New legislation in Turkey requiring automatic enrolment in the voluntary funded individual pension scheme

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A new law modifying the Turkish voluntary funded pension scheme has come into effect in January 2017: unless they request to opt out in writing, all employees younger than 45 are now automatically assigned to a pension plan and contribute 3% of their taxable earnings. If individuals do not opt out of this automatic enrolment, the new policy will increase "non-mandatory" coverage substantially and narrow the savings gap.

Description

Employees have been having access to an existing supplementary pension scheme

The pension reform process that has been going on for about 20 years in Turkey includes enactment of Law No. 4632 in 2001. This law allows insurance companies to offer individual retirement plans, which has essentially transformed the single-component pension system in Turkey into a two-component system, with one compulsory component (pay-as-you-go statutory public pension schemes) and one optional component (voluntary funded individual pension schemes).

The current voluntary funded scheme enabled all individuals, including those informally employed and those out of the labour force, to select a level of contributions to the system and pick a portfolio of financial assets. Those who pay contributions for at least 10 years could collect the initial savings plus the return on their portfolio as early as at 57 years of age. This option was initially thought to have a significant potential to further develop financial markets over the following years, and to visibly contribute to the closing of the savings gap facing the country –revealing itself most notably through Turkey's traditional large current account deficits. Yet, relatively modest rates of participation in the system have prevented it from producing the expected remarkable results in terms of boosting the Turkish people's propensity to save, underlining the need for additional incentives to increase participation and, hence, contributions.

Additional incentives provided after 2012 made purchases of individual pension plans more attractive

There were complicated tax breaks for pension plan purchases right from the outset, but they were not visible or understandable to most participants. Law Number 6327 was enacted in June 2012 to further promote (savings for) purchases of complementary pension plans by the working population, by making the tax benefits and incentives more visible. The law stipulated that the state matches 25% of all annual contributions (premiums) paid by individuals to funded pension schemes, starting in January 2013 (up to the annual pre-tax total of monthly minimum wages). This helped increase contributions somewhat but a further boost was deemed necessary.

The latest supplementary pension provisions

The most recent step taken to address this need is Law No. 6740, which was enacted in August 2016 and has come into effect in January 2017. Under the new law, all publicly and privately employed wage and salary earners (covered under articles 4.a and 4.c of

Law No. 5510) who are less than 45 years of age are automatically assigned to an individual pension plan and start contributing at the minimum rate of 3% of their taxable earnings, unless they request to opt out within two months of their automatic enrolment in the plan. In 2015, informal employees (18% of all wage-workers [or, put differently, 14% of all paid-employment]) and self-employed (24% of paid-employment) are not required to enrol, leaving 62% of paid-employment in the scope of the new law. The major change brought about by the new law is that all wage and salary earners younger than 45 will have to opt out of an individual (funded) pension plan, rather than opt in, as in the case of workplace pension plans in the UK.

Outlook & Commentary

This automatic inclusion in the individuals' (funded) pension system for wage and salary earners is likely to significantly increase the number of participants. It is estimated that there are more than 10 million working individuals who are younger than 45, making up the target audience to be covered automatically by individual pension plans. This compares favorably to the number of currently enrolled participants, which stands at about 6.6 million. Together, these have created a total fund value of about 53.4 billion Turkish Liras (TRY) through their contributions over the past 14 years - i.e., around €13.35 billion at the average exchange rate for January 2017. With the addition of 7.4 billion TRY (€1.85 billion) coming from state contributions, the total fund size of 60.8 billion TRY (€15.2 billion) corresponds to about 2.4% of Turkish GDP as of the end of 2015.

If these individuals stay in, rather than use their right to opt out, it would provide a substantial boost to the extent of optional (funded) coverage provision in Turkey. This would also contribute to a further "deepening" of financial markets (i.e. an expansion of the financial markets combined with a change in the structure of the funds, with increased longer term investment portfolios) and to the narrowing of the savings gap in the country. While the government hopes a large enough majority will stay in, the early signs indicate a larger than expected withdrawal rate. Yet, industry analysts expect 10+ million new contributors and more than 90 billion TRY (€22.5 billion) to be collected in pension contributions and returns over the next decade, due to this automatic inclusion. Given the magnitude of the so far created total fund value of currently enrolled 6.6 million, this represents a major boost to the privately managed pension system. It is, however, still too early to assess the impact of the new legislation. While there is recent news concerning thousands of people (including employees in the financial services sector) requesting to drop out of the automatic coverage provided, it is impossible to judge whether these exits will continue in bulk numbers or not.

Further reading

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"90 milyarı çok aşarız" [We will easily surpass 90 billion], Dünya, http://bit.ly/2j86LSS

"Türkiye, kalkınmasına yakıt olarak BES'i kullanabilir" [Turkey may fuel her development via individuals' pension system], Bloomberg, http://bit.ly/2kn865n

"BES'te 39 bin kişinin 21 bini cayma hakkını kullandı" [In the individuals' pension system 21 thousand out of 39 thousand contributors opted for a withdraw], Bloomberg, http://bit.ly/2j7Ybn5

BES'te fon büyüklüğü 60 milyarı geçti" [The total fund value of individuals' pension system has passed over 60 billion], İş'te Kobi, http://bit.ly/2lPHdro

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