PENSION SYSTEM IN SLOVAKIA

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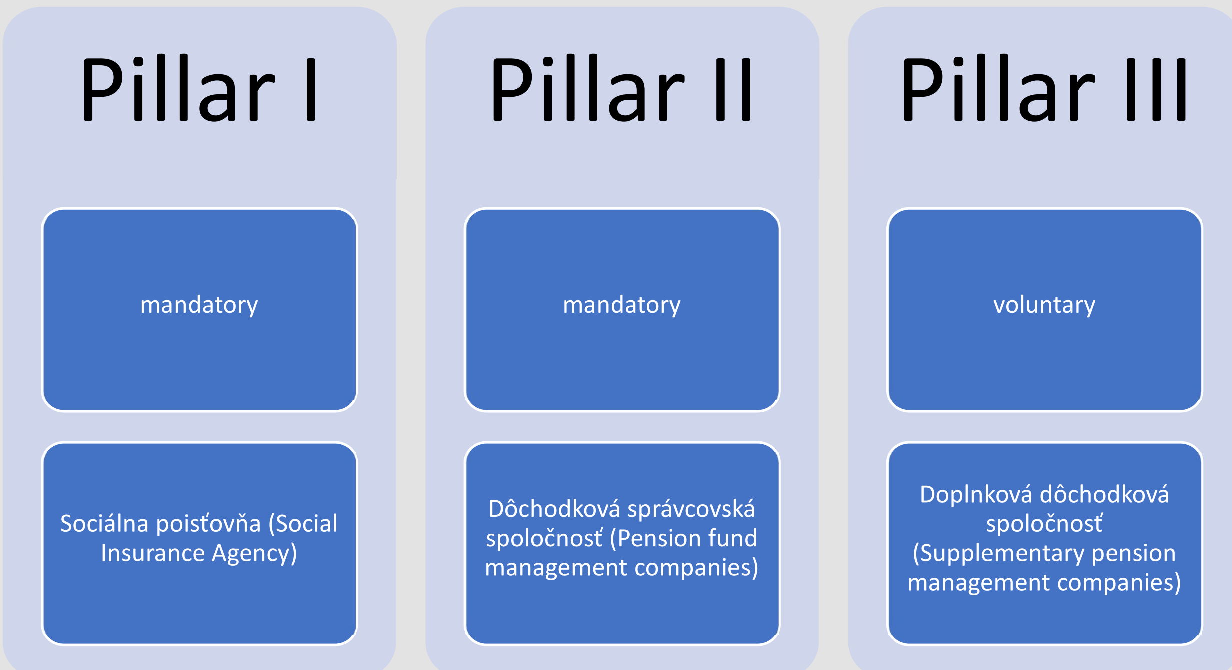
What is a pension?

A pension is a benefit or amount of money to which a pensioner is entitled. There is a different pension system in each country. In Slovakia, the pension system reform came into force in 2005 and significantly changed the whole system. From this date, we are talking about the so-called three-pillar pension system.

How does it work?

Every working person who has an income must pay a part of it (from the gross wage) to the state, the Health Insurance Company and the Social Insurance Company. One amount is intended for the future pension and we pay it to the Social Insurance Agency. Overall, it is 18% of gross salary, which at a gross salary of 1000EUR represents a payment of 180EUR per month. This is a mandatory part of the pension system and everyone can decide whether to leave the whole amount exclusively to the Social Insurance Company (Pillar I) or to send part of the amount to the Pension fund management companies (Pillar II). In addition, everyone in Slovakia can save for retirement voluntarily (Supplementary pension management companies, Pillar III).



If you start working, you can decide whether or not to enter the second pillar.

Characteristics of the Pillar I:

• Entry to the first pillar is mandatory, it is the basis of the pension system in Slovakia.

• We pay 18% of the gross wage (for a person who did not enter the 2nd pillar), or 18% of the gross wage reduced by the contribution to the II. pillar (for the person who entered the second pillar).

• The pension amount is calculated as the product of AxBxC

 o A: number of years worked (eg 45 years)

 o B: average personal wage point (indicates whether you earned more or less than the average wage. If someone earned twice the average wage in Slovakia all his life, B = 2, if someone earned only half the average wage in Slovakia, B = 0,5) o C: current pension value (determined annually for the whole Slovakia, in 2019 C = 12,6657EUR)

• This is a pay-as-you-go system, which means that your money is not saved but paid to current pensioners.

Characteristics of the Pillar II:

• Entry is voluntary, but following payments are mandatory.

• We pay 4.75% of the gross wage and this share gradually increases up to max. 6% in 2024. However, we pay a total of 18% of gross wages for the pension.

• The amount of the pension will depend on the amount saved.

• The money you send to DDS (Pension fund management companies) is invested in securities, and if their value increases, your pension will be higher (and vice versa).

• You decide where you invest your money. You can choose low-risk and low-profit investments, but also high-risk and more profitable investments.

• Saved money is inherited until the date of signing the pension payment agreement with the insurance company.

Characteristics of the Pillar III:

• Entry is voluntary.

• It takes various forms but is generally associated with supplementary pension savings.

• This is a system where part of the contributions to your Supplementary Pension Management Company account are paid by the employer and part by you.

• The amount of your contribution must be at least equal to the amount of your employer's contribution (if your employer contributes 20EUR, you must also save 20EUR).

• You decide where you invest your money. You can choose low-risk and low-profit investments, but also high-risk and more profitable investments.

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Why was the Pillar II introduced in Slovakia?

Population aging is one of the main reasons why Slovakia, like other European countries, changed its pension system in 2005. The traditional pension system, represented by the Social Insurance Agency, works on a pay as you go basis. This means that current workers are obliged to pay contributions to the Social Insurance Agency, which are immediately paid to current pensioners. Workers today believe that when they retire, their working children will fund their old age pensions. However, the Social Insurance Agency can only pay as much in pensions as it collects from today's workers. As fewer and fewer children are born and people live longer, fewer and fewer workers are working for more and more retirees. Without a reform, Slovakia would not be able to bear this burden and would either have to significantly reduce pensions, increase the contributions of current workers, or both at once. Since every worker has the possibility to decide whether he will only be in the first pillar or join the second pillar, it is necessary to compare the advantages and disadvantages of both pillars:

Common attributes of Pillar I and Pillar II

• The amount of your pension depends on the gross earnings, respectively from the pension insurance share sent the Social Insurance Agency and the Pension Fund Management Company,

• Workers will not be entitled to a pension until they have reached retirement age, respectively minimum savings period (currently a pension age ceiling of 64 years is in place, the minimum savings period is 15 years),

• Pillar II is substantially influenced by government legislation (political power), there is virtually no guarantee that the current situation will continue in the future without significant changes in the pension system,

• Frequent changes in legislation can significantly affect the benefits or disadvantages of Pillar I and Pillar II,

• If you lose your job (short or long term) and if you do not want to lose any years that will be counted towards your retirement payment, you need to voluntarily join the Social Insurance Agency and pay the pension insurance contributions in percentage (at least average nominal wage in the Slovakia). If the worker is also a participant of Pillar II, part of the old-age insurance contributions will go to the pension fund management company.

Pillar I (Social Insurance Agency)

benefits

• lifetime pension payments, resp. temporary for old-age, early-retirement, widow's and widower's pensions.

• the state adjusts the pensions in line with inflation or average nominal wage growth. However, the amendment must be approved by Parliament.

• the assumption that the Social Insurance Agency will be here by 30 years is higher than the existence of pension fund management companies (Pillar II).

• The state is legally obliged to pay pensions to pensioners. The Social Insurance Agency is protected by the state and the state must find funds to pay pensions even if it is to be borrowed,

• Pillar I policy is merit and solidarity - high earners receive high pensions, poor earners less, very low pensions are artificially increased, very high pensions are artificially reduced.

drawbacks

• money is not deposited in the future (not saved in the saver's account) on an individual saver's account, but is used to pay pensions to current pensioners;

• the amount of the pension is very dependent on future income of the state budget and the decision of the government. If there is no money in the state budget for pensions, the state must borrow money which will increase the country's debt,

• The amount of the pension is closely linked to the amount of the current pension value at the time of applying for the old-age pension. This indicator (current pension value) is determined and agreed by the government for each year individually,

• inheritance of the first pillar is practically impossible. In the first pillar, only the life partner, in the form of a widow's, widower's or orphan's pension for a certain period exist.

Pillar II (Pension fund management companies)

benefits

• is more individualized, each saver has a separate savings account held in a pension fund management company (DSS). What a worker saves on it will be available at the time of retirement. For the money saved, he will be able to buy a pension from insurance companies.

• diversification of risk, resp. spreading the risk of investment, saving for pension into 2 options (Pillar I and Pillar II),

• The money can be appreciated depending on the DSS investment strategy and the choice of the right investment fund according to the preference for the saver's risk attitude. (conservative, balanced and growth fund),

• DSS is subject to 5-fold control - NBS, depository, independent audit, client and internal control of the company,

• the client of the DSS can choose how he / she wants to receive the money saved (which part should be payed in form of a one-off payment or gradually every month),

• in the event of the saver's death amount is inherited by parents, children, or other designated close person,

• possibility to check pension account balance via internet and smartphone applications

• the merit of the system: the more you earn, the more you pay and the more you will save on your DSS account per month.

drawbacks

• there is no principle of solidarity. Low-income citizens (partially disabled, disabled) will have lower pensions. These groups of citizens will not have increased pensions as in the case of Pillar I.,

• the value of money saved on the pension savings account and the amount of revenues depends on the development in the financial markets and their turbulence,

• account management fees, fund management fees, and depository fees may be higher than DSS investment returns,

• at the time of retirement, the client will have to choose from which insurance company he will buy pension, we still have almost no experience with this system,

• at a more advanced age, it is not possible to choose a riskier investment strategy;

• DSS - does not guarantee the average return,

• There is a 19% income tax. It is paid by DDS, but ultimately reduces money for the retirement,

• DSS charges fees monthly and also in case you are unemployed, and not currently contributing to a personal retirement account,

• if the client has chosen to pay a pension in a lifetime form and dies after, for example, 2 months of retirement, in this case there is no inheritance because the recipient no longer has a DSS account. Inheritance is not possible because lifetime annuities imply an insurance company's obligation to pay a lifetime pension no matter how long the pensioner lives.

List of Pension Fund Management Companies representing Pillar II as well as a list of Supplementary Pension Fund Companies that represent Pillar III is updated by the National Bank of Slovakia and you can find it here: https://subjekty.nbs.sk/?aa=select_sector&bb=5&cc=&qq=.

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