SUB-ACCOUNT OF THE INSURED PERSON AS AN INSTRUMENT OF INCOME ALLOCATION OVER THE LIFE COURSE. LEGAL ASPECTS

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Abstract
The sub-account held in the Social Insurance Institution is a mechanism for income allocation over the life-cycle, which is supposed to have a less distortive effect on the fiscal situation of the pension system than member’s account held in the Open-end Pension Fund. However, due to frequent legal changes in the Polish pension system, motivated by the temporary politics, it is not so. Contributions registered on the sub-accounts are the growing financial liability to the pension system in Poland. This indicates that the pension rights acquired and registered at the sub-account are not as firm as insured individuals might expect. The purpose of this research is to: 1) describe the construction of the legal institution of the sub-account held in the Social Insurance Institution; 2) determine if the legal institution of the sub-account is coherent with general principles of social insurance; 3) to evaluate if sub-account is a reliable instrument of income allocation over the life course. To achieve the research objectives the logical and historical legal methods were applied and scientific literature and normative documents were critically reviewed.

Keywords: pension systems, pension wealth, Social Insurance System, sub-account.

JEL codes: H53, I38, J11.

1. Introduction
The reform of the Polish pension system in 2011 introduced new legal institution of sub-account of the insured person. Since that moment the Social Insurance Institution (ZUS) is obliged to register information on the number and the value of the retirement pension insurance contributions paid to the sub-account. This new legal institution is regulated by art. 40a of the Act of 13th October 1998 on the Social Insurances System (Journal of Laws 2017, item 1778, with further amendments, from now on: the Social Insurance System Act). The sub-account has an individual character, and for each insured person only one sub-account is kept, which is marked with the PESEL identification number (Polish equivalent of Social Security Number).
The primary function of the sub-account is accounting and controlling. The information on registered retirement pension insurance contributions of the
insured person is used to calculate a temporary retirement pension as well as a final pension from the Social Insurance Fund. Moreover, the information registered on the sub-account is also used to calculate payments in cash from the Social Insurance Fund. If the insured person dies before the retirement age or within the first three years from the day of claiming the first retirement benefit his family or other inheritors receive lump-sum payments.

The introduction of the sub-account fuelled the dispute among the representatives of social insurance law doctrine. The first controversy is over the coherency of this legal institution with the Polish Social Insurance System and general principles of social insurance. The second controversy is over the inalterability of acquired pension rights registered on the sub-account (Pacud 2015; Ślebzak 2009).

Therefore, the purpose of this research is to:
1) describe the construction of the legal institution of the sub-account held in the Social Insurance Institution,
2) determine if the legal institution of the sub-account is coherent with general principles of social insurance,
3) to evaluate if sub-account is a reliable instrument of income allocation over the life course.

To achieve the research objectives the logical and historical legal methods were applied and scientific literature and normative documents were critically reviewed.

Legal status as of March 1st 2018.

2. Introduction of the sub-account held in the social insurance institution

The reform of the pension system in Poland, introduced in 1999, ultimately changed the rules of financing and functioning of the mandatory pension system for people born after 1968 (Dybał 2017). The old system was a traditional, pay-as-you-go defined benefit scheme (DB scheme). The new system is a defined contribution scheme (DC scheme) (Chłoń-Domińczak and Strzelecki 2013). The financing of the reformed pension system has been changed (Stevens 2017). At first, the pension insurance contribution (19.52% of the basis of contribution rate\(^1\) was split into two accounts: first public and based on pay-as-you-go method is held in the Social Insurance Institution. Second private and based on capitalisation method is held in an Open-end Pension Fund.

The account held in the Social Insurance Institution is non-financial defined contribution scheme (NDC). Till today 12.22% of the basis of contribution rate is recorded on this account and is indexed to the price index of consumer goods and services magnified by the change in the overall contribution revenue (to covered wage bill growth). Therefore the final indexation is a mixture of price and wage

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\(^1\) Basis of retirement and disability pension insurance contribution rate is regulated by art. 18 of Social Insurance System Act. In case of majority insured persons it's equal to remuneration for work.
indexation (Nerka 2015, pp. 63-74). The second account held in an Open-end Pension Fund is financial defined contribution scheme (FDC). Until 2011 a contribution of 7.3% of the basis of contribution rate was transferred to the chosen Open-end Pension Fund and invested in assets on the financial markets. Therefore a rate of return that account in a private pension fund earns is linked to the financial market performance.

From 2008 to 2014, facing worsening public finance situation resulting from the global financial crisis Poland decided to introduce changes to her pension system (Dybal 2014), which strengthened the role of pay-as-you-go (PAYG) components in her scheme. First significant change of the design and financing of the pension system was introduced in 2011. The private pillar based on capitalisation method was downsized to 2.3% of the basis of contribution rate. The remaining part of the open-end pension fund contribution was directed to a newly introduced sub-account held in the Social Insurance Institution (Dybal 2014). This new sub-account is quasi non-financial defined contribution account (NDC-2) because indexation is based on five-year averaged GDP growth and contribution recorded there is inherited if an insured person dies before reaching the retirement age or dies in the first three years after claiming retirement.

Thus, those that are fully covered by the new system have currently three separate pension accounts: primary account held in the Social Insurance Institution (NDC), sub-account also held in the Social Insurance Institution (NDC-2) and member account held in Open-end Pension Fund (FDC). Second significant change of the design and financing of the pension system was introduced in 2014 when 153 151,2 mln PLN was transferred from Open-end Pension Funds to the Social Insurance Fund and reduction of fully funded contribution was permanently set at the level of 2.92% of the basis of the contribution rate (Jedynak 2016).

3. Inflows registered on the sub-account

People born after 1948 who decided in 1999 to become a member of an Open-end Pension Fund and all the people born after 1968 that are obliged to participate in the social insurance are the holders of the sub-account. Therefore a portion of their retirement pension contribution is transferred to their sub-accounts. The contribution rate registered on a sub-account is calculated in accordance with art. 22 par. 3 of the Social Insurance System Act. The amount registered on a sub-account depends on the decision of the insured person. Since February 2014 insured individuals are enabled to choose if they still want to pay part of their retirement pension contribution to Open-end Pension Fund. According to art. 11 of the Act of 6 December 2013 on the amendment of certain laws relating to rules of paying out retirement pensions from assets accumulated in Open-end Pension Funds (Journal of Laws of 2013, item 1717, from now on the Reforming Act of 2013) between April 1st and July 31st 2014 every member of Open Pension Fund had a chance to officially declare the will of continuation to pay pension contribution to a chosen Open-end Pension Fund. Since 2016 every four years, between April 1st and July 31st every member of OPF will have to formally
declare the will of continuation to pay part of pension contribution to Open-end Pension Fund (art. 39a par. 1 of the Social Insurance System Act).

If an insured person formally declares the will to continue to pay part of his retirement pension contribution to an Open-end Pension Fund his contribution is split between:
- a basic account held in Social Insurance Institution (12,22% of the basis of contribution),
- sub-account also held in Social Insurance Institution (4,38% of the basis of contribution),
- member account held in Open-end Pension Fund (2,92% of the basis of contribution).

If an insured person does not declare his will to continue paying part of his pension contributions to an Open-end Pension Fund the total pension contribution (19,52% of the basis of contribution) is received by the Social Insurance Fund and split between:
- a primary account held in Social Insurance Institution (12,22% of the basis of contribution),
- sub-account also held in Social Insurance Institution (7,3% of the basis of contribution) (Chybaliski 2013).

The contributions shall be registered by the Social Insurance Institution on a sub-account immediately, no later than within 15 working days since the receipt of the contributions paid with the documents of payment, monthly reports and declarations.

Not only part of the pension insurance contribution is registered on the sub-account. Also, transfers of assets from the Open-end Pension Funds to the Social Insurance Fund are registered there. First and so far the most significant transfer took place on February 3rd 2014. The legal basis for this transfer was the Reforming Act of 2013. According to this statute, Open-end Pension Funds were forced to transfer 51,5% of their accounting units to Social Insurance Institution on February 3rd 2014. The total value of transferred assets was 153 151,2 mln PLN. The nominal value of transferred securities was 146 bn PLN. This included:
- bonds and bills issued by the Treasury;
- bonds issued by the Bank Gospodarstwa Krajowego (highway bonds guaranteed by the State Treasury);
- other securities guaranteed by the State Treasury;
- cash;
- bank securities;
- bonds and other debt securities issued by local government units, their unions or the city of Warsaw.

Debt securities transferred to Social Insurance Institution were redeemed by the Ministry of Finances. At the same time, the value of transferred accounting units was registered on sub-accounts of insured persons.

A similar transfer of remaining assets from Open-end Pension Funds to the Social Insurance Fund was announced in 2016 (Jakubowski 2017).
Last category of inflows registered on the sub-accounts are monthly transfers of accounting units from member’s account held in Open-end Pension Funds. Article 13 of the Reforming Act of 2013 also introduced monthly transfers of accounting units from member’s account held in the Open-end Pension Fund to the insured person’s sub-account held in the Social Insurance Fund (Bielawska 2016, pp. 3-17). This process starts ten years before a member of Open-end Pension Fund reaches retirement age (art. 24 of the Act of 17th December 1998 on Retirement and Disability Pensions Payable from the Social Security Fund, Journal of Laws 2017, item 1383, with further amendments, from now on: the Pensions Act and art. 100c of the Act of 28th August 1997 on organisation and operation of pension funds, Journal of Laws 2017, item 870, with further amendments, from now on: the Pension Funds Act). Each month 1/120 of accumulated accounting units of this member is transferred to his subaccount at Social Insurance Institution (art. 22 par. 3 of the Social Insurance System Act). This mechanism was introduced to protect insured individuals from the volatility of financial markets in the last stage of their professional career (Dziensiiuk 2016).

4. The conjugal property and succession of amounts registered on the sub-account

The primary purpose of holding a sub-account is to use the registered information to calculate the periodic capital pension (as regulated in the Act of 21st November 2008 on Capital Pensions, Journal of Laws 2014, item 1097, with further amendments) or retirement pension payable from the Social Security Fund (as regulated in the Pensions Act). However in the case of early death of the insured person, before reaching the retirement age, the information is used to calculate one-off money payment benefit from the sub-account. Also in a case of early death that takes place after retirement, within three years after claiming the first retirement pension benefit, the information is used to calculate guaranteed payment. Also, this payment has a form of lump-sum payment (in cash) to one or several persons.

The specific feature of the sub-account is the legal possibility to inherit the sub-account balance. This is unique even from the international point of view. It is difficult to find other public Social Security Systems that are based on pay-as-you-go method and allow the deceased individuals’ families to inherit registered pension insurance contributions.

The first aspect that needs to be analysed is the conjugal property of amounts registered on sub-account (art. 31 § 1 of the Act Of 25th February 1964 Family and Guardianship Code, Journal of Laws 2017, item 682, with further amendments).

The amounts registered on sub-account are divided between the spouses when:
- the marriage of an insured person is dissolved by divorce or declared void,
- the joint property of spouses is ceased during the marriage of an insured person,
- the statutory joint property of spouses between an insured person and his/her
  spouse is excluded or limited by an agreement,
- death of an insured person (Jędrejek 2015, p. 173).

The amounts registered on the sub-account of that insured person which are due
to his/her ex-spouse are transferred to the sub-account of the ex-spouse in Social
Insurance Institution (art. 40e of the Social Insurance System Act).

The joint property of spouses of amounts registered on sub-account is similar legal
construction to the conjugal property of accounting units accumulated on
member’s account held in an Open-end Pension Fund (art. 126-128 of the Pension
Funds Act). The significant difference is that the latter account is financial defined
contribution scheme (FDC) (Nadrowski 2000, p. 14) and accounting units
are assets similar to financial instruments (Jakubowski 2015). In this legal
construction conjugal property of accounting units is reasonable. In opposition to
that, the sub-account is non-financial defined contribution scheme (NDC-2) and
contains only information on registered pension insurance contributions (Jędrasik
and Jankowska 2010, pp. 141-142).

The reasons why amounts registered on sub-account are subject to the conjugal
property are rooted in the origins of the sub-account. It was created in 2011 by
splitting and downsizing the private pillar of the pension system. The contribution
to Open-end Pension Funds was lowered to 2,3% of the basis of contribution rate.
The remaining part of the Open-end Pension Fund contribution rate was directed
to the newly introduced sub-account. To limit the discontent of insured
individuals, the sub-account has to imitate legal constructions of member’s
account held in Open-end Pension Fund. Therefore the sub-account is linked with
legal relations characteristic for a capital part of the Polish pension system, also
from the legal point of view.

Nevertheless, application of joint conjugal property of amounts registered on sub-
account is questionable and is commonly criticised in the doctrine of social
insurance law (Pacud 2012, p. 21).

Another unique feature that needs to be analyses is the division of registered
amounts on the sub-account, that are not subject to joint property of spouses, in
case of insured person death before reaching the retirement age. The insured
person has the legal right to nominate a natural person or natural persons in favour
of whom the payment of registered amounts should be made after his death (art.
39 par. 1b of the Social Insurance System Act and art. 83 par. 1 of the Pension
Funds Act). The Social Insurance Institution is obliged to pay amounts registered
on sub-account to the persons previously nominated by the deceased insured
individual in the form of lump-sum payment within three months. If no disposition
is made in the case of death, the amounts registered on the sub-account become
a part of the inheritance of the deceased insured person. Therefore the critical
element, in case of early death of an insured person is to find out if the deceased
insured person was married or not (art. 40e par. 1 of the Social Insurance System
Act and art. 131 par. 1 of the Pension Funds Act). If at the time of death the insured
person was married, a part of the amounts registered on sub-account is recorded
on the sub-account of the spouse, to the extent that these funds were the subject
of the joint conjugal property. It should be emphasised that this part of the registered amounts on the insured deceased person sub-account is not subject to the lump-sum payment. The remaining part of the registered amounts on deceased insured person sub-account is paid out in the form of lump-sum payment to the persons previously nominated by the deceased insured individual. It should be emphasised that these lump-sum payments (in cash) do not have insurance nature and are incoherent with general principles of social insurance. The final unique feature that should be analysed is the legal institution of “guaranteed payment”. This one-time lump-sum payment in cash is paid out if the insured person dies within three years since claiming the first retirement pension benefit (art. 25b of the Pensions Act). The guaranteed payment is paid to persons previously nominated by the deceased insured individual. If nobody had been indicated, the guaranteed payment is paid to the spouse of the deceased insured person. If the deceased insured person had not been married or the spouses did not enjoy the conjugal property, the amounts registered on the sub-account become a part of the inheritance of the deceased insured person (Pacud 2015). The value of the guaranteed payment is determined by the amounts registered on the sub-account of the deceased insured person. It should be emphasised that guaranteed payment does not constitute an integrated element of the social insurance system and is not coherent with general principles of social insurance.

5. Indexation

The legal institution of the sub-account is supposed to be a substitute for member’s account held in an Open-end Pension Fund. This may create the impression that the sub-account can be alternative for pension savings. The impression is magnified by the generous indexation of the amounts registered on the sub-account. This indexation, unlike the indexation on primary account of an insured person held in the Social Insurance Institution (NDC), is related neither to the consumer price index (price indexation) nor the average wage growth index (salary indexation).

Value of contributions paid to sub-account is indexed to five-year averaged GDP growth. This indexation is difficult to match even with investments on financial markets. Moreover, from the legal point of view, the indexation cannot be negative (art. 40c of the Social Insurance System Act). Thus it is not possible to reduce the amounts registered on the sub-account, even if the economy experiences a macroeconomic shock. In this way, the legislator eliminated the possibility of suffering nominal losses on amounts registered on sub-account. This is possible from technical point of view, because the sub-account is non-financial defined contribution scheme (NDC-2). Unlike member’s account held in the Open-end Pension Fund (FDC), the sub-account contains only information on registered pension insurance contributions.

The guarantee for the registered amounts on the sub-account is the Social Insurance System and the support of the state budget. According to the art. 2 par. 3 of the Social Insurance System Act payment of all social insurance benefits is guaranteed by the State. Moreover art. 62 of the Social Insurance System Act
directly indicates that the State budget shall guarantee payment of pension benefits from the Social Insurance Fund. This means that as long as the state is solvent, retirement benefits will be paid out.

6. Conclusion

The purpose of this analysis was to describe the construction of the sub-account held in the Social Insurance Institution, to determine if this legal institution is coherent with general principles of social insurance and finally to evaluate if sub-account is a reliable instrument of income allocation over the life course. The inheritance of the sub-account balance and payments in cash from the sub-account in case of death of insured person turn the sub-account into unique legal institution among social insurance systems. At the same time, the inheritance of the sub-account balance makes the sub-account incoherent with the general and the most basic principles of social insurance. Coherence is preferable to chaos, but it is not the most important goal of social insurance systems. More important are social security and enabling income allocation over the life course. No doubts the sub-account is an instrument that supports these goals. Nevertheless, seven years is not enough, from the pension system perspective, to evaluate if the sub-account is a reliable instrument of income allocation over the life course.

The legal institution of inheritance of the sub-account balance and the payments in cash from sub-accounts will be growing burden for the Social Insurance Fund in the future. Already today retirement pension insurance contributions are not enough to cover the payment of retirement pension benefits for today’s pensioners. Rapidly growing public debt and persistent budget deficit decrease the state guarantee potential for the System of Social Insurance in the long term. According to Social Insurance Institution’s forecasts, the budget subsidy and loans to cover the imbalance of the pension fund in the Social Insurance Fund will grow from PLN 42.5 billion in 2017 to PLN 217.8 billion in 2060. The economic and demographic situation in the future will not alleviate this problem (Marcinkiewicz 2018, pp. 207-220). This will lead to changes in the Polish pension system, again. Some modifications were already announced and are being prepared in this parliamentary term. Political uncertainty and instability of the Polish pension system are the most important factors that undermine the reliability of the sub-account as an instrument of income allocation over the life course.

References


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**Legal acts**


Sub-account of the insured person as an instrument of income allocation...

The Act of 6th December 2013 on the amendment of certain laws relating to rules of paying out retirement pensions from assets accumulated in Open-end Pension Funds, Journal of Laws 2013, item 1717.