Bulgaria sets up liberal pension regime

Industry-driven reform

In practice, the reform in Bulgaria was not initiated by the government but from the lower levels. The first supplementary pension funds in Bulgaria were created as public limited companies with shares in 1994 and 1995, on the initiative of financial institutions, banks, trade unions and insurance companies.

In 1997, the Bulgarian Association of Supplementary Pension Security Companies was set up. This was a very important stage in the pension reform, because the country was able to use the full potential of the pension funds. It also gave the government the possibility to take part in the pension reform.

In 1999, the law on supplementary pension insurance was drafted and adopted. Then, in 2000 the law on the supplementary mandatory pension system was introduced.

Other significant stages include: in 2000, the special state supervisory agency was set up and the pension companies were licensed; between 2001 and 2002, the occupational and universal pension funds began collecting contributions and in 2003 the new Social Insurance Code was adopted which in practice elaborated on the existing legislative base and reinforced the philosophy of the pension reform implemented in Bulgaria.

Prior to the establishment of the state supervisory agency in 1999, there were a number of social insurance problems. There was easy access to the system, a lack of funds to pay the benefits, inadequate financial coverage and a high level of unemployment. There were unfavourable trends in the economic situation, social injustices, high taxes on pension funds and a low level of pensions.

The main characteristic of the system prior to 1999 was that it was based on the pay-as-you-go principle – the redistribution of funds between those who were working and the pensioners. In 1997, Bulgaria found itself in a deep economic crisis, and consequently the pension system suffered. These new circumstances created an incentive to achieve a consensus regarding reform of the pension system. On that basis, in 1998 the government supported the idea of creating a three-pillar system and also the philosophy of implementing a radical reform of the system.

The main objectives of the reform were: a higher level of social justice, an increase in the level of protection for the population and improvements in the material conditions of pensioners, a fortification of the structure of the pension system and diversification of the methods of social security for pensions.

In order to achieve those objectives, a deep comparative analysis was carried out outside the potential strategies for implementing this reform. The first alternative was to carry out the reform within the framework and limits of the existing pay-as-you-go system. However, analysis showed that the disadvantages of the system far outweighed its benefits.

The second was to completely abolish the first pillar. But due to the tradition of social security in Bulgaria and the potential conflict between the generations, it was impossible to switch completely to the individual capitalisation system.

The third was the winning combination of the positive features of a modernised public pay-as-you-go system, the advantages of a fully-funded mandatory supplementary system and a voluntary supplementary system.

The Bulgarian model has a first pillar – the mandatory social insurance system, a second pillar – the mandatory supplementary pension insurance and a third pillar – supplementary voluntary pension insurance. The second pillar has two types of funds: the universal pension fund set up for those born after 1959 and the occupational funds which are, for example, for certain categories of workers who work in difficult conditions and are entitled to retire at an earlier age.

The Bulgarian social insurance system is set up as a logically bound matrix. One of its advantages is the three pillars of pension insurance are mutually related. There is a very good partnership between the public sector and the private pension funds.

Since this year, including additional forms of pension insurance such as the professional pension by other institutions initiated by the employer or collective labour contracts, should be realised very carefully.

The employer may influence products much more, that is, the workers’ or resulting pension. These might be established supplementary pensions, compulsory pensions in case of death, pensions for life. The terms for transfer of rights (for instance when changing jobs) are also important and are set in the collective labour contract or in an agreement between the employer and the personnel. The employer can also influence the way pension assets are managed in these schemes.

The Bulgarian model

The special independent state supervisory body for pension funds was created in 2000. In 2003, this body was incorporated in the structure of the financial supervision commission, which supervises all non-banking financial institutions in the country, including pension funds.

There are some features specific to the Bulgarian pension model which differ from those adopted by other countries. In particular, these are: retaining a more important role for the public pay-as-you-go system; a gradual increase of the coverage of the fully-funded system by transferring an increasing portion of mandatory contributions towards it; establishing the possibility for each company to manage three supplementary pension funds; mandatory payment of contributions in occupational (100% paid by the employer) and universal pension funds. In the case of universal pension funds, the distribution of the payment between the employer and the worker is currently 65% and 35% respectively, and the law provides that this ratio should reach 50% each.

The Bulgarian pension model allows for interaction between the public and private systems. Employer and member contributions for the pillar II funds are collected by the National Social Security Institute and are then transferred to private pension funds, where members and employers make direct payments into the pension fund for pillar III. Adopting this scheme for collection of contributions is one of the significant factors in the success of the Bulgarian pension reform.

The priorities and challenges for the next stage of development of the Bulgarian pension system are: the reinforcement of the privileged participation mechanism, growth of the specific weight of capitalisation, strengthening the role of the universal funds, increasing the contribution rate for supplementary funds, daily asset valuation and the rationalisation of the administration system.

The successful activity of the pension funds in Bulgaria is fundamental for the country’s economic development.

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