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Sustainability of private and special pension system reforms in Romania

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Abstract: *As pension funding becomes increasingly problematic due to the aging population, the level of benefits will need to be revised according to the balance between the living standards of pensioners and the living standards of taxpayers and by taking into account people's self-maintenance efforts. From the point of view of equity, the provisions on public pensions should treat equally all the protected persons and where is it possible to eliminate unjustified special treatment for certain special groups. Although the retirement age is the same as in all state members, a trend of gradual increase we can find as well in Romania as in Bulgaria, Poland, and Slovenia, among the only ones which do not envisage an equalization, between women and men. In the conditions of the pandemic and financial-economic crisis that is expanding it is likely to increase in the next period, the situation of pensioners is a major element of the debate of political and government strategy. In this context, I chose to present the analysis of the two pillars of the system (Pillar II and Pillar III), the participants and net assets of the pension systems, the number of participants in the pension system pillars II and III and the special private pension system.*

Keywords: *pension system reform, social equity, sustainability of private pensions.*

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I. Introduction

When Central and Eastern European countries began socio-political and economic transformations in the late 1980's, all countries began concomitantly the process of reforming their public pension systems. From 1991, Romania started the reform in this important field, but the inequalities in the public pension system have not been solved yet, even after 20 years. The pension system in Romania consists of three components, namely the public pension system (PAYG type scheme based on intergenerational solidarity), known as the first pillar (operating under Law No. 263 / 2OO on the unitary pension system public, with subsequent amendments and completions), privately managed pension funds (defined contribution scheme; part of the individual contribution from the public pension system is accumulated in individual accounts), known as Pillar II (operating under Law no. 411/2004 on privately managed pension funds, as subsequently amended and supplemented) and optional private pensions (defined contribution scheme, optional participation, and individual accounts), known as Pillar III (operating under Law No. 204/2006 on optional pensions, with subsequent amendments and completions).[i] The implementation of the private pension system is an important step in the pension reform aimed at removing the pressure on the public pension system, the pressure generated by the evolution of demographics which predicts: population aging, declining birth rate, and declining share of the active workforce.[ii] According to the statistics, a substantial increase of the number of pensioners is expected while the number of employees will be reduced, which means that the amounts with which employees will contribute to social insurance will have a decreasing trend, while the amounts to be paid to pensioners will grow.

Social equity has been defined as a theory that explains how individuals can assess the level of investment they make in an exchange situation relative to the level of benefits received and can be described in various ways, including consistency in their treatment, decisions, adopted about the level of benefits obtained in proportion to the efforts made and following the principle of reciprocity. Most countries have already started pension reform processes or at least are planning such changes for the coming years. Although apparently, the problems are the same, the directions of change, although sometimes convergent, are still different. 10 years ago, the main way of reform discussed and implemented was generally the parametric one (changing retirement ages, replacement rates, etc.). At present there is an almost explicit consensus in the Western capitalist world: at least a partial transition to the private sector which guarantees the viability of pension systems. Romania has not taken this step yet, but it cannot afford delaying this reform for a long time. On the other hand, the transition, electoral interests, and other objective or subjective factors have created and maintained serious inequities in Romania's public pension system. The necessity to reform this system has made it much more difficult and belated in comparison with the most countries in the area, in the period 1990-2011, to carry out those four stages of the reform of the pension system, the most important being the second one (2001-2005), when both the Law no. 19/2000 on the public pension system, and the third stage (2005-2010) in which the legislation on the multi-pillar pension framework was implemented, particularly through the commencement of privately managed pension funds (Pillar II) and optional pensions privately administered (Pillar III)[iii].

In this article, based on the study, I made a brief presentation of the methodological aspects involved in the analysis of the two pillars of the system (Pillar II and Pillar III), the participants and net assets of the pension systems, the number of the participants in the pension system pillar II and III and also, the analysis based on age groups that provided useful conclusions.

II. Materials And Methods

- The documentation was made based on data available from the Financial Supervisory Authority.
- Limitation to the data from the Financial Supervisory Authority, they were available for the years 2017,2018,2019,2020 but only for June.

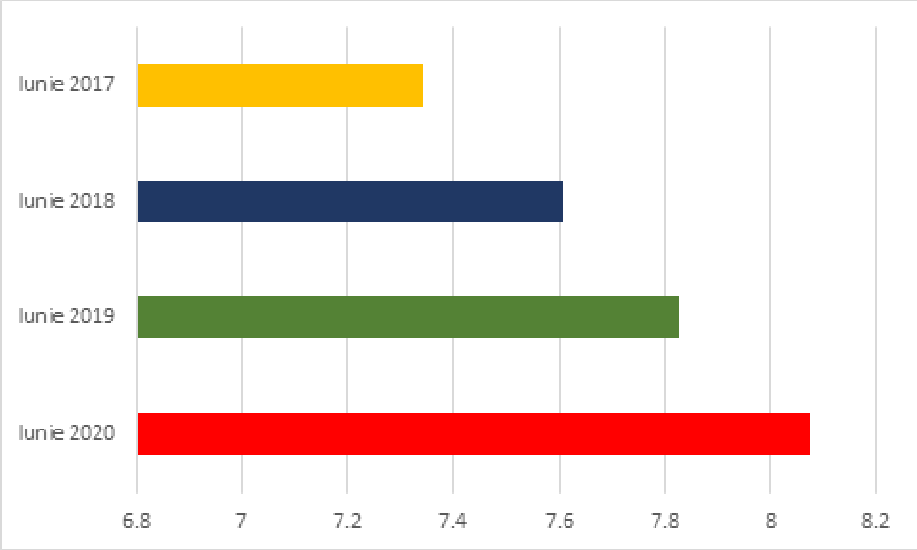
III. Review of the scientific literature

The problem of pensioners and the pensions they receive has been the subject of much research, from which we mention the study effected by Anghel, M.G.[iv], also, Anghelache C. made an extensive analysis of the economic and social evolution of Romania in the last century. Anghelache, C., Voineagu, V., Anton-Carp, A. approach the aspects related to the pension calculation system. Bouchet, M., Marchiori, L., Pierrard, O. were concerned about the pension reform during the massive demographic changes. Chen, D., Beetsma, R., Ponds, E., Romp, W. approached the issue of pension funding considering the risks between generations. Hairault, J., Langot, F., Sopraseuth, T. considered the issue of employment of older workers and the hypothesis of extending the retirement age. Vogel, E., Ludwig, A., Börsch-Supan, A. underline the essence related to the extension of the retirement age and the formation of human capital. The reform of pension and social protection systems for the elderly are topical issues for several areas of the world: Western Europe, North and South America, but also Central and Eastern Europe. Consulted by the World Bank, many of them considered it necessary to create a multi-pillar system, which would take over a part of the burden which on the public budget. The experiments were performed for the first time, with questionable results, in Latin America. The public system is also affected by the low level of absorption manifested in certain sectors, due to the reduced possibilities of professional requalification, especially among the age group of people between 50-60 years old. In this case, an additional effort on the part of the social insurance budget appears, because there is an obligation to pay additional early pensions. Meanwhile, international institutions such as the World Bank and the IMF have insisted that CEE countries adopt a multi-pillar pension system, setting the example of states that have implemented such strategies earlier and insisting on the expected macroeconomic correlations between private pension system development, capital market development and economic growth. Arza made an interesting diagnostic analysis of the multi-pillar pension system established in Argentina in 1994 and found out that "in the last two decades, major transformations of social security systems have taken place around the world. Ten Latin American countries have privatized some or all of their pension systems, and similar phenomena can be found in nine Central and Eastern European countries and the former Soviet Union. Other Western European countries (such as Sweden, Denmark, and Italy) have also set up private pension schemes, alongside public pensions to protect the incomes of people who will retire in the future. Nowadays, there are about 23 countries that have mandatory individual private account systems and many others with private voluntary pension systems" (International Social Security Association, using the Social Security Worldwide database). The integration of the most CEE states into the European Union has made EU initiatives to facilitate the transferability of pensions within the Union and the enshrinement of the prudent person principle as a premise for pan-European pension system reform relevant to Eastern Europe. Viable solutions were to create Pillars II (privately and compulsorily administered), III (privately but optionally administered), and even a Pillar IV (privately and also optionally administered), especially created in countries such as Bulgaria and Hungary, for stimulating investments on a higher level of assets (bonds, mutual funds, shares, government securities, etc.) than the one allowed for pillars II and III. As the population get older, the active labor force declines and each state must implement particular reforms, depending on the social aspects which must be considered. The success of these reforms is supported by the existence of over 20 million customers (pillars II and III) in Poland, the Czech Republic, Bulgaria, and Hungary (representing about 31% of the population). Arza rightly pointed out that private pensions may be less susceptible to political manipulation due to private property and management rights: political pressures on structural aspects of pensions - such as early retirement, unsustainable pension level, as well as redistributions hidden from various influential groups are avoided, because each person's contribution determines the benefits they will receive in the future. Competition and the right to choose were two additional elements specific to the private pension system. The competition between directors was expected to increase efficiency in capital allocation, while individual choice would make the competitive system better by encouraging companies to be more efficient.

IV. Research methodology

The private pension system in Romania is one of the defined contributions, which determines that the level of pension to which participants will have the possibility to obtain depends on the result by administrators, the participants being ultimately those who have the investment risk, specific to the financial environment.[v] To prevent the deterioration of the assets of private pension funds, the legislator has established investment limits and qualitative requirements for assets in order to protect the net personal assets, relative and guarantees have been established. Systems in other European countries also include occupational pension plans, which complement existing pension schemes. At the same time, in the context of the free movement of the persons from the European Union, it is necessary to regulate and implement the way of establishing the pension right of persons working both in Romania and in other states.

The evolution of the main indicators of the private pension system in Romania on June 30



Graph 1. Participants – millions/lei
Source: Own research by the financial supervisory authority

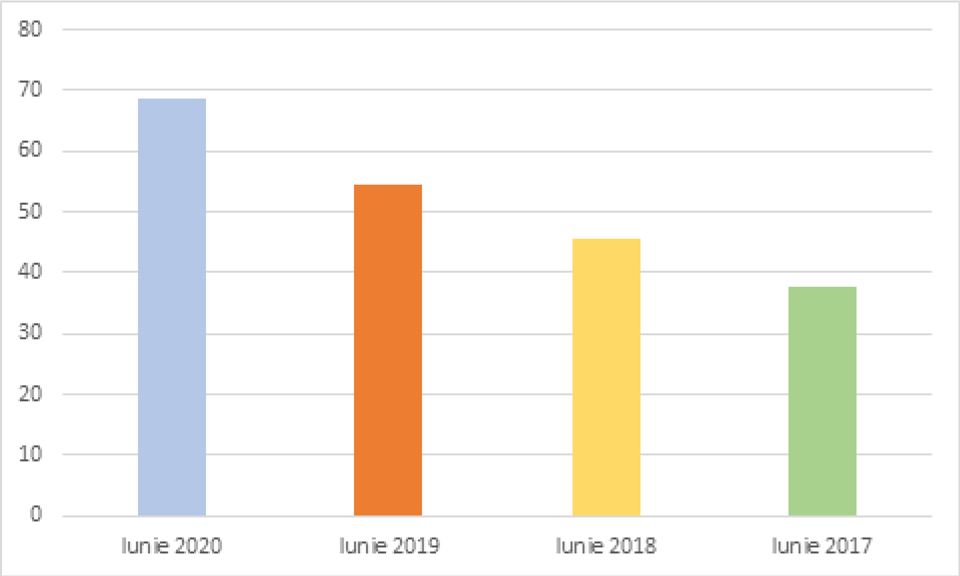


Chart 2. Net assets – billions/lei[vi]
Source: Own research by the financial supervisory authority

On June 30, 2020, there were 8.07 million participants in the private pension system, 1.37% more than at the end of 2019 (7.96 million participants) and 3.12% more than at the end of the month. June 2019 (7.83 million participants). On June 30, 2020, the total value of net assets of private pension funds was 68.54 billion, increasing by 6.31% compared to December 2019 (64.47 billion lei) and by 19.39% compared to the end of the month June 2019 (57.41 billion lei).

Participants of the privately managed pension funds.

Nr.	Privately managed pension fund	Dec-2019	June-2020
1	NN	2.02	2.03
2	AZT VIITORUL TAU	1.59	1.6
3	METROPOLITAN LIFE	1.04	1.06
4	VITAL	0.93	0.95
5	ARIPI	0.77	0.78
6	BCR	0.67	0.68
7	BRD	0.45	0.46
	TOTAL	7.46	7.56

Table 1. Pillar II Number of participants (millions pers.)

7.56 million participants were registered in the privately administered pension system at the end of June 2020, with an advance of 1.25% compared to the end of 2019. In the first six months of 2020, 96 thousand new participants were registered in the system, having been increased by 2.04% compared to the first six months of 2019 (94 thousand participants). The first three privately managed pension funds based on net assets held by, “FPAP NN”, “FPAP AZT” “Viitorul Tău” and FPAP Metropolitan Life remained in the top positions, summing on June 30, 2020, approximately 62% of total participants and 71% of net assets.

Optional pension fund	Dec-2019	June -2020
NN OPTIM	188.862	194.732
BCR PLUS	137.594	138.77
NN ACTIV	52.085	53.609
AZT MODERATO	39.053	39.356
BRD MEDIO	30.307	31.499
AZT VIVANCE	20.266	20.225
PENSIA MEA	9.547	15.073
RAIFFEISEN ACUMULARE	14.174	14.509
STABIL	5.404	5.439
AEGON ESENTIAL	3.832	3.845
TOTAL	501.124	517.057

Table 2. Pillar III Number of participants (pers.)

517,057 participants were registered in the voluntary pension system at the end of June 2020, with an advance of 3.18% compared to the end of 2019. In the first six months of 2020, 20 thousand new participants were registered in the system, having been increased by 9.66% compared to the first six months of 2019 (18 thousand participants). The first three voluntary pension funds according to the net assets held by, FPF NN Optim, FPF BCR Plus, and FPF NN Activ, summed on June 30, 2020, approximately 75% of the total participants and 72% of the net assets.

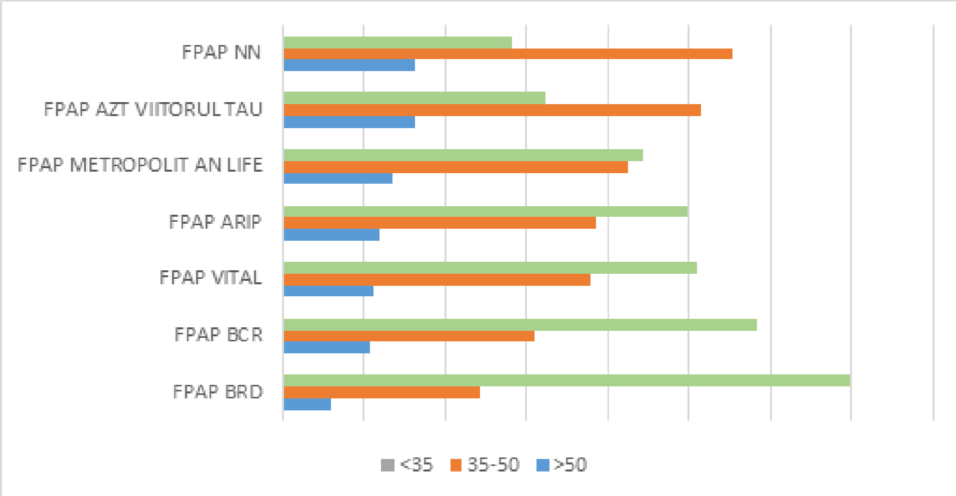


Chart 3. Pillar II Structure of participants by age groups on 30 June 2020
Source: Own research by the financial supervisory authority

Regarding to the structure of groups by age of the participants of the privately managed pension funds, it is found that FPAP BRD registered on June 30, 2020, the highest share of participants up to 35 years old, respectively 69.85% of the total participants of the fund (464,315 people), significantly above the average on the total system of 41.71%. Another fund that registered a significant value of the share of persons was FPAP BCR with 58.33% of the total fund (681,340 persons), also being above the average on the total system (41.71%). The lowest nominal values of the number of participants under the age of 35 registered FPAP NN with 28.29% of the total fund (2,028,638 people) and FPAP AZT Viitorul Tău with 32.38% of the total fund (1,601,752 people). It should be mentioned, however, that as the system has matured, the two funds have seen a steady increase in the share of participants aged between 35 and 50 years.

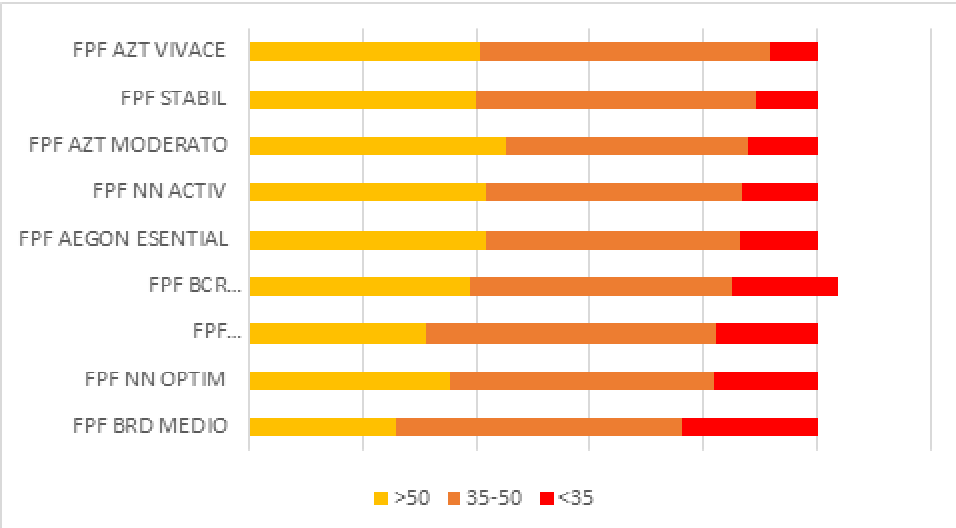
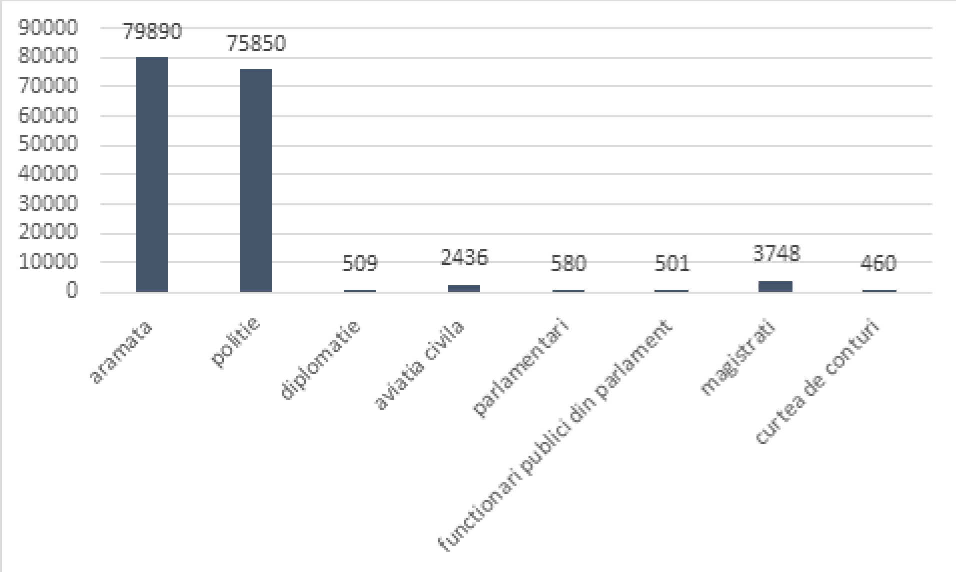


Chart 4. Pillar III Structure of participants by age groups on 30 June 2020
Source: Own research by the financial supervisory authority

Regarding to the structure of groups by age of the participants of the voluntary pension funds, it is found that FPF Raiffeisen Accumulation registered on June 30, 2020, the highest share of participants up to 35 years old, respectively 31.92% of the total participants of the fund (14,509 people), significantly above the system average of 16.54%. Another fund that registered a significant value of the share of people under the age of 35 was FPF BRD Medio with 23.65% of the total fund (31,499 people), also being above the average per total system (16, 54%). At the opposite pole was FPF AZT Vivace with the lowest share of participants up to 35 years old, respectively 8.31% of participants (20,225 people.[vii]



Graph 5. Number of beneficiaries of special pensions in June 2020

Source: Own research based on data from the Ministry of Labour, Family and Social Protection.

As we can see in Chart 5, most beneficiaries of special pensions worked in the army - 79,980 people and in the police - 75,850 people and the fewest beneficiaries worked in the Court of Accounts - 460 people and as civil servants in Parliament - 501 people. In Romania, the army and the police have their own pension funds, and the social insurance contribution for an employee in these fields is 5%, being lower than the contribution for the other employees.

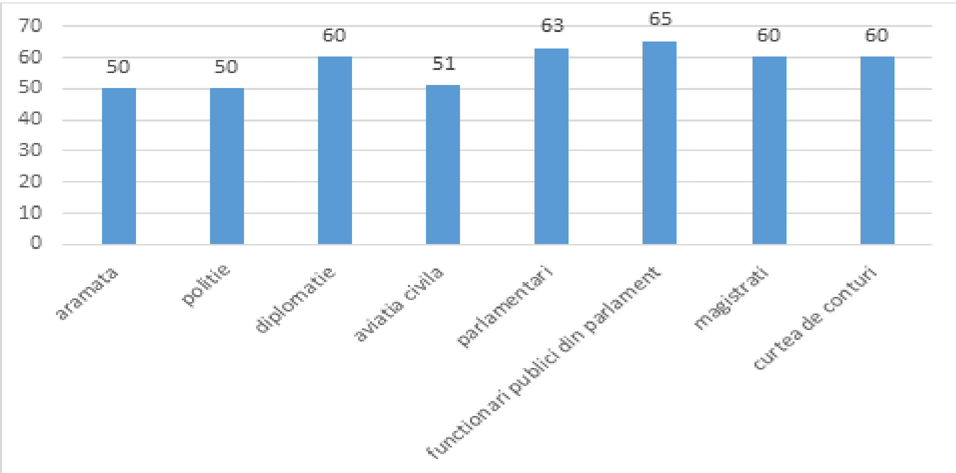


Chart 6. Average retirment age

Source: Own research based on data from the Ministry of Labour, Family and Social Protection.

From the calculations, the retirement age for the civil aviation sector is the average between the retirement age of pilots (50 years) and the retirement age of flight crew (52 years). We determined the retirement age for social insurance as the average between the retirement age of men (65 years) and the retirement age of women (60 years). In the privileged fields, men and women retire at the same age. The lowest retirement age (51 years) is related to the civil aviation sector, and the highest (65 years) corresponds to the civil servants in the Parliament and the men included in the social insurance system.

V. Results And Discussions

The current situation of pensions in Romania is due, first of all, to the very low income determined by the health crisis, which is now combined with the economic-financial crisis that is spreading rapidly and tends through the effects on the national economy in general, to be the most devastating crisis which manifested in the last 30 years. Moreover, we can affirm, without any fear of being wrong, that it is the vivid and profound one, in a negative sense, of the last 75 years. We make this assessment because in the nationalized system of the national economy (1945-1990) it was not possible to accurately detect a state of crisis, on a larger European (world) level that would have effects on the Romanian economy. Secondly, the critical state of pensions in Romania is also influenced by the electoral campaigns (local and parliamentary), in which without being an element of dispute, there are no concerns about the resettlement of pensions.[viii]

In Poland, in 2009, when the first payments of pensions based on the second pillar for old age (for women born in 1949) were expected to be paid, it turned out that the necessary measures for payment were not ready. As a temporary measure, Poland introduced a special benefit (periodically funded pension) for women between the ages of 60 and 65, paid by the Social Insurance Institution, with funds transferred from members' individual accounts. In Bulgaria, the system based on the second pillar (Professional Fund) is intended to provide early retirement for employees in dangerous jobs or strenuous physical jobs. However, these benefits will continue to be paid from the State Pension Fund until the end of 2014, with transfers of funds from the balances of the individual accounts of the Professional Fund. Croatia has faced demands from the government to pay pension supplements (which were initially introduced to supplement the state pension) and for second pillar beneficiaries. In September 2011, the Croatian government allowed insured persons who voluntarily opted for the second pillar system (aged between 40 and 49 on the date of implementation of the system and chose to join the system) to return to the system of state pensions. Since the introduction of the second pillar system in 2005, the Slovak Republic has made frequent changes, each of them being imperative in comparison to the next one (although the contribution rate for the second pillar has not changed since the initial rate of 9 percent). In 2008 and 2009, the Government offered all insured persons two opportunities to move from one system to the other one. In 2008, participation in the second pillar became optional for new people entering the pension system. However, a more recent amendment again allows new entrants to automatically join the second pillar, with the possibility to retire from the system for two years.[ix]

In 2008, the pension qualification period was extended from 10 years to 15 years for state pensions. In the same year, it was decided that members of the retirement system based on the second pillar, who retire after 15, or more years, the member should buy annuities. However, the minimum membership period for the second pillar required to buy annuities has recently been reduced to 10 years. In general, countries with second pillar systems have implemented measures to further reduce the maximum rates of different types of administrative fees, which could be precepted by pension funds. In conclusion, the following common features of the recent pension reform measures implemented by the eight CEE countries mentioned above are highlighted.

VI. Conclusion

From the analysis of the article based on the study carried out by the authors, some practical conclusions can be deduced. Thus, it results that the level of pensions in Romania is lower than the situation registered in the other member countries of the European Union. Private social pension systems have been motivated by demographic change (aging population, declining population in European and American countries, increasing life expectancy) and by development in financial markets in general. The efficient administration of the private pension system determines the maintenance and even the increase of the purchasing power of the future pension gain but also an important source of financing the economic development.

In addition to the important social role of the pension system in Romania, an additional benefit of the mechanism is represented by the formation of domestic capital and its investment in the national economy. The private pension system is in a period of accumulation, in which the number of participants is increasing and the exit from the system are rare. The importance of the fund managers is to ensure prudent management of the assets, the fact for which the structure of investments in easily liquidable financial instruments, with a high degree of profitability and in the conditions of foreseeable risk. Each country should find a policy package that is best suited to its specific national context. The task of reforming pensions will therefore probably remain an important issue for the coming decades. At the same time, due to the specific nature of pension systems, as long-term action systems, the implementation of any reforms requires a sufficiently long transition period. Actually It is essential that the decision-makers take proactive actions by 2020, when population aging, according to the statistics, will intensively increase.

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