portfolio should be moving more towards safer assets, like government bonds, due to the ageing process of the population.

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