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Poland's Pension Reform and Its Implications for the Capital Market

Equity Market, Poland

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The Polish government on Wednesday approved a draft bill to push forward the planned reform of the current pension system. The bill proposes to transfer all the retirement savings of Poles currently managed by state-guaranteed private pension funds (OFEs) to private retirement accounts (IKE). The so-called "OFE law" will enter into force in January 2020, followed by an asset transfer in July. Poles will have two months in January and February to decide whether they want their savings moved to IKE accounts (the default option), or to the state social insurer ZUS. The IKE option is subject to a levy of 15%, to be collected by the government in two installments of 70% in 2020 and 30% in 2021. The following is our analysis of how the reform will impact current and future pension fund flows, and whether OFEs can withstand the pension outflows without selling their holdings in publicly-traded equities.

The 2020 Timetable:

- 1 January: The OFE law enters into force. OFEs stop receiving pension contributions.
- 1 Jan-1 Mar: Decision Time: IKE (default) vs. ZUS.
- 31 March: End of OFE-ZUS asset transfers under the "zipper" mechanism (whereby individuals within 10 years before retirement have their OFE savings gradually transferred to ZUS accounts on a monthly basis).
- 1 July: Asset transfer to IKE/ZUS.
- October 2020: Gov't takes first installment of the 15% transfer charge.

Underlying Assumptions:

- 80% of savers opt for IKE accounts.
- Total net outflows from OFEs (pension AuM, dividends, transfer charge) of PLN 12bn in 2020 and PLN 3.3 bn in 2021.
- With an assumed 20% opting for ZUS, given the July timing of the asset transfer, IKE managers will receive lower dividends (largely paid out in Q3) in 2020 than OFEs would have before the reform.
- OFEs will be making up for the pension outflows with divestments, broken down as follows: 40% cash, 20% debt and other securities (mostly through securities reaching maturity, rather than selling), 40% shares in companies listed on foreign stock markets.

Projection of OFE net flows and financing sources

(PLN bn)	2019P	2020P	2021P	2022P
Net OFE Flows				
Pension contributions transferred to ZUS	-1.8	-2.2	-0.4	-0.9
Dividends	0.0	2.8	2.6	2.6
Transfer		-12.7	-5.5	
Total	-1.8	-12.1	-3.3	1.7
(PLN bn) Financing Sources				
Cash	-0.7	-4.8	-0.5	
Bonds & other	-0.4	-2.4	-1.6	
Foreign equities	-0.7	-4.8	-1.1	
Polish equities	0.0	0.0	0.0	

Source: Dom Maklerski mBanku; Not counting asset outflows to ZUS

Under the assumptions set out above, OFEs will not have to sell Polish equity portfolios. Of course in reality there is nothing to stop managers from divesting themselves of Polish companies if foreign equities can guarantee superior returns for their portfolios. At the end of the day, however, the difference in the implications of either strategy is trivial, especially if we consider the size of current monthly trading volumes on the WSE, averaging PLN 20bn.

Projection of OFE assets

(PLN bn)	Sep-19	2019P	2020P*	2021P	2022P
Cash	12.1	11.4	4.3	3.8	5.5
Debt & Other	15.4	15.0	9.6	8.0	8.0
Foreign equities	10.3	9.6	2.9	1.7	1.7
Polish equities	115.5	115.5	92.4	92.4	92.4
Total	153.3	151.5	109.2	105.9	107.6

Source: KNF, Dom Maklerski mBanku; *Proportional transfer of 20% of assets to ZUS

How much of Poland's saving population will actually choose the default IKE option is impossible to predict at this point. Assuming an 80% participation rate, the amount transferred to ZUS will approximate 30bn, of which (proportionately) PLN 23bn will be in the form of shares in WSE-listed companies. In this scenario, the **state pension vehicle, or, rather, the PFR fund tasked with managing the nation's retirement savings, will become one of the largest investors in Polish companies.** The PFR's asset management strategy is not known at this time.

We are aware that we might have underestimated the proportion of people opting to move their savings to the state system. Like all stakeholders in the Polish capital market, we will be watching closely how the crucial decision time plays out during the first two months of 2020.

Assuming OFEs refrain from selling Polish company shares as a way of compensating for the pension AuMs, the WSE should see continued liquidity coming in from the private pension savings system in 2020. If we add to the equation the newly-launched voluntary PPK employer-sponsored pension savings scheme, assuming it has a participation rate of 51%, according to our calculations PPK asset managers could allocate about PLN 2.6 billion next year toward Polish equity purchases, followed by nearly PLN 4 billion in 2021.

Net equity flow projection incl. PPK

(PLN bn)	2019P	2020P	2021P	2022P
PPK (total)	1.3	7.8	11.6	12.0
PPK (Polish equities)	0.5	2.6	3.9	4.1
Polish equities: OFE & PPK	115.9	94.9	98.1	101.4
PPK	0.5	3.2	7.1	11.2
IKE/OFE	115.5	92.4	92.4	92.4
Polish equities: PFR		23.1	23.1	23.1

Source: KNF, Dom Maklerski mBanku

List of abbreviations and ratios contained in the report:

EV – net debt + market value (EV – economic value)
EBIT – Earnings Before Interest and Taxes
EBITDA – EBIT + Depreciation and Amortisation
PBA – Profit on Banking Activity
P/CE – price to earnings with amortisation
MC/S – market capitalisation to sales
EBIT/ EV – operating profit to economic value
P/E – (Price/Earnings) – price divided by annual net profit per share
ROE – (Return on Equity) – annual net profit divided by average equity
P/BV – (Price/Book Value) – price divided by book value per share
Net debt – credits + debt papers + interest bearing loans – cash and cash equivalents
EBITDA margin – EBITDA/Sales

OVERWEIGHT (OW) – a rating which indicates that we expect a stock to outperform the broad market
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UNDERWEIGHT (UW) – a rating which indicates that we expect the stock to underperform the broad market

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NAV – valuation based on equity value, one of the most frequently used method in case of developing companies; the weak point of the method is that it does not factor in future changes in revenue/profits of a company.

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