

ROMANIA'S PRIVATE PENSIONS SYSTEM

C.M. Marc¹, C. Buzea²

¹Oradea University, Faculty of Textiles and Leatherworks, 4 Stefanescu Delavrancea, 410058 Oradea, Romania

²Transilvania University of Brasov, Faculty of Law and Sociology, 25 B-dul. Eroilor, 500030 Brasov, Romania

Abstract: This paper emphasises the importance of the insurances of the private pensions, presenting some advantages and disadvantages of the private pensions, the results obtained in Romania by the privately managed mandatory pensions fund system (2nd pillar) and by the privately managed optional pensions fund system (3rd pillar) and by the difficulties occurred in their implementation. A part of the results of a qualitative research in Bihor County is illustrated, results obtained from individual interviews with 14 specialists in the pensions' domain.

Keywords: balanced average efficiency, economic crisis, tax incentives, individual choice, private pensions

1. Introduction

The demographic changes and the difficulties that the pension systems face, transforms the delivery of social protection for the old persons in an important challenge for many of the world's countries. The insurance of the welfare for the old persons and the preventing of their poverty and social exclusion represent a priority of the European Union. Therefore, the member states introduced reforms to consolidate the pension systems.

The conclusions of a survey led in 2008 by the Committee for the Social Protection of the European Commission confirms the tendency towards an increased role of the private pensions among the pension systems of the member states of the European Union [1].

2. Private Pension Insurances – Advantages, Disadvantages, Challenges

Traditionally, the private pension systems from the member states of the European Union are of three types: regulated pension systems, mainly being represented by the private managed component of the public system; occupational pensions, established by the work contract and individual plans of pensions.

As authors Sørensen and Buhl consider, a simple observation would be that private pensions stimulate the deferred retirement by the fact "that deferred retirement translates into higher benefits later" but "the assessment of work incentives related to private pensions in multi pillar systems is a rather complex matter". The structure of the incentives depends on the role of private pensions in the overall pension package, on the accessibility and generosity of age related social benefits and on the fiscal treatment. A reflection upon the effects of the private pensions on the participation of the old workers on the labour market, suggests two opposite effects - it can increase their participation but it can decrease it too [2].

In the same time, the private pensions DC (*defined contribution*) are protected against the uncertainty of the earnings. Furthermore, only the private funded component of the pension systems "has the potential for international diversification which can reduce country-specific risks" [3].

Regarding the private pensions in the scientific literature other aspects are registered. Thus, besides the capital given to the insurants, the private funds constitute sources of investment and profit for the organizers. In case of over demand of private insurances, "the economy cannot efficiently capitalize the entire amount it should operate with, and this, first of all, negatively affects the insurant" [4].

The private pensions are, according to some author's state, sources of economic increase too, the private funds "can make an important contribution to financial market development which in turn can contribute to more sustainable economic growth" [5].

The individual choice is very important in the case of private pensions and requires a great understanding of the financial problems, in order to make a witting option. Thus, in The European Parliament Resolution of November, 20, 2008 is shown that the tendency towards individualization contributes to the modernization of the second and the third pillar and "enable people, especially women and other vulnerable groups, to have more freedom of choice and thus become more independent and able to build up their own, additional pension rights" [6].

Mihai Şeitan, the Minister of the Labour, Family and Social Protection and former president of National Pension House and Other Rights for Social Insurances, declared in March 2007: "The private pensions are taking the step from sympathetically approaching to implementing the economic market in the pensions' domain: we are talking about property – the profit accounts are owned by the contributors – the money are invested and capitalized by a professional management, of individualization - the

prosperity at the age of retirement depending at a great degree on the personal options of saving through private pensions. Hence, in time, the existence of this complex system of pensions will bring an important contribution in the change of mentality and in the education of a certain entrepreneurial spirit of the population” [7].

3. The Evolution of the Private Pensions Systems in Romania

After an unsuccessful attempt to introduce the pensions based on capitalization, namely of the optional occupational pension system, brought under juridical regulation by 249 law of June, 9, 2004 regarding the occupational pensions, in the second stage of the Romanian pensions' system reform the legislation regarding the multi-pillar system was finalized and implemented. The components of the pensions with capitalization, privately managed in Romania, both mandatory and voluntary, are the type of those with contributions defined DC.

The second pension pillar of the Romanian system, represented by the mandatory pensions, privately managed was brought under the 411 law of October, 18, 2004. The initial adherence to the pension pillar II developed between Sept 17 2007 and Jan 17 2008. The continuous adherence process began on the 25th of April 2008. *The third pension pillar*, of voluntary pensions, regulated by the 204 law of May, 22, 2006 regarding the voluntary pensions was enforced on the 1st of June 2007 and is opened to persons aged 52.2 under. It is addressed to those who, because of the age, cannot contribute to the mandatory pillar, but are interested in a higher income at the age of retirement, being attractive for those who wish to get a third pension. The 50 Ordinance of June, 9, 2005, appointed a *Commission for the Surveillance of the Private Pensions System*, autonomous managerial administration, which has as main objectives market regulation, the selection of the operators who will manage the private pensions and the system's surveillance. In April 2010, 10 private funds and 13 voluntary funds were active.

The results obtained with the pension pillar II surpassed the optimistic prognosis of the specialists [8]. According to the final results [9], at the beginning of the adherence period, 4.156.316 persons aged 45 under adhered to the private pensions fund, from which 3.823.610 persons adhered pension pillar II and 332.706 were randomly distributed among the 18 existing funds at that time. From the whole number of participants, the greatest part 66% was represented by the persons aged under 35 and 34% participants aged between 35 and 45. Depending on gender, 49% were women and 51% were men, representing 75% respectively 63% from the female/male engaged population in the domains under the law.

According to the official data between 2008 and 2009, the number of the persons validated in the Participants' Record was constantly increased, but with significantly lower increases in 2009, reaching to 4.936.522 persons in January 2010, 30% higher than in May 2008, when the collecting of the contributions began. The numbers of con-

tributors for whom payments were made increased significantly too, therefore, in January 2010 it reached 4.598.349 persons, 44% higher than in 2008 (3.194.961 persons) and the net actives summed 2537.7 mil lei (616 mil Euros).

By the end of 2008, the degree of covering in the case of the pension pillar II, related to the whole number of the salaried it was of 85%, compared with 67% in May 2008. The balance in the total number of participants by gender, respectively by age, in January 2010 are similar to with those in May 2008, namely 51% men and 49% women, respectively 61% persons aged 35 under and 39% aged between 35 and 45. Depending on the structure of the participants by gender and age, the highest group was represented by men aged up to 35. The dispersion of the participants in the private pensions funds from the CNPAS Record function of Romania's 8 regions of development, function of the location of the employer was approximately determined between 2008 and 2009, the higher value being recorded in Bucharest-Ilfov area, 22% - 25%, followed by North-West and Central areas with 11% - 12% participants, and last, the South-West region with 7% [10].

By the end of 2007 the number of those who chose to adhere to a *voluntary pensions fund* was much reduced - 50.887 persons (coverage of 1.08% from the number of salaried). In 2008 and 2009 a slow increase of the number of participants in the pension pillar III, reaching in January 2010 to 188.471 persons (coverage of 4% from the number of salaried in Romania) and 215 million Lei the value of net actives - 52 million Euros [10].

Depending on gender, on December, 31, 2007, from the total of those who adhered to the voluntary private pensions, about 52% were women and 48% were men, representing 0.64, respectively 0.49% from the female/male employed population. The values recorded in January 2010 are almost equal, namely 50% men and 50% women. Depending on the groups of age, in December 2007, the participants aged between 16 and 29 represented approximately 20%, those aged between 30 and 44, 49% and those aged 45 over, 31%. Until January 2010, this structure undergone minor changes, so that the participants aged between 16 and 29 decreased to 15%, those between 30 and 44 to 50% and those aged 45 over 35% from the total of participants in the voluntary pensions. Therefore, the most representative group of participants in the voluntary pensions fund is that of women aged between 35 and 39. The dispersion of the participants - engaged in the voluntary pensions funds emphasises the fact that the best represented areas were, in the first month of 2010, Bucharest - Ilfov area, 31.80%, South-East, 12.13% and Central Area, 12.05%, and the dispersion of the employed participants indicate as the best represented areas Bucharest-Ilfov, 21.70%, North-West, 15.41% and the Central Area, 14.43%.

It is also interesting the analysis of the implication of the employers in the payment of the contributions for pension pillar III. In January 2010, for 56% of the participants, the contributions were paid by the employers, for 12% were made together with the employees and 32% paid their own contributions.

Despite the hostile economic environment, the private

mandatory pension funds obtained an average balanced performance on the last year (March 2009 – March 2010) of 24.2% and an annual medium from the beginning till present, of 17.7% and the private voluntary pension funds obtained an average performance of 23.0% on the last year and an annual medium of 10.2% [11].

4. Perceptions of the Specialists from Bihor County Regarding Romania's Private Insurances

Taking into account the existing problems in the Romanian pensions system, in September 2009 we made a qualitative survey, one of its objectives being the identification of some provisions to contribute in the assurance of the sustainability of the pensions system. We took individual interviews to 14 specialists from Bihor County.

The importance of the II and III pillars of the pensions system was supported by those interviewed, who considered that the multi-pillar system would increase the financial security and the quality of life for the retired persons.

Pension pillar III is extremely welcomed. It offers an addition to the income at retirement.

The private pensions assure an additional income besides the public pension. The participation in these systems depends on each individual's financial power, vision and choice.

Pension pillars II and III are favourable elements for the development of the long-term system... On the background of economic increase and stability of the system, for the young generation, obviously, theoretically, this could be an alternative, because a pension system is more powerful when based on several pillars. In the private system things begin to evolve. The behaviour of economy and investment has to be stimulated.

The respondents consider that the present fiscal deductibility in the case of the pension pillar III should be increased and supplemented with other provisions which should stimulate the participation in the private, voluntary pensions system. Those interviewed claim that the elimination of the limits of 15% from the monthly gross salary, the percentage of the contribution being left at the choice of those who choose to participate in this system.

The deductibility is not sufficient. It should be increased with at least 1000 EU per year.

The fiscal deductibility should be complete, should apply to social contributions too.

One problem should be the setting of the limits of the contributions at 15% from the monthly gross salary. The individual should be allowed to establish by himself the rate of his participation.

It was noticed that, in the pension pillar III, the participants save as much as it is deductible and even less. There is a minimal monthly contribution for each fund and many pay this amount... this is a beginning, too. Some participants doubled their contributions ever since the deductibility doubled...

Some respondents referred to the under developed culture for private saving, to the lack of financial education of the Romanian population.

The plain fact that this fiscal deductibility exists doesn't guarantee the participation in the system. There hasn't been such a culture in Romania yet, for the employer to settle an amount for

private pensions. Nor the employees are used to this type of incentives. On the long term... they are not seen, they are little visible, the people doesn't realize. On short term, there is this economic crisis, you can't know if, after a month, the firm, the place where you work, is still there, if you are or not going to work in that place.

People do not know the system very well, they don't have trust. The regulation and surveillance of the private pensions system is very important.

The opinion of those interviewed is that, the effects of the implementation of the pension pillar II are, mainly positive.

I think that, the moment the pension pillar II was implemented, it became clearer for every participant, what pension pillar I means, what pension pillar II means and implicit, what pension pillar III means. If up to this moment the pension pillar III was unknown to the average citizen, together with the implementation of the pension pillar II, a real chance was granted to pension pillar III. There are other positive effects: a decrease in the black labour market, an increase in the payments made for the National Pension House. The implementation of the pension pillars II and III brought real benefits to the Romanian pensions system, in fact, it modernized it...

The obligation of information and transparency of the managers, the informing of the participants made these "acknowledge" the situation of the money saved in their personal accounts. The employees began to "call the employers to account"...

The main effects would be: the decrease of the contributions for the pension pillar I, increasing the deficit of the public system; the acknowledgement of the positive effects on long term; the improvement of the resource management of the contributions.

The motivation of the contributors will increase, because they invest in their own pensions.

The importance of the surveillance of the private pensions system, as an assurance of its safety, was receipted by the majority of the respondents.

A control is necessary (of the private pensions system, n.i.) not to become a new business, a new NFI. In other countries, there were bankruptcies... An efficient surveillance system is needed.

The idea of implementing the "multi-fund" system and the occupational pensions was supported.

The fiscal deductibility alone is not sufficient. I am "for" the diversification of the payments in multi-funds.

The implementation of the multi-fund system would strengthen the private pensions system, by optimizing the investments and by decreasing the risk at the same time the participant reaches the retirement age.

I think that the creation of an occupational pensions system for those working in every branch would be necessary...

According to those interviewed the main effects of the economic crisis upon the private pensions systems are represented by: a decrease in the number of contributors and in the level of contributions, the settling of the level of contributions in the pension pillar II at 2% in 2009, the increase in the number of accounts, unfed with contributions and of associated costs, an decrease in the activity of the pension pillar III (a decrease in the number of adherence contracts).

Because of the crisis, the number of contributions decreased, the increase of the rate was limited to the pension funds privately

managed. According to some studies, the settling of the level of contribution at 2% in 2009, will determine a decrease of 15% of the final pension, at the end of the period of paying.

Almost 25% of the accounts are not fed with money. Some employers detain the contributions of the employees but do not transfer them to CNPAS and others do not respect the legal limits of handing in the nominal declaration. There are also persons who change their working place or get unemployed... the present crisis makes the phenomenon wider.

The adherence contracts for the pension pillar III are decreasing. People are afraid of the crisis, they heard all kinds of information especially from the mass-media, or they simply don't understand... Although there were many employers who wanted to adhere in the pension pillar III this year, because of the crisis they cannot take the costs.

5. Conclusion

The private pensions system in Romania is rather new, in its full evolution, and the present economic crisis increases the necessity of the private components' development. The number of participants in the pension pillar II surpassed the expectations of the specialists. An increased interest for the adherence of the persons aged 35-45 for whom the participation is voluntary, is noticed. Unlike the private managed funds system, the pension pillar III records a very slow increase in the number of participants, which remains at a low level. The most interested are the persons aged 30 to 44.

The qualitative survey led by the specialists from Bihor County indicates the fact that the pension pillars II and III are considered indispensable for assuring the sustainability of the system on average and long terms and the provisions proposed by the respondents comprise: the observance of the initial calendar of the contributions to the pension pillar II, complete fiscal deductibility, the increase of deductibility and elimination of the limits to 15% from the monthly gross income for pension pillar III, financial discipline of the employers regarding the transfer

of the contributions, informing of the citizens, efficient surveillance of the private pensions system and the implementation of the multi-funds system and the occupational pensions.

References

- [1] European Commission – The Social Protection Committee, “Privately managed funded pension provision and their contribution to adequate and sustainable pensions”, 2008.
- [2] O.B. Sørensen, O.B. Ole, “The interplay of retirement systems, social security, labour market policies and taxation in shaping retirement patterns”, Technical Report 11, ISSA Technical Commission on Old-age, Invalidity and Survivors' insurance, Moscow, 2007.
- [3] R. Palacios, E. Whitehouse, “The Role of Choice in the Transition to a Funded Pension System, Social”, Protection Discussion Paper Series, No. 9812, The World Bank, Washington, D.C., 1998.
- [4] I. Mărginean, *Tendințe în evoluția asigurărilor sociale din România*, in Cătălin Zamfir (coord.). *Politici sociale în România: 1990-1998*, Expert, 1999, București.
- [5] R. Holzmann, R. Palacios, “Individual Accounts as Social Insurance: A World Bank Perspective”, Social Protection Discussion Paper, Series No. 0114, The World Bank, Washington, D.C., 2008.
- [6] European Parliament resolution of 20 November 2008 on the future of social security systems and pensions: their financing and the trend towards individualization (2007/2290INI).
- [7] <http://www.pensii-private.eu/Stiri/Stiri/Un-debut-mult-asteptat:-Pilonul-II-de-pensii.html>, accessed on 25th September, 2008.
- [8] M. Șeitan, “Reforma pensiilor în România”, *Raporturi de muncă*, Vol. 2, pp.12-16, 2007.
- [9] *Commission for the Surveillance of the Private Pensions System, Activity Report 2007*, 2008.
- [10] *Commission for the Surveillance of the Private Pensions System, Monthly Bulletin, January 2010*
- [11] <http://www.apapr.ro/rezultate-fonduri.html>, accessed on 6th April, 2010.