

# EMPLOYEE CAPITAL PLANS – PUBLIC POLICY ANALYSIS

**Antoni Kolek**

*Instytut Emerytalny*

*antoni.kolek@instytutemerytalny.pl*

## 1. Introduction

The universal, mandatory social security system introduced in 1999 is based on a defined contribution. The funds registered on the insured's account constitute the basis for determining the amount of the old-age pension and divided by the average life expectancy allow determining the amount of the monthly benefit. This way of determining the amount of the old-age pension is accompanied by a significant reduction. The benefits that will be paid by the Social Insurance Institution in the next decades will be only a fraction of the insured person's last salary.

According to forecasts, the average pension from ZUS in 2040 will be around 35% of the average salary, and in 2050 even 25% of the average salary. Therefore, it has been assumed since the 1999 reform that additional savings would be created. The so-called Third-pillar voluntary forms of saving. However, over the past twenty years, additional forms of saving have not become common in Poland (Jedynak 2016). The insufficient level of retirement savings of Poles met with the reaction of public authorities, which from 2019 obliged all employers to create a group form of long-term saving.

The purpose of this article is to determine on which axiological foundation the system of Employee Capital Plans (EPC) is based and to answer the questions:

- how do the authorities want to achieve universal participation in EPC?
- what obligations have been imposed on employers, and what are the expected benefits for enterprises?
- will investing in EPC funds support the development of the Polish economy?

In order to be able to answer the above questions, the first part of the study presents a method of analyzing public policy. Further, the work contains characteristics of behavioral economics mechanisms on which the main ECP institutions were based. Then the Author presents the obligations of employing entities and possible benefits to be achieved by entrepreneurs. In turn, the third part of this article presents the possible benefits for employees.

## **2. Metodology and theory – public policy analysis**

Public policy analysis is a form of reflection that allows juxtaposing various aspects of political decisions. Assuming the functioning of the social security system under a democratic state of law together with the strong key role of legal regulations to which citizens and public institutions comply. Based on the principle of legalism, where citizens can do anything that is not prohibited by law, and state institutions operate within the limits and on the basis of law. When conducting public policy analysis, the researcher's interest should focus on identifying the interests of parties involved in shaping public policy, and if possible also be based on evidence or justifications of the legislators. In this case, it is not the most important issue of policy impact, i.e. the outflow of implemented activities assessed *ex post*, or the area related to the acquisition of power – politics. In contrast, the area of policy analysis focuses on issues such as the role and participation of various actors in shaping legal regulations, or the assessment of assumptions and forecasts presented by intervention project promoters (Kraft and Furlog 2007).

Based on Dunn's concept, public policy analysis should be based on a review of activities undertaken in the course of designing and implementing regulations (Dunn 1981). In turn, W. Parsons claims that the format of expert analyzes carried out as part of public policy analysis should refer to the problem identified, the goals set by the authorities, possible alternative scenarios, the options chosen for implementation, and the results obtained as a result of intervention. Therefore, public choice theory may be appropriate to explain public policy analysis (Parsons 2005).

Public choice theory assumes that people are only motivated by their own interests to make choices. Although they sometimes act in a way for the good of other people, their main interests are their own interests. This theory equally applies to the choices of an employee, employer or consumer (Buchanan 2000).

Drawing attention to the above issues, the subject of public policy analysis in the area of introducing Employee Capital Plans in Poland is the analysis of the reasons for the introduction of ECP, as well as the relationships of various entities at the stage of designing a new institution, as well as the planned obligations and rights during its functioning.

The research method of institutional analysis adopted in this article, adopting the assumptions of new institutionalism, allows to explore the nature and genesis of the institution of social life, which are employee capital plans. The analysis allows defining and characterizing the reasons for which the institutions are established and the functions they perform. The achievements of new institutionalism also make it possible to ask questions about the very nature of the relationship between individuals and the new institution (Kolek 2016).

### **3. Employee Capital Plans as a behavioral public intervention**

The concept of Employee Capital Plans proposed by public authorities, which entered into force on January 1, 2019, is based on the achievements of behavioral economics (ECP act 2018).

In response to the identified public problem, which was the low level of retirement savings for Poles, it was pointed out that additional forms of saving for retirement organized by employers (intended for over 60 years of age) were indicated. Based on the assumption that the key to effective public intervention is to change the behavior of individuals, or collectivity, to date, it was found that, while maintaining freedom and freedom to dispose of private property, employees should be encouraged to save. To this end, ECP was introduced.

The authors of the ECP concept assumed that people are inherently inclined to act and are afraid of risk. What's more, people do not behave rationally, but make decisions under the influence of emotions, views, habits, as well as mental errors and taking actions based on such premises as:

- unwillingness to lose – in a situation where an individual feels that he or she is threatening to lose something that they had before, they are ready to take action to prevent loss,
- tendency to maintain the status quo – expressed as fear of change and new (Kolek and Wojewódka 2017).

Therefore, the mechanisms contained in the regulations shaping Employee Capital Plans deliberately affect the elements of the long-term saving system.

### **4. Employee Capital Plans duties for employers**

The fundamental mechanism of ECP is to relieve the employee of any administrative duties. The legislator has introduced that the employer is responsible for enrolling employees in the long-term saving program. Pursuant to the provisions of the Act of October 4, 2018 on employee capital plans, the obligation to create ECP lies with the employing entity, which will have to choose a financial institution in the appropriate period depending on the number of employees, and then implement ECP in its company. Employees aged 18-55 whose employment period at the employing entity is at least 3 months will be automatically enrolled in the ECP. On their behalf, the employer concludes a ECP contract to which the ECP participant and the financial institution will be parties. In turn, people aged 55-70 will be able to join ECP at their request submitted to the employer. This treatment is aimed at creating an informed choice for people who are closest to retirement so that they can decide for themselves what will be the best form of saving for them. It should be emphasized that an important group of people who will be able to participate in ECP has been defined more broadly than just employees and those who have been obliged to save in ECP were also covered by mandatory social insurance of the contractor, persons performing outwork, members of agricultural production cooperatives, and members of the supervisory board contributory remuneration for his work.

Another mechanism to facilitate savings in ECP is the employer's obligation to calculate, collect and transfer payments to a financial institution. Ensuring

regular savings and the lack of obligations on the part of the participants themselves is to relieve employees of administrative obligations.

In addition, the introduction of a savings co-financing mechanism in which the ECP participant discharges 2.0% of his remuneration, the employing entity adding 1.5% of remuneration. Additionally, from public funds, by financing the welcome payment – PLN 250 and the annual surcharge – PLN 240, it is expected to contribute to a real increase in the accumulated funds. The legislator also allowed the possibility of larger payments to ECP by introducing an additional payment of a participant – up to 2.0%, as well as an additional payment of the entity employing up to 2.5% of remuneration.

An important mechanism from the perspective of participation in ECP is the possibility of reducing the basic payment made by the participant of the capital plan. If the gross remuneration of a ECP participant does not exceed an amount equal to 1.2 times the minimum remuneration. The saving person will have the right to make a declaration on reducing the payment to 0.5%, provided that his remuneration does not exceed PLN 3,120 gross in 2020. The employing entity is responsible for verifying the achievement of the 1.2-fold limit, however, if the ECP participant exercises this right despite exceeding the limit – incurs a penalty in the form of no annual surcharge – PLN 240 from the labor fund (ECP act 2018). The provisions of the Act of October 4, 2018 on employee capital plans also contain a catalog of sanctions for non-compliance with obligations, as well as non-implementation of statutory assumptions. One of the basic regulations is the ban on imposing savings on ECP. The legislator has indicated that the employing entity or persons acting on its behalf discouraging participation in ECP are exposed to a sanction of 1.5% of the remuneration fund for the previous financial year. This sanction will be granted in the form of a fine imposed by the National Labor Inspectorate (ECP act 2018).

From the employers' perspective, an important aspect of introducing ECP is to increase labor costs. Basic employer's payments amounting to 1.5% of the salary, as well as the costs of implementing and servicing ECP constitute real expenses for companies. It is true that these expenses are tax deductible costs, but the economic effect in the form of an increase in labor costs has not been compensated in any way.

## **5. Employee Capital Plans responsibility of state**

It is also worth noting that the voluntary participation in the ECP will have a character that determines the need to renew your declaration of resignation. By introducing ECP, the government, fearing that many people would give up saving, introduced a mechanism of self-saving. Re-enrolled people who have made a declaration of resignation for some reason in the past is a form of cyclical incentive to save. Therefore, the legislator imposed on the employing entity the obligation to re-enroll all employees who had withdrawn from the Plan to ECP. Every 4 years, starting from February 2023, the employer will be required to inform (by the end of February) all those who have resigned from saving and are under 55 years of age that if they do not receive a resignation declaration again,

from April 1, 2023, these persons become participants of ECP – by concluding a ECP contract on their behalf and for their benefit.

The responsibility of the state in the ECP area is related to both launching a long-term saving program, as well as controlling employers whether they perform obligations allowing participants to accumulate funds in ECP. To this end, the legislator has granted inspection rights to both PFR S.A. as well as for the Labor Inspectorate to ensure the correctness of performed duties. In turn, to carry out information and education activities, a special purpose company was established to manage the PFR Portal S.A. In turn, the Financial Supervision Commission watches over the correct way of investing in ECP. All these entities being the emanation of the state are aimed at protecting ECP participants and enforcing the statutory obligations of employers and financial institutions.

However, from the perspective of public authorities who have decided to introduce ECP, the key goal is to achieve universality of savings. After the first stage of implementation, the level of participation in PPK is about 40% (Kolek Wojewódka 2019), which should be assessed as a result significantly below expectations, because at the stage of designing the government the government talked about 75% participation (Impact assessment of the ECP act 2018).

## **6. Employee Capital Plans – perspective of savers**

The use of behavioral economics mechanisms does not mean, however, completely abandoning the tools and motivators used so far. Employee Capital Plans provide for exemption from public levies both at the accumulation stage and after reaching the age of 60. It is worth emphasizing that payments made to ECP are exempted from social security contributions. In addition, funds accumulated in ECP are free from classes and bailiffs' execution (except for maintenance due to maintenance), which is supposed to protect funds. The legislator also decided on the default form of payment of accumulated funds, indicating that no deductions (taxes and contributions) will occur if the participant decides to make a one-off payment of not more than 25% of the accumulated savings, and the remaining 75% will be spread over at least 120 monthly installments. This mechanism is to deter early withdrawal of funds.

At the stage of accumulation of funds to mitigate the so-called "Bad date risk", when an ECP participant just before acquiring the right to benefit invests its assets in risky financial instruments, the legislator decided to introduce a precise framework for investment policy. Each ECP participant will be enrolled in the Defined Date Fund appropriate for his age and date of reaching 60 years of age. Each of the funds will have a specific investment policy appropriate to the age of the participant. This means that by adapting to the age of a ECP participant, the Fund will invest more funds in the debt part – to reduce investment risk. The ECP participant will be able to change the fund in which he accumulates funds, and the instruction should be sent to a financial institution.

In turn, the participant will have the right to use the funds accumulated in ECP both at the stage of accumulation and after 60 years of age, regardless of gender.

Before reaching 60 years of age. The Act on Employee Capital Plans provides for the possibility of payment at the accumulation stage in 4 cases:

- transfer payment – i.e. transferring 100% of accumulated funds to another ECP account or other participant's account related to long-term saving,
- in the event of a serious illness – a ECP participant will have the right to pay up to 25% of the accumulated funds if a participant, his spouse or child of a participant in a specific disease entity is diagnosed or is completely incapable of work or has moderate or severe disability,
- to cover own contribution – in connection with applying for a mortgage for the purchase of real estate, the ECP participant will be able to obtain a loan of up to 100% of the funds accumulated on the ECP account, which will be used to cover the own contribution; it should be remembered, however, that the possibility of using this form of withdrawal will take place only up to the age of 45 of the ECP participant and will be connected with the obligation to transfer funds to the account,
- payback – the ECP participant will be able to withdraw 100% of the funds accumulated in the ECP at any time, however, before receiving the funds, the financial institution will make appropriate deductions from public tributes and transfer funds from the welcome and annual payments to the state Labor Fund (ECP act 2018).

Noting the short-term effect of ECP implementation, the problem of reducing the net salary of an employee appears in the minds of savers. 2.0% of remuneration transferred as savings in ECP means that disposable household income has decreased. The legislator noticed this problem in the case of people earning less than 120% of the minimum wage, but in the case of other groups of employees no mechanism was introduced to compensate for the loss due to saving in ECP.

## **7. Perspective of financial institutions**

Admission of commercial financial institutions by the legislator requires financing for their functioning. It is worth emphasizing that ECPs have the right to create only financial institutions with relevant experience and an appropriate level of equity, and offering funds for a defined date. In addition to organizational costs, the financial institution must pay a fee for registration in the ECP Register for the right to offer ECP.

When adopting the optics of a financial institution, it should be noted that it may receive remuneration for managing the fund on a defined date, in an amount not exceeding 0.5% of the fund's net asset value. In addition, if the financial institution meets the criteria, it will acquire the right to a success fee of 0.1% of the value of the fund's assets. This means that the ECP product is cheap for the participant and low-margin for the financial institution. Therefore, it should be pointed out that launching the ECP product by financial institutions is an investment and involves many obligations and costs of conducted activity. Only achieving economies of scale, gathering hundreds of thousands of participants and assets counted in PLN billion will allow financial institutions to achieve business success (ECP act 2018).

## 8. Conclusions

In connection with the changes introduced in 2019 in the area of social security, attention should be paid to the need for additional savings by ECP participants. Benefits received from the universal retirement system will be determined by the contributions paid to the system, which means that the replacement rate will drop to as much as 25% in 2050. Therefore, an indispensable action of the authorities was the introduction of an additional source of income from payments paid during the period of professional career. These benefits will supplement the benefit received from the system based on the insurance method – from ZUS.

Answering the research questions indicated in the introduction to this article, it should be stated that the mechanisms of ECP functioning adopted by public authorities are associated with current benefits for employees. The universality of participation in ECP is to be achieved thanks to automatic enrollment to ECP, subsidies from public funds to the accounts of participants and tax preferences when withdrawing funds. The private nature of ECP funds is also important, as well as the possibility of using them before the age of 60.

The analysis of public policy shows that the authorities have shifted the burden of implementing ECP to the employers. Employers bear the economic and organizational cost of ECP, and in the event of failure to comply with statutory tasks they are also required to pay the cost of any penalties. From the capital market perspective, ECP as a relatively cheap product is not of a high margin character and for financial institutions in the first years or even 10 years of operation will be a source of costs, not potential profits.

Thanks to ECP, the capital form of investment financing is gaining importance. By investing in shares of companies listed on the Warsaw Stock Exchange that are in the WIG20 and mWIG40 indexes, investments implemented by these entities have the chance to be financed. From the perspective of government involvement of state-owned companies, the universality of participation in ECP will allow for raising investment-friendly capital.

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