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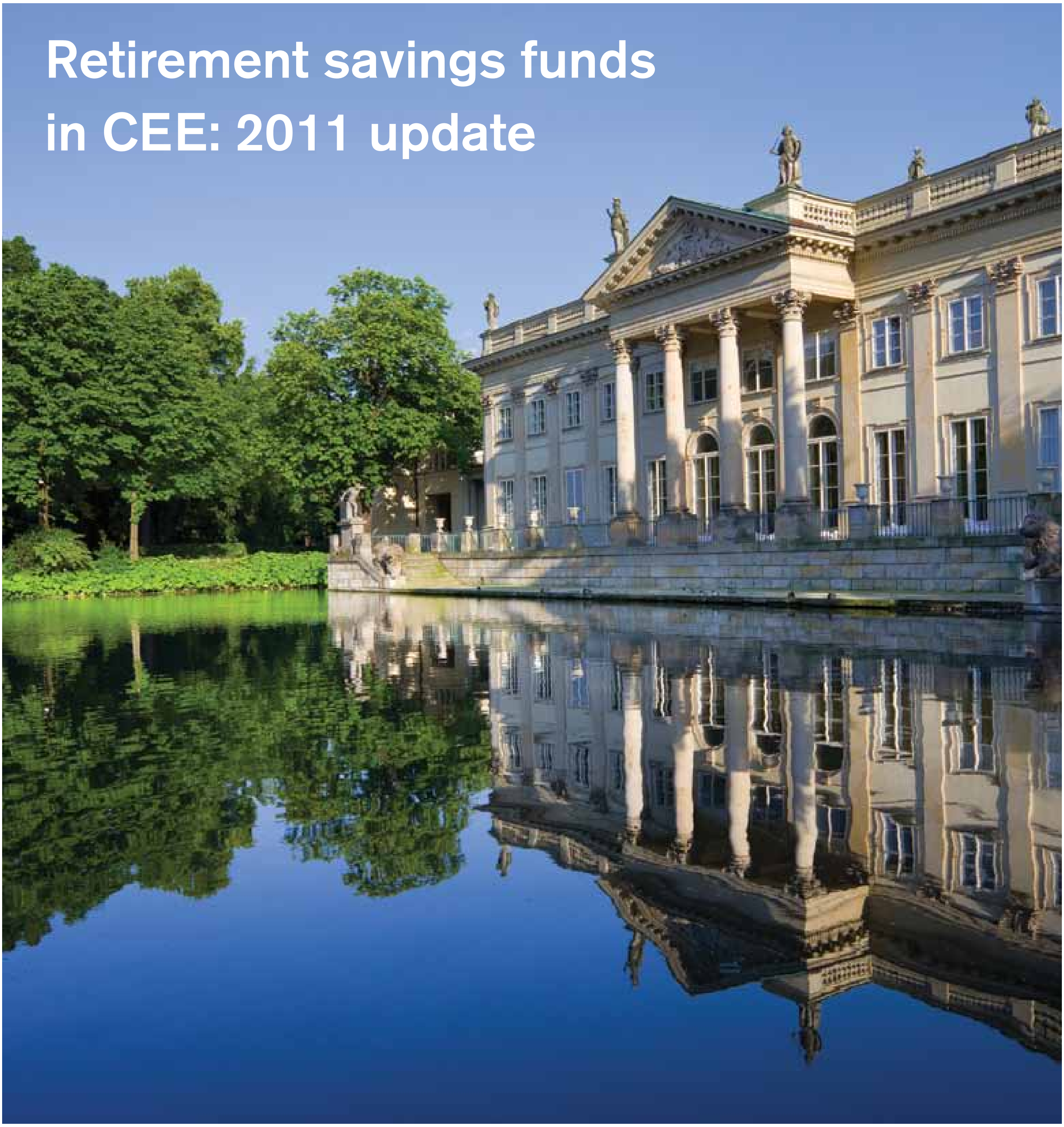
Milliman

Retirement savings funds in CEE: 2011 update



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FOREWORD TO THE CURRENT EDITION

This report was initially issued in 2009, containing data as at the end of 2008. At this time the global financial crisis was in its initial stages, and the impact that it would have on central government finances was only beginning to become apparent.

Three years later, we can look back and see how various governments around the region have modified their retirement savings policies in response to the crisis. Responses have generally taken one of three forms:

1. **Targeting of long-term financial stability and security** (e.g., Czech Republic, Moldova). Governments in this group have recognised that one of the major contributors to the deterioration of their finances is demographic change, in particular the declining support ratio (pensioners per worker) evident in most European countries. These governments have pushed ahead with reforms to increase savings rates and to gradually move the burden of funding retirement incomes from the public to the private sector.

2. **Short-term modifications to cope with crisis conditions** (e.g., Romania, Estonia). Governments in this category have not interfered with the fundamental structure of their existing pensions policy, but have made short-term changes to ease budget deficits while longer-term plans for other fiscal savings are put in place.

3. **Severe curtailment of private pensions** (e.g., Hungary, Poland). Governments in this group have sought to reduce their budget deficits in the short to medium term by taking over the assets of the private pensions system and/or indefinitely redirecting future contributions to the state pension system.

The third approach is of considerable concern given the demographic changes we are likely to see in this century (declining support ratios, longer life expectancy). In the long term, people in countries without funded systems may be highly reliant on government pay-as-you-go pensions for their income in retirement; however, those same governments may only be able to provide small pensions due to the large number of beneficiaries relative to workers.

This revised report describes the region's private pension systems as they are at the time of writing, including the changes that we have observed during the financial crisis.

SCOPE

For more than two decades, the World Bank has been active in promoting a move away from total reliance on pay-as-you-go public pension provision.

The Bank's preferred model is a *three-pillar* pension environment in which a state pension (typically universal, pay-as-you-go) is supplemented by two defined contribution pension arrangements, one funded by mandatory contributions from workers and the other voluntary but tax-advantaged.

The original template for the funded pillars was the pension systems of Chile and other Latin American countries; however, the bank considered that their introduction would also be appropriate in the Central and Eastern European region, given that state pension provision in those countries was particularly weak and that they faced similar demographic changes to developed countries.

Tentative reforms commenced in the mid-1990s in Hungary and the Czech Republic.

In 1998, Poland became the first country in the region to implement the full World Bank model; it has subsequently been followed by a number of others.

Private pensions grew strongly in most countries in Central and Eastern Europe (CEE) prior to the economic crisis of 2008–2009. Although the pension systems in the region face important challenges from the current period of economic weakness, they continue to represent a significant growth opportunity for financial services providers.

The purpose of this report is to help Milliman's clients and partners gain a better understanding of the variety and current state of funded pension systems in the region, 13 years on from the Polish launch, and of the opportunities and challenges facing pension providers in these countries.

We have focussed our study on five markets. These have been chosen to provide a representation of the diversity in the region. An overview of the private pension systems in other markets is included for comparison.

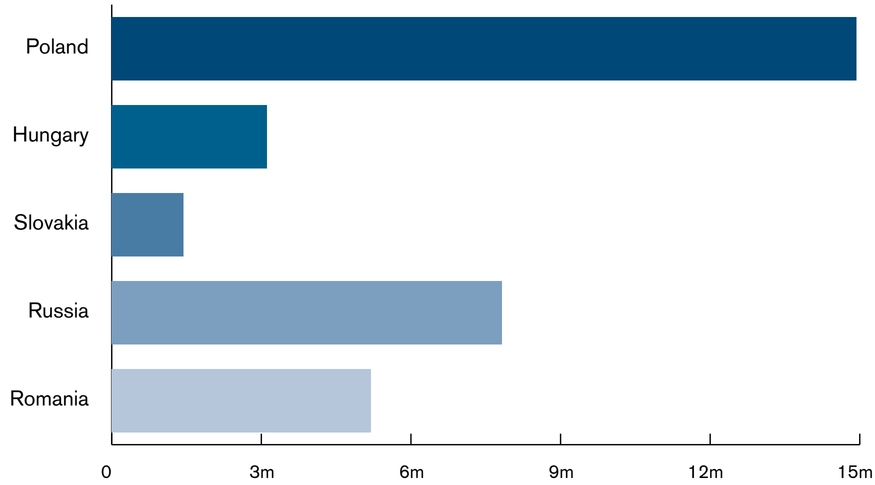
OVERVIEW OF PRIVATE PENSION SYSTEMS

Mandatory pensions

Scheme metrics

Member numbers in mandatory pension funds are determined by 1) the size of the workforce in a particular country and 2) the eligibility rules under which workers participate in the system. In the CEE region, the Polish system is by far the largest in terms of member numbers. This is, first and foremost, because Poland has a relatively large workforce.

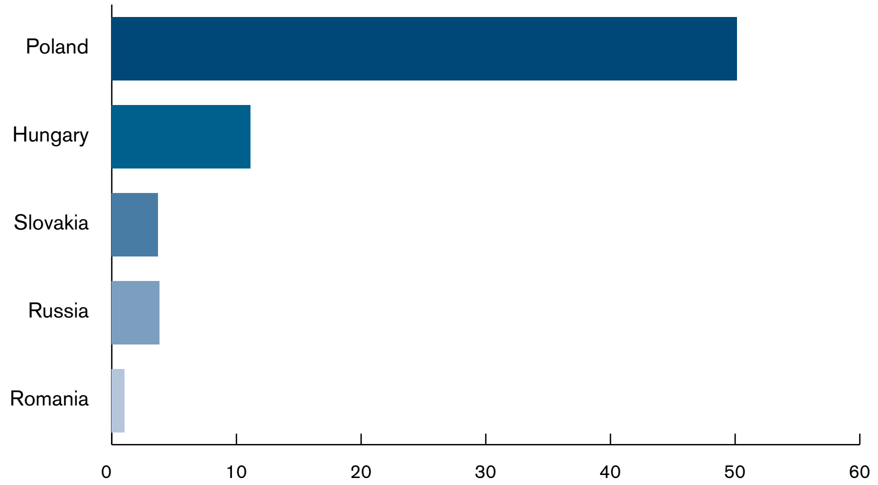
FIGURE 1: PII MEMBERS



Some countries in the region have struggled to extend the coverage of their pension system to all economically active people. Because of tax structuring, these jurisdictions tend to have high proportions of self-employed or professional people, while pension systems are typically designed for those earning salaries. More work needs to be done to ensure that the self-employed are not overlooked.

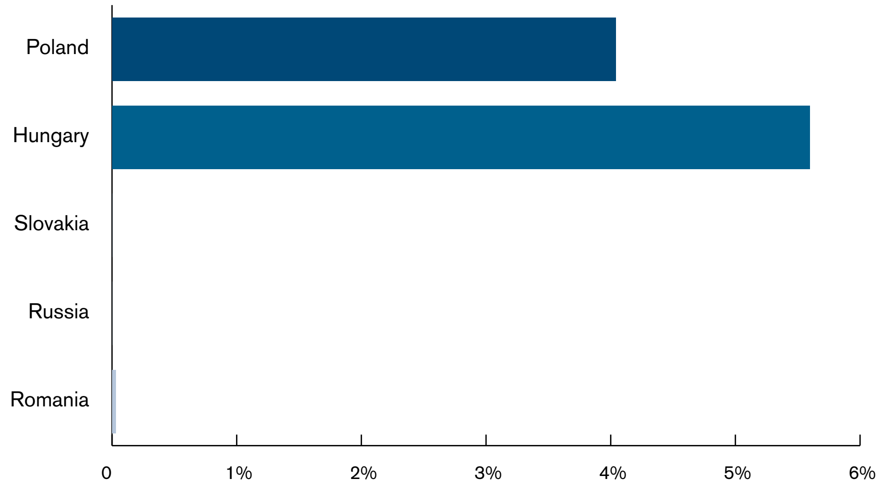
Second, the Polish system is nearing maturity in the sense that it now covers most employees in the workforce. The Romanian system, by comparison, is relatively new, although it is expected to significantly increase its membership over the next two decades as younger people enter the workforce and are automatically enrolled in the system. Pension systems are similarly underdeveloped in Russia relative to the potential eligible membership, and this once again reflects the relative newness of the system.

FIGURE 2: PII AUM (€ BILLION)



Assets under management (AUM) are a function of 1) member numbers, 2) contribution rates, 3) charge rates, 4) investment returns, and 5) the age of the system. Once again, Poland is by far the largest market in the region, benefitting from 12 years of accumulated contributions, high participant numbers, and a relatively high contribution rate (prior to the recent reduction).

FIGURE 3: PII TRANSFER RATES



Transfer rates (the percentage of system participants electing to transfer from one provider to another) vary significantly around the region for 2008. In Romania they are very low, which is due to some practical impediments to transfer contained in the regulations. In Poland and Hungary there is a stronger history and tradition of transfers, although even here rates are moderate.

When calibrating a transfer environment, regulators need to balance the need to create a competitive environment market against the costs to the system (administration, sales commission) of excessive transfers. The best systems appear to be designed in such a way that member-originated transfers are relatively easy to process while distributor-originated transfers are discouraged. Under this regulatory treatment transfer rates appear to be minimal.

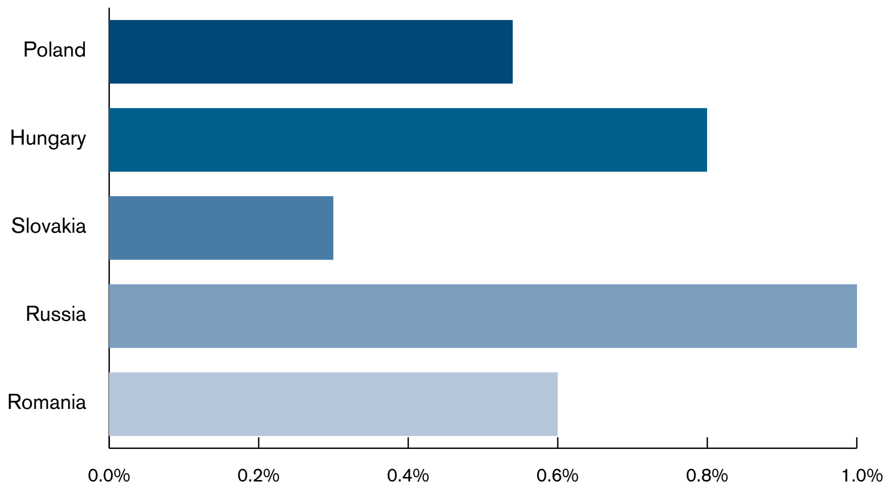
Charging structures

Most mandatory pension schemes impose a limit on the level of charges that can be applied by providers, in order to protect consumers and maximise the investment returns on pension contributions. The charge caps imposed by regulations can take different forms and in the savings accumulation phase are typically defined as a maximum fund management charge and/or charge on contributions. The fund-based charge limits are lowest in those countries (e.g., Slovakia) where political pressure on costs to participants has been strongest.

In Poland maximum charges on contributions were reduced a few years ago, although providers were allowed to maintain relatively high charge levels for a number of years after the establishment of the system. In Slovakia charge levels were forced down by the government shortly after the introduction of the system, leading to severe disruption of provider business plans. In Romania charges were established at relatively low levels from the outset and to date have not been subject to significant pressure.

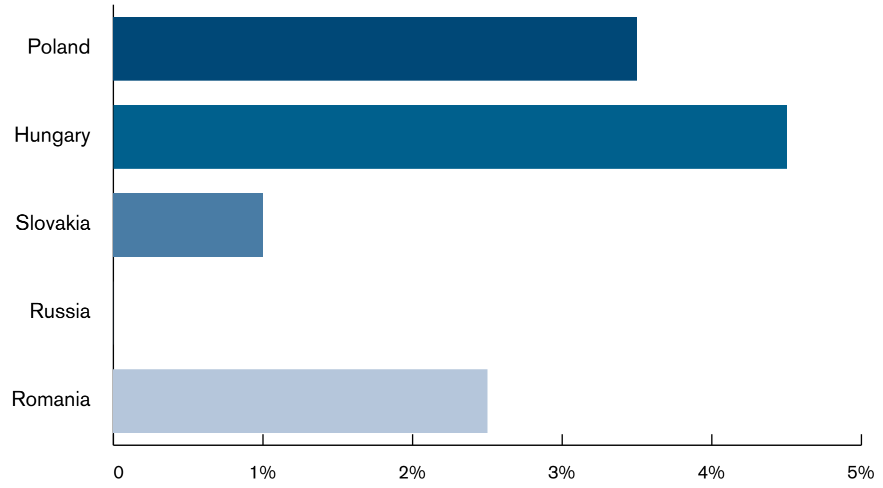
In some countries, performance-related fees or explicit charges to cover expenses (e.g., custody costs) can be charged in addition. Fees of up to 25% of the investment return can be levied by providers in Russia, for example, in addition to the maximum fixed charge of 1% p.a.

FIGURE 4: PII FUND CHARGE LIMITS



Poland has the most sophisticated fund-based charging structure with the maximum management charge, charged from the net asset value (NAV), dependent on the fund value. Under regulations applying from 1 January 2010, a sliding scale applies for fund values ranging from PLN 8 billion (€1.8 billion) to more than PLN 45 billion (€10.2 billion). Maximum charge rates reduce as assets under management grow.

FIGURE 5: PII CONTRIBUTION CHARGE LIMITS



Slovakia also has the lowest contribution charge limit of just 1%. In Poland the current contribution charge limit is 3.5% (reduced from 7% on 1 January 2010). In Russia no contribution charge limits apply.

Reductions in allowable administrator charges and other regulatory changes to mandatory Pillar II (PII) pensions may be making some pension systems unviable for administrators. In Romania some administrators have been prepared to accept projected returns below those normally required by their group head offices. In Slovakia business plans have been turned upside down by legislative change, and the initial investment in acquisition of business is unlikely to be recovered. In Poland, similarly, the legislative changes introduced are likely to significantly alter the current market dynamics.

Investment options

Most mandatory systems offer a choice of at least three investment fund options, as shown in Figure 6. Generally these are *low risk* (taken as a maximum of 10%-30% in *risky* assets), *balanced* (30%-50% maximum in *risky* assets), and *aggressive* (more than 50% in *risky* assets). None of the countries analysed offer a secure (cash) fund option. No fund choices are available in Poland, but the typical investment strategy of pension funds is to invest over 70% of assets in bonds with only around 20% in equities. In Russia, fund options depend on the investment strategy and offering of each non-state pension fund (NPF), subject to limitations imposed by law. Across the region there is usually only one investment strategy per fund, although in some countries providers can offer multiple funds, each with its own strategy.

FIGURE 6: INVESTMENT OPTIONS AVAILABLE

	SECURE	LOW	BALANCED	AGGRESSIVE
POLAND	NO	NO	YES	NO
HUNGARY	NO	YES	YES	YES
SLOVAKIA	NO	YES	YES	YES
RUSSIA	NO	NO	YES	NO
ROMANIA	NO	YES	YES	YES

Most countries provide for some form of minimum investment guarantees on pension contributions. In Romania the accumulated contributions less applicable charges are guaranteed at the date of retirement (and possibly earlier, depending on legal interpretation). In Poland and Romania there is a minimum rate of return defined as the lesser of 50% of the rate of return of the weighted average rate of return of all open funds in the period or the average rate of return less 4%. Absolute and market-relative guarantees apply in Slovakia while there are no investment guarantees in Russia or Hungary. The investment guarantees in various markets are summarised in Figure 7.

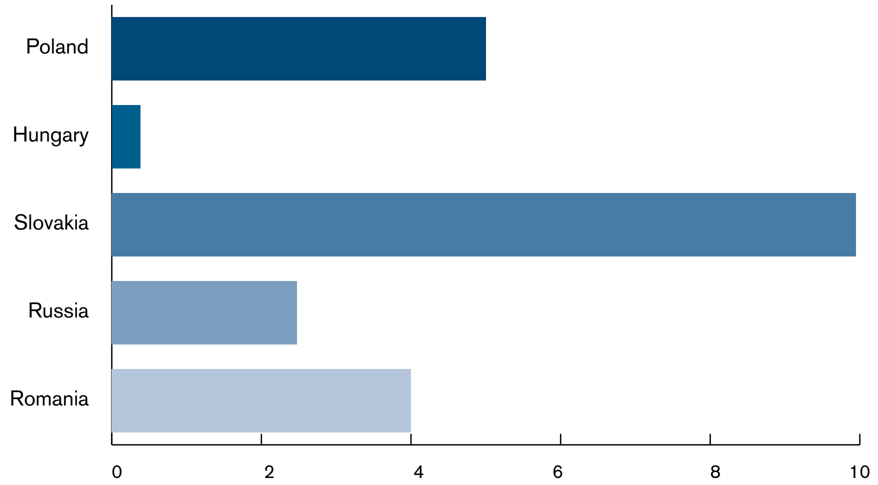
FIGURE 7: INVESTMENT GUARANTEES

	ABSOLUTE	MARKET-RELATIVE
POLAND	NO	YES
HUNGARY	NO	NO
SLOVAKIA	YES	YES
RUSSIA	NO	NO
ROMANIA	YES	YES

Average investment mixes may be suboptimal given the long-term investment horizon of a pension fund. Political and marketing considerations, however, lead regulators and administrators to promote *low-risk* or *medium-risk* funds, with relatively low exposure to *risky* assets such as shares and property. Over the long term, however, these strategies may suppress returns and reduce pensions payable.

Prudential supervision

FIGURE 8: PII CAPITAL REQUIREMENTS (€ MILLION)



The minimum capital requirements specified by the local pension fund regulators in Poland and Romania are broadly similar, at around €4 million, with Slovakia rather higher, at some €9.95 million. In Russia, the effective minimum is RUR 100 million (€2.5 million). In Hungary, the minimum capital requirement of HUF 100 million (€0.36 million) applies only to pension funds that pay out benefits. This is waived if benefit payments are outsourced by the pension fund.

Romania has the most extensive range of risk management controls, covering all six areas examined: actuarial reserves, depository unit price checking, guarantee fund, auditing, internal risk management process, and external custody. Poland covers all areas except actuarial reserves, while Hungary covers all areas except external custody and depository unit price checking. Only the Russian system does not include a guarantee fund.

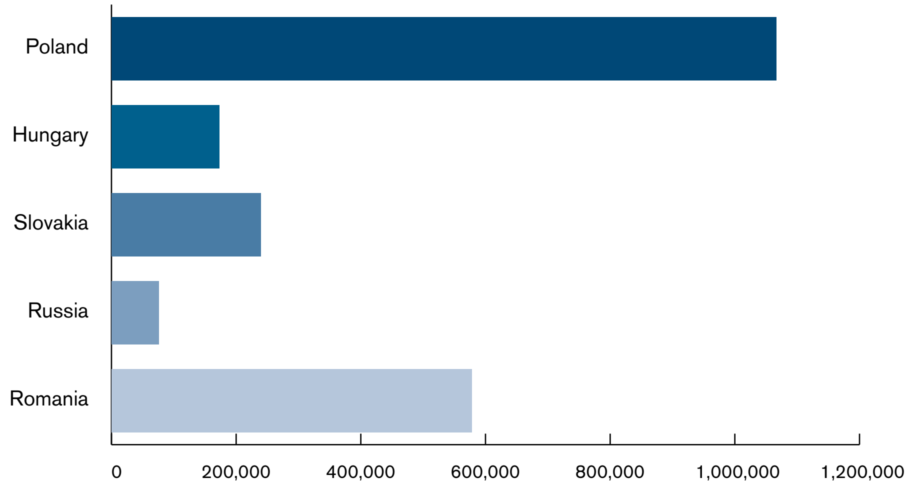
FIGURE 9: RISK MANAGEMENT CONTROLS

	ACTUARIAL RESERVES	GUARANTEE FUND	UNIT PRICE CHECKING	EXTERNAL CUSTODY	EXTERNAL AUDIT	INTERNAL RISK MGMT
POLAND	NO	YES	YES	YES	YES	YES
HUNGARY	YES	YES	NO	NO	YES	YES
SLOVAKIA	NO	NO	YES	NO	YES	YES
RUSSIA	NO	NO	YES	YES	YES	YES
ROMANIA	YES	YES	YES	YES	YES	YES

The capital framework in which pension funds operate is made up of a number of components, which do not necessarily fit together and can be somewhat arbitrary. Nowhere in the region have we observed a comprehensive risk-based capital framework similar to Basel II or Solvency II. Regulators and legislators appear to be focused on form rather than substance in this matter.

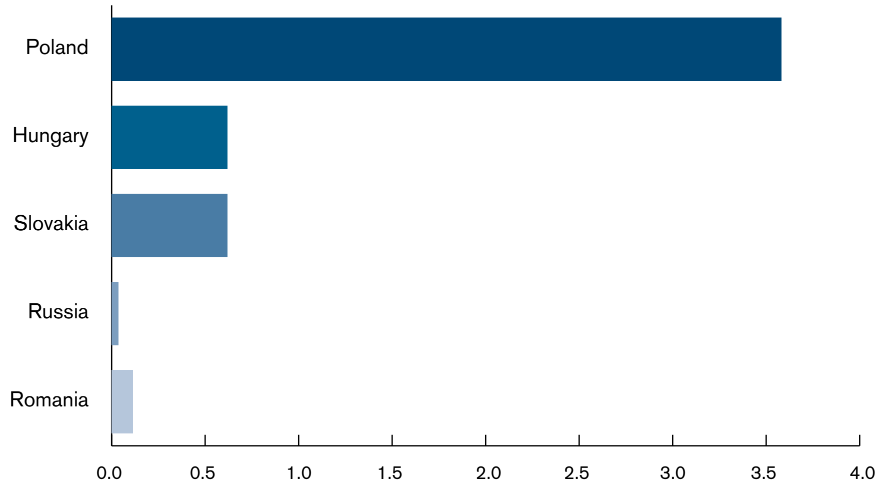
Competitive landscape

FIGURE 10: PII AVERAGE MEMBERS PER PROVIDER



Countries with more developed systems have seen consolidation among pension fund providers, with smaller players exiting the market in favour of larger providers, as companies look to achieve critical mass. In Poland, the largest and most developed market, the average number of members per provider exceeds the 1 million mark, significantly higher than in all other countries. Although the number of members is only one of the factors affecting provider profitability in some markets, especially Russia and to a lesser extent Hungary, providers may struggle to realise the necessary economies of scale because of low membership levels.

FIGURE 11: PII AVERAGE AUM PER PROVIDER (€ BILLION)



A similar picture can be seen for assets under management, with Poland recording an average of €3.6 billion per provider. Hungary[1] and Slovakia are more developed than Romania, which has only low levels of assets because of the relative newness of the system. Nevertheless, at some €112 million per provider, Romania's savings are still considerably higher than the levels in Russia.

In jurisdictions where regulation allows cost-sharing between entities in a financial services group, scale may not be as important as it appears at first glance. The major fixed costs are initial advertising, system development, and the minimum personnel structure that has to be maintained within the administration company.

Contribution rates

Contribution rates as a percentage of gross salary are as set out in Figure 12. Romania is still in the phase-in period, such that current contribution rates are expected to rise eventually to 6%. With effect from 1 May 2011 the contribution rate to PII for Poland has been reduced to 2.3% (from 7.3%). The 5% difference is now paid to the individual PI subaccounts. The contribution rate is expected to rise eventually to 3.5% (by 2017)–please refer to the section on Poland for more details.

FIGURE 12: CONTRIBUTION RATES

POLAND	**2.3%**
HUNGARY	**8.0%**
SLOVAKIA	**9.0%**
RUSSIA	**6.0%**
ROMANIA	**3.0%**

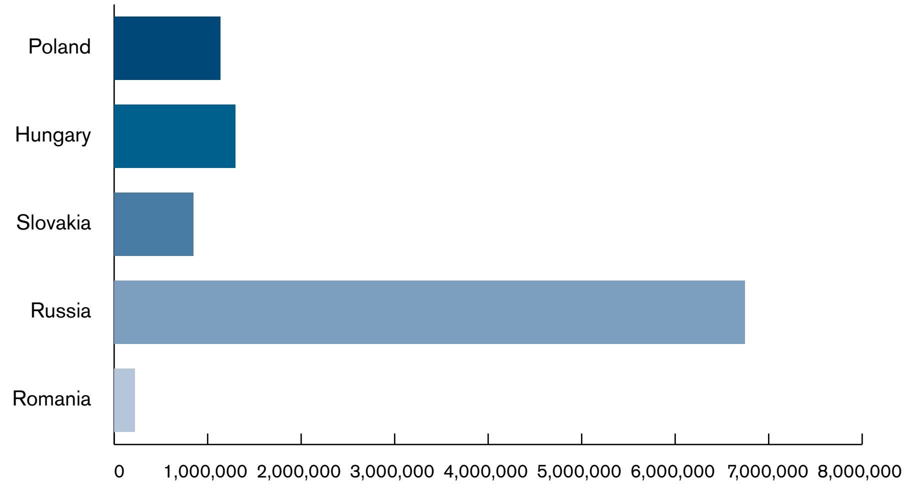
Contribution rates at the levels set out above will only be capable of funding pensions that will replace a minor part of pre-retirement income. Pillar I state pensions, Pillar III (PIII) voluntary pensions, and personal savings will need to fill the gap if retirees are to maintain their standard of living in retirement.

[1] Prior to the mass transfer out in early 2010.

Voluntary pensions

Scheme metrics

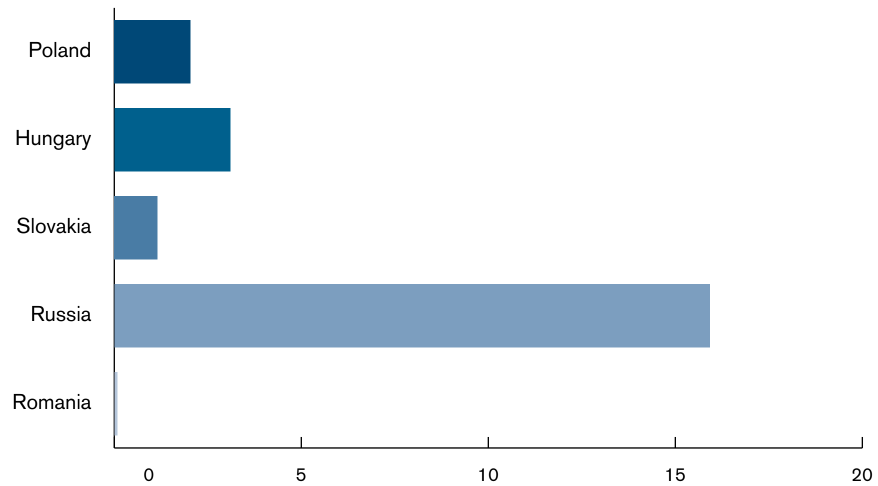
FIGURE 13: PIII MEMBERS



Governments in many countries have introduced voluntary pension systems that aim to encourage individuals to make additional private pension contributions to reduce income shortfalls at retirement.

As would be expected, the take-up in voluntary systems is generally much lower than for mandatory systems because of the lack of compulsion. Russia is an exception, however, because the voluntary system has operated for more than 12 years, whereas the mandatory system is much newer. The volume of assets under management is much higher in the voluntary system (despite the lower number of members).

FIGURE 14: PIII AUM (€ BILLION)



In contrast to the well-developed mandatory system in Poland, the voluntary system, which consists of individual and employer-based schemes, is very small. The low level of take-up is partly linked to the limited tax incentives offered. The system in Hungary is reasonably well developed with relatively high membership but low asset volumes, while Romania's is still in its infancy.

Voluntary pension saving should be an attractive solution to fiscal authorities, as the contributions are not withdrawn from the tax base used to fund Pillar I pay-as-you-go pensions. Governments around the region have, by and large, failed to recognise this potential. Regulatory environments are flawed, tax incentives are paltry, and promotion is weak.

Other features

As with mandatory systems, tax incentives are offered, with premiums deductible from personal income tax up to defined limits. In Poland participants may also choose a product where benefits are exempt from capital gains tax. Voluntary pensions generally can only be provided by pension fund companies, except in Romania, where they are also offered by life insurance companies, and Poland, where they are also offered by life insurance companies, banks, investment managers, stock broking companies and, starting from 1 January 2012, pension fund management companies.

As with mandatory systems, some countries impose restrictions on charges that can be levied by providers. In Hungary, Romania, and Slovakia, the maximum annual fund-based charges are set at 0.8%, 2.4%, and 3% respectively. In Poland there is effectively no limit on the management charge, while in Russia this may not exceed 15% of the investment return and the maximum contribution charge is 3%.

Similarly, most countries impose restrictions on charges that can be applied by providers on transfers. We understand that in Russia these depend on the scheme rules.

FIGURE 15: RESTRICTIONS ON TRANSFER CHARGES

POLAND	ONLY ALLOWED IN THE FIRST YEAR
HUNGARY	4.5% MAXIMUM
SLOVAKIA	5% MAXIMUM FIRST 3 YEARS, THEREAFTER 1% OF ACCOUNT BALANCE
RUSSIA	NO
ROMANIA	5% MAXIMUM YEAR 1, 2.5% IN YEAR 2, AND 0% THEREAFTER

PRIVATE PENSION SYSTEMS IN SPECIFIC MARKETS

POLAND

Overview of the system

With effect from 1 January 1999, a new pension system was introduced in Poland. The aim of the reform was to change the pension system in order to provide its participants with an adequate level of income after retirement. In the new system for people born after 1948 the pension depends only on the capital accumulated throughout the life of a person. The pension system introduced is based on a so-called three-pillar framework.

The first pillar is represented by the individual account of the insured person at the Social Insurance Institution (Zakład Ubezpieczeń Społecznych, ZUS). The deposited capital is value-adjusted by the factor announced by the Minister of Labour and Social Policy (until 25 May the following year), based on the consumer price index (CPI) and the growth of contributions to the pension scheme. Factors for preceding years are presented in the table in Figure 16.

FIGURE 16: FACTORS FOR CAPITAL VALUE ADJUSTMENT IN THE FIRST PILLAR

YEARS	FACTOR
2000	112.72%
2001	106.68%
2002	101.90%
2003	102.00%
2004	103.63%
2005	105.55%
2006	106.90%
2007	112.85%
2008	116.26%
2009	107.22%
2010	103.98%

The pension from the first pillar is funded on a pay-as-you-go basis. This means that pensions paid out currently are financed by contributions from current employees. In return for mandatory contributions paid to ZUS amounting to 12.22% of gross salary (the overall pension contributions equal 19.52% of gross salary), individuals acquire pension rights, which cannot be transferred away by inheritance.

The second pillar of the pension system is based on open pension funds (pension funds, OFE), which are managed by separate pension fund management companies (PTE). The activity of pension funds and management companies is regulated by the Act on Organization and Functioning of Pension Funds from 28 August 1997, with subsequent amendments (the Act). The latest consolidated text of the Act was published on 9 February 2010, and later amendments were introduced in the Amendment to the Act on Organization and Functioning of Pension Funds dated 28 July 2011. The level of contributions to the first and a second pillar is regulated by the Act on the Social Security System from 13 October 1998 with subsequent amendments. The latest amendment regarding the level of contributions to first and second pillar (currently in force) is the Amendment to the Act on the Social Security System and other acts from 25 March 2011.

The essential activity of mandatory pension funds is to collect and invest the contributions of pension fund members with the purpose of paying out benefits to the members of the fund when they reach retirement age. Member contributions are transferred to pension funds through ZUS as part of overall pension contributions. With effect from 1 May 2011 the member contribution was decreased from 7.3% to 2.3% of gross salary until the end of the year 2012. In subsequent years, member contributions will rise as presented in Figure 17.

FIGURE 17: MEMBER CONTRIBUTIONS TO PENSION FUND

YEARS	MEMBER CONTRIBUTION (% OF GROSS SALARY)
2011-2012	2.3%
2013	2.8%
2014	3.1%
2015-2106	3.3%
2017 +	3.5%

The difference between 7.3% of gross salary and the current contribution rate of 2.3%–i.e., 5% of gross salary until 31 December 31 2012, 4.5% in 2013, 4.2% in 2014, 4.0% in 2015 and 2016, and 3.8% thereafter, is paid into the individual first pillar subaccounts, which are run by ZUS (in addition to mandatory contributions registered on the individual accounts in ZUS amounting to 12.22% of gross salary). The amounts collected are subject to indexation according to the average growth of GDP over the five years preceding indexation.

At the moment of contribution the second-pillar premiums are exempt from income tax. While the first pillar is mandatory, the second one is mandatory only for those born after 31 December 1968.

The legislation dated 25 March 2011 changed the organization of the second pillar by creating subaccounts within existing member accounts in ZUS. The decision came after Eurostat's decision to treat second-pillar contributions as part of the public debt, whereas in the first pillar only current-year contributions are the government's liability. In these subaccounts ZUS is required to register the contributions complementary to the OFE member contributions (i.e., the difference between 7.3% of gross salary and the amounts allocated to OFE funds). In practice, the part of contribution which used to be transferred to OFE supports the first pillar pay-as-you-go system but the subaccount still enjoys some characteristics of the second pillar, such as the indexation and inheritance, subject to some restrictions.

The third pillar of the system is voluntary and includes employee pension schemes (Pracownicze Plany Emerytalne, PPE), individual pension accounts (Indywidualne Konta Emerytalne, IKE) and, with effect from 1 January 2012, individual pension insurance accounts (Indywidualne Konta Zabezpieczenia Emerytalnego, IKZE). Because the third pillar is less strictly regulated, other forms of pension savings (e.g., ordinary life insurance or mutual funds) are often also referred to as *third pillar*.

Mandatory pensions

Revenues of pension funds (PTEs) consist of asset management charges and charges on contributions/premiums paid by pension fund members.

Upper limits for both types of the charges are specified in the Act (and were decreased starting from 1 January 2010).

Upper limits on management charges as a percentage of NAV are presented in the table in Figure 18.

FIGURE 18: UPPER LIMITS ON MANAGEMENT CHARGES

NAV IN PLAN (MILLION)		MAXIMUM MONTHLY MANAGEMENT CHARGE
0	8,000	0.045% OF NAV
8,000	20,000	3.6M PLN + 0.040% OF NAV EXCEEDING 8,000M PLN
20,000	35,000	8.4M PLN + 0.032% OF NAV EXCEEDING 20,000M PLN
35,000	45,000	13.2M PLN + 0.023% OF NAV EXCEEDING 35,000M PLN
45,000		15.5M PLN

Recent legislation changes (introduced with effect from 1 January 2010) decreased the upper threshold for NAV from PLN 65 billion to PLN 45 billion and put a cap on the maximum monthly management charge equal to PLN 15.5 million (previously in case NAV exceeded PLN 65 billion the maximum monthly management charge equalled PLN 20.1 million + 0.015% of NAV).

The maximum charge from contributions paid by pension fund members is 3.5%. (Prior to 2010 it was 7% and was envisaged to be gradually reduced beginning in 2011 to reach 3.5% in 2014. However, this reduction took place starting 1 January 2010.)

Another source of revenue for the PTEs is the profit received as a reward for good investment performance. OFEs transfer up to 0.005% of NAV each month to PTEs. This amount is then passed to a *bonus account*, which is managed by OFEs.

The bonus account transfer depends on the investment performance of PTE and is calculated in proportion to the average weighted rate of return of all pension funds announced by the Polish Financial Supervision Authority (KNF) each month.

The PTE managing the pension fund with the highest rate of return transfers 100% of funds collected in the bonus account to the *reserve acco*unt. The PTE that manages the pension fund with the lowest rate of return is obliged to transfer all assets accumulated in the bonus account back to the OFE. The remaining PTEs transfer part of the assets accumulated in the bonus account to the reserve account in proportion to their investment returns and transfer the remaining part to the OFE.

PTEs have the right to withdraw money from the reserve account twice a year if the investment return for the previous six years is higher than the CPI. This is considered to be a reward for good investment performance.

There also used to be another source of revenue: the income from transfer charges paid by fund members in case of switching funds prior to completion of two years of membership. The transfer charge equalled PLN 160 (approximately €38) in the first year of membership and PLN 80 (approximately €19) in the second year. Transfer charges were typically used to help finance acquisition costs, e.g., commissions incurred by PTEs on member transfers. Starting from 1 May 2011 the transfer charge was cancelled. This measure is related to the fact that starting from 1 January 2012 the acquisition for Pillar 2 pension funds becomes prohibited by law. This means that any activity in attracting new members to the fund–either by agents, direct PTEs' activities, commercials, etc.–is forbidden.

Expenses of pension funds

There are two types of expenses that are incurred by the pension fund: systemic and non-systemic. Systemic expenses are listed by the Act and are presented below.

Costs of supervision (for the account of the fund): PTEs transfer to the Supervisor, KNF, 0.1064% of monthly contributions received by open funds.

Ombudsman costs: PTEs transfer 0.0071% of monthly contributions received by the open fund managed by PTE.

Costs of the guarantee fund: Created in order to protect OFE members against a financial deficit (see below).

Cost of deficits in open pension funds: Detailed information is included under Guarantees below.

Fees paid to ZUS from contributions paid by fund members: According to the law, ZUS is entitled to receive not more than 0.8% of premiums received by open pension funds. The level of the ZUS fee (to cover its operating costs) is determined annually in the state budget.

Transfer fee paid to both ZUS and the National Depository for Securities (KDPW): According to the Act, the transfer charge paid to ZUS equals 1% of the minimum monthly wage for each new membership agreement resulting from incoming transfer, whereas the charge paid to the KDPW equals 1% of the minimum monthly wage for transfers between OFEs.

Costs of acquisition/disposal of assets (i.e., dealing costs) of open pension funds.

Cost of depository bank.

The guarantee fund (please see following pages for description of guarantees) consists of basic and additional parts. The basic part of the guarantee fund is administered by the National Depository for Securities (KDPW S.A). PTEs make contributions to the basic part of the guarantee fund and the total value of the basic part of the guarantee fund cannot be higher than 0.1% of the NAV of all OFEs operating in the market.

PTEs also make payments to the additional part of the guarantee fund administered by their OFE. The total value of the additional part is between 0.3% and 0.4% of the NAV of the OFE managed by the PTE (see below).

Expenses of pension fund administrators

The costs not regulated by the law are called non-systemic costs and involve all other expenses incurred in the operation of a PTE such as:

- General management costs including salaries
- Minimum required rate of return and elimination of deficits

Because acquisition is banned starting from 1 January 2012 the acquisition costs, including costs of marketing will not be incurred or at least will be materially decreased.

Guarantees

The law guarantees a minimum rate of return to fund participants. In cases where the rate of return on the fund drops below the minimum required rate of return, a deficit appears.

In cases where the current rate of return on the fund for the last 36 months is lower than minimum required rate of return, then the amount of the deficit is determined by multiplying the number of units of account in the pension fund on the last working day of the period of 36 months by the difference between the value of the unit of account that would ensure achievement of minimum rate of return and the actual value of the unit of account on the last working day of the period of 36 months.

The minimum rate of return is defined as the lower of 50% of the weighted average rate of return of all open funds during the period or the weighted average rate of return less 4%.

Open pension funds are obliged to redeem fund units kept in the reserve account in order to cover any deficit. The income from the redeemed units increases the value of remaining units of the fund. In the case where the deficiency cannot be fully offset by the reserve account, the fund redeems units from the additional part of the guarantee fund. If the deficit is still not offset, the PTE has to compensate the shortfall from its own assets. If the above sources are not sufficient to cover the deficit the remaining amount is compensated from the basic portion of the guarantee fund. In case the basic portion of the guarantee fund is insufficient to cover the deficit, the remaining amount is guaranteed by the state.

Inheritance

Assets gathered by OFEs and in individual Pillar 1 subaccounts in ZUS may be inherited, subject to some restrictions.

In case of the death of an OFE member, 50% of the account value is transferred to the spouse's OFE account. The remaining 50% is inherited according to the rules given in the law. The OFE member may, however, choose the beneficiaries and override the inheritance law. Inheritance of ZUS subaccount values follows the inheritance rules as for OFE accounts.

Distribution strategy and agent/broker remuneration

As the system has been in operation since 1999, the market is already saturated and has stabilised. New entrants to funds are mostly new young employees entering the workforce for the first time.

It is obligatory to choose a pension fund on entering employment for the first time. If an employee fails to do so in a specified period, a fund will be allocated to him or her by lottery. The allocation is made twice a year, with the exclusion of any funds that have an excessive market share.

Membership of OFE funds used to be offered directly by the PTEs through call centres and the Internet and by insurance agents (including multi-level networks). The market was estimated at around 600,000-700,000 new members annually. Several times a year there were massive sales campaigns by PTEs (especially on TV). With effect from 1 January 2012, acquisition will be banned and customers would be able to join/change the pension fund exclusively by mail. The publically available KNF data on members' transfer in recent months shows that some PTEs have already ceased acquisition whereas others are taking advantage of the last months before the ban.

Insurance agents typically used to receive commissions of between PLN 200 and PLN 500 for each new member. Commissions were higher for transfers with high assets under management (and have exceeded PLN 500). For the career starters, the commissions tended to be at the lower end of the above range and were independent of the expected contribution level. However, according to our knowledge, commission levels have already been significantly decreased for the second half of 2011 and the commission payments are expected to stop as of 1 January 2012.

There were 321,057 new members allocated by the lottery in 2011 (up 92% from 2010). Twenty to thirty percent of all new OFE members have been gained this way in the past few years. Only funds that have higher investment returns than the market average and a share of AUM lower than 10% may take part in the lottery.

Investment strategies

The law stipulates investment limits for the PTEs. The most important limitation used to be that up to 40% of assets could have been invested in shares listed on the Warsaw Stock Exchange. Starting 1 May 2011 the limitation for shares listed on the Warsaw Stock Exchange was increased to 42.5% and a gradual increase of up to 90% in 2034 has been prescribed by the law.

PTEs are not allowed to invest in derivatives of any kind.

Foreign investment may total up to 5% of a fund's assets. This regulation was questioned by the European Commission, which considered the investment restrictions imposed by law on OFEs to be contrary to the principle of free movement of capital. This dispute has been resolved by the judgement of the European Court of Justice from 21 December 2011 stating that Poland failed to fulfil its obligation to meet this principle. Voluntary funds, i.e., funds managed by PTE for IKE and IKZE products (Pillar 3), have always been allowed to invest in foreign securities.

Taxation of contributions and benefits

Contributions paid to the OFE are deducted from gross salary and are not subject to taxes or social security charges.

Regular benefit payments paid out by the OFE in the future are expected to be subject to the general rules of personal income tax (e.g., growth in value may be subject to capital gains tax).

Expected changes in legislation

The government is responsible for the review of the functioning of the pension funds and for submitting to the Parliament information on the impact of existing legislation on pension funds with suggested changes at least every three years. The first review must be performed before 31 December 2013.

The temporary law regarding the pay-out phase of first pensions from OFE was passed in 2008. Several thousand women born before 1949 are entitled to pensions from OFEs starting from the beginning of 2009. Because the retirement age for men is higher, it is expected that they will start to receive their first pension benefits in 2014.

In accordance with the (transitional) law, the new pensions will be paid in two forms: fixed-term annuities and life annuities. Lump-sum payments are not allowed. Current OFE members (practically only women) will be entitled to a guaranteed five-year annuity upon attaining the age of 60 years. After 65, the member of OFE will be entitled to a life annuity under a new, permanent law.

The total pension paid will be the sum of the Pillar 1 and Pillar 2 pensions. In the case of life annuities, an OFE member will be able to choose among offers of life annuities available in the market. Funds accumulated in an OFE account will be transferred via ZUS to the chosen life annuity funds (Fundusz Dożywotnich Emerytur Kapitałowych, DEK fund), which will be managed by a pension company (Zakład Emerytalny).

Annuities cannot be inherited. However, if the retiree dies within three years of the first annuity payment, the guaranteed lump sum will be paid to the beneficiaries.

The pay-out phase system for the fixed five-year term annuity was adopted as a temporary law at the end of 2008. However, the law that stipulates the creation, organization, and operation of DEK funds has been vetoed by the president in 2009 and is expected to be rewritten before 2014. The main issues to be decided include equity among participants, the choice of the entities responsible for the payments and the factors contributing to the expected profitability of the business. Any changes are likely to have an impact on designated pension providers rather than PTEs, however.

The Polish government is expected to address the recent judgment of the European Court of Justice on the foreign investment limits for the pension funds. This might become a starting point for a new discussion on legislative change in respect of the existing benchmark for the rate of return. The most recent KNF proposal suggested a benchmark referring to indices of equities, bonds and inflation. Furthermore, a volatility margin was suggested to replace the minimum rate of return. However, no legislative projects have been provided in writing yet.

Voluntary pensions

The law provides tax incentives for additional savings through individual pension accounts. An Indywidualne Konto Emerytalne (IKE) and an Indywidualne Konto Zabezpieczenia Emerytalnego (IKZE) account holder may choose one form of saving, including bank deposits, unit-linked insurance products, mutual investment funds, and direct stock exchange investments. IKE accounts are offered by almost all mutual fund companies, most banks, some insurance companies, and stock exchange brokers. The newest law has introduced a new tax-incentivized product IKZE and additionally the PTEs have been allowed to offer IKE and IKZE accounts.

In case of survival to the age of 60 (or premature retirement) for IKE and 65 for IKZE, investment returns from the IKE and IKZE will be exempt from capital gains tax. The IKZE premiums decrease the taxable income in the year when they were paid; however, the benefits from the IKZE will be subject to the personal income tax scale. Benefits from IKE accounts were reconfirmed not to be subject to personal income or capital gains tax.

There is effectively no limit imposed on providers for the level of fund management charges. Additional costs such as dealing charges have to be charged by providers at the actual cost levied by third parties.

A limit is imposed on charges applied on transfers. A charge can only be applied in the first year and thereafter no charge is permitted.

In case of surrender of an IKE account, the IKE account holder will be taxed with a capital gains tax of 19%. The value of an IKZE account, on the other hand, will be added to the income in the particular year in which the surrender occurred and taxed according to personal income tax regulations.

Take-up of IKEs has been weak because of low levels of sales commission and perceived limited tax incentives for the IKE product.

Until 2008, the annual IKE contribution was limited to 1.5 times the average monthly gross salary per year. Starting from 1 January 2009, the annual contribution limit has been increased to three times the average monthly gross salary per year (PLN 10,077 in 2011). The top limit is adjusted annually by a factor of expected average salary increase. The tax-deductible annual IKZE contribution is limited to 4% of actual remuneration of an employee but not more than 4% of 30 times the average monthly gross salary per year (thus not more than PLN 4,030.80 in 2011). In case the amount calculated individually does not exceed the 4% of the minimum annual salary, the IKZE holder is entitled to make a supplementary payment to IKZE.

Data on the number of accounts at the end of period, new entrants, and assets under management are presented in the table in Figure 19.

FIGURE 19: ACCOUNTS, ENTRANTS, AND ASSETS UNDER MANAGEMENT

	NO. OF ACCOUNTS AT END OF PERIOD	NEW ENTRANTS DURING THE YEAR	ASSETS UNDER MANAGEMENT [€ M][2]
2006	840,263	447,115	313
2007	915,492	120,955	423
2008	853,832	55,360	366
2009	809,219	42,275	499
2010	792,466	40,723	618
HY 2011	798,912	36,098	663

Source: KNF

[2] Exchange rate as of 30 September 2011: 1 EUR=4.4112 PLN. Source: National Bank of Poland.

The fall in the volume of assets in 2008 is due to the decreasing number of accounts and contributions, e.g., from individuals closing their accounts or not making any contributions, as well as from the significant decrease in global asset values that year.

Pracowniczy program emerytalny (employee pension programs)

Employee pension schemes are defined as organized, collective, and regular-payment forms of retirement saving. The contributions of program participants are paid in by the employers to the financial institutions that handle the management of such funds. The Pracowniczy Program Emerytalny (PPE) scheme itself is a contract that sets out the mutual duties of employers and employees in respect of the program offered by the employer to the employees.

The PPE itself is not a financial institution, but contributions to the program are managed by existing providers such as insurance companies and mutual investment funds. There are three forms in which an employer may offer the PPE to its employees:

- Group unit-linked life insurance
- Agreements for employees to pass contributions to an investment fund through the employer
- Employee pension fund (PFE)

The table in Figure 20 presents basic figures regarding the PPE market.

FIGURE 20: PPE MARKET

	NO. OF PROGRAMS	NO. OF EMPLOYERS OFFERING PROGRAMS	NO. OF MEMBERS	PREMIUM PER PERIOD [€ M]
2006	974	1,024	281,495	157
2007	1,019	1,061	312,121	169
2008	1,078	1,112	325,009	189
2009	1,099	1,132	333,544	202
2010	1,113	1,148	342,489	221

Source: KNF

Employees have a right to join the PPE if they are employed for longer than three months and fulfil the conditions stipulated in the agreement between employee and employer. The contributions paid by the employer are divided into two parts:

- Basic, paid by the employer, up to 7% of the gross salary of an employee
- Additional, paid by the employee, deducted from the employee's salary and transferred to the program by the employer

There is a small tax advantage for PPE contributions compared with those made to IKEs and IKZEs in that the basic contribution paid by the employer is not subject to social security insurance (ZUS).

Assets saved in the individual account are rolled up free of capital gains tax. In the pay-out phase, which begins upon attaining the age of 60, the benefits are also tax-free.

One of the special forms of mutual investment fund is the employee pension fund (PFE), which is an entity created especially for the collection and management of contributions from several PPEs. A PFE is managed by an employee management fund under the same legislation applying to OFEs and PTEs. Currently there are five PFEs in the market. The number of participants and assets under management are presented in the table in Figure 21 on page 22.

FIGURE 21: PFES

	NO. OF MEMBERS AT THE END OF PERIOD	ASSETS UNDER MANAGEMENT [€ M][3]
2007	60,058	238
2008	59,215	235
2009	58,349	302
2010	57,147	353

Source: KNF

Pension companies

The pension market in Poland is 12 years old with 14 pension companies present (reduced from 21 originally). The market already seems saturated and, as has been the case for several years, no new PTEs are expected to enter the market. Three major players in the market in terms of assets managed are Aviva, ING, and PZU, accounting for 62% of the market. The top five players cover 75%.

FIGURE 22: MARKET SHARE (MEMBERS) AS AT 31/12/2010

AEGON	5.6%
Allianz Polska	3.0%
Amplico	7.6%
Aviva BZ WBK	18.7%
AXA	6.6%
Generali	5.3%
ING	19.6%
Nordea	5.8%
Pekao	2.3%
PKO BP Bankowy	3.1%
Pocztylion	3.5%
POLSAT	2.1%
PZU *Złota Jesień*	14.7%
WARTA	2.1%

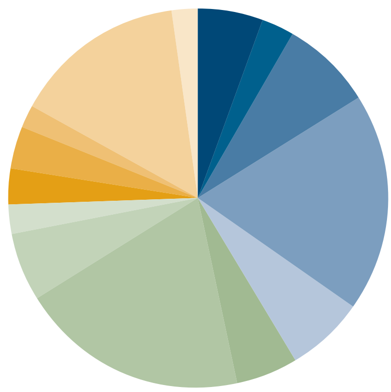
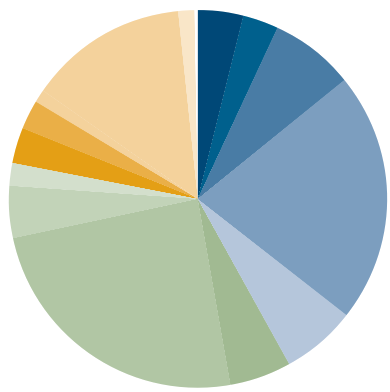


FIGURE 23: MARKET SHARE (CONTRIBUTIONS) AS AT 31/12/2010

AEGON	4.1%
Allianz Polska	2.9%
Amplico	7.3%
Aviva BZ WBK	21.4%
AXA	6.4%
Generali	5.2%
ING	24.4%
Nordea	4.6%
Pekao	1.8%
PKO BP Bankowy	3.0%
Pocztylion	2.4%
POLSAT	1.3%
PZU *Złota Jesień*	13.6%
WARTA	1.5%



[3] Exchange rate as of 30 September 2011: 1 EUR=4.4112 PLN. Source: National Bank of Poland.

FIGURE 24: MARKET SHARE (ASSETS) AS AT 31/12/2010

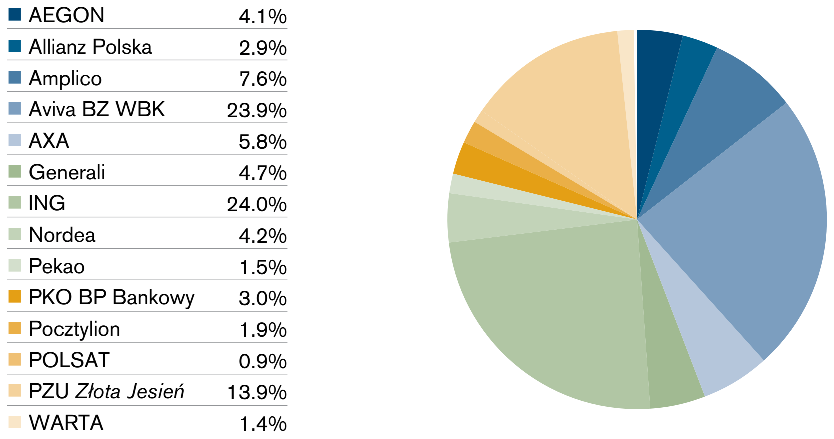
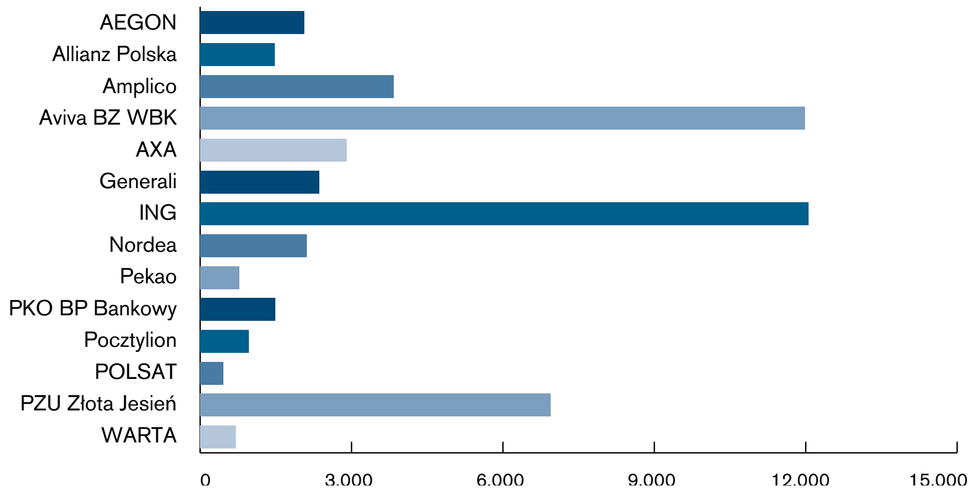
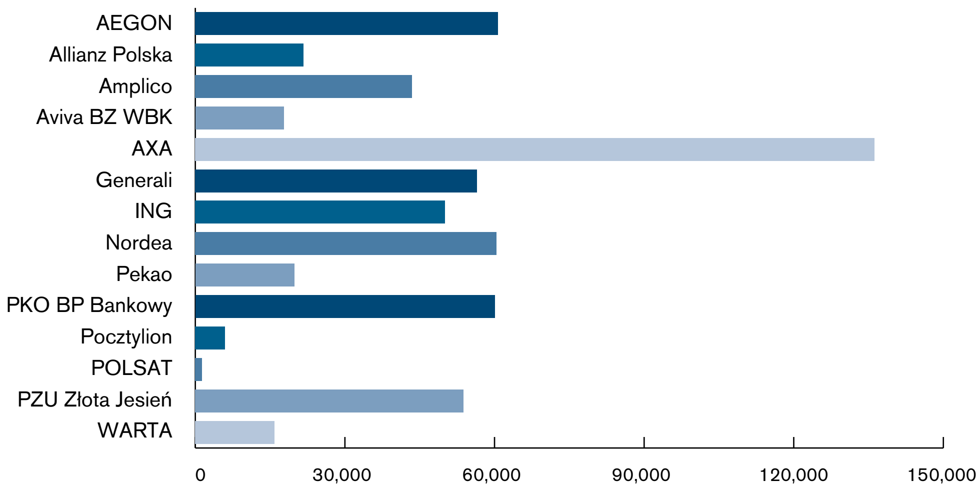


FIGURE 25: ASSETS UNDER MANAGEMENT (€M) AS AT 31/12/2010



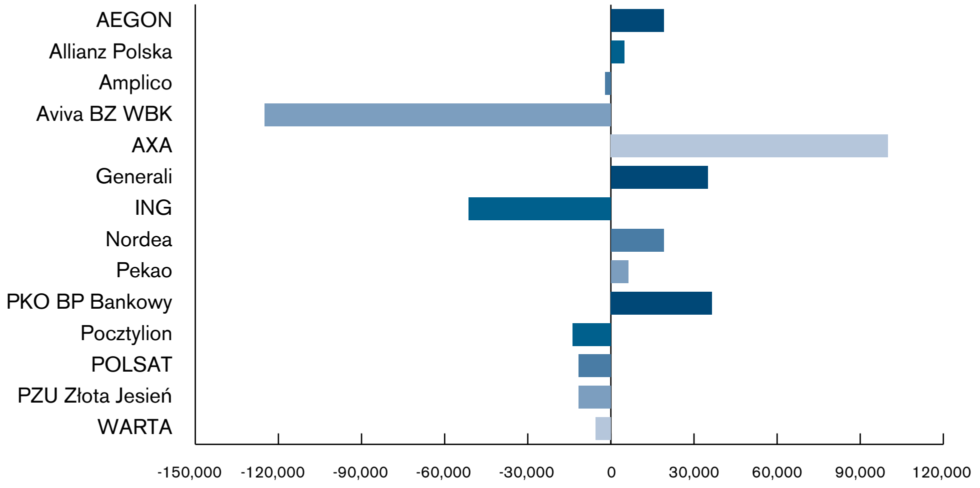
Prior to regulatory changes there were only two possible ways of acquiring new clients in the market: transfers between OFEs and career starters. The clear leader in active acquisition was AXA OFE. It seems that previous leaders ING and AVIVA resigned from the active acquisition after the legislation changes introduced with effect from 1 January 2010 implying a 15.5m PLN cap on the monthly management charges (in the case when fund NAV exceeds PLN 45 billion). Mid-sized funds such as AEGON, Generali, Nordea, PKO BP Bankowy, and PZU also had a significant share in acquiring new entrants to the system.

FIGURE 26: NEW ENTRANTS IN 2010



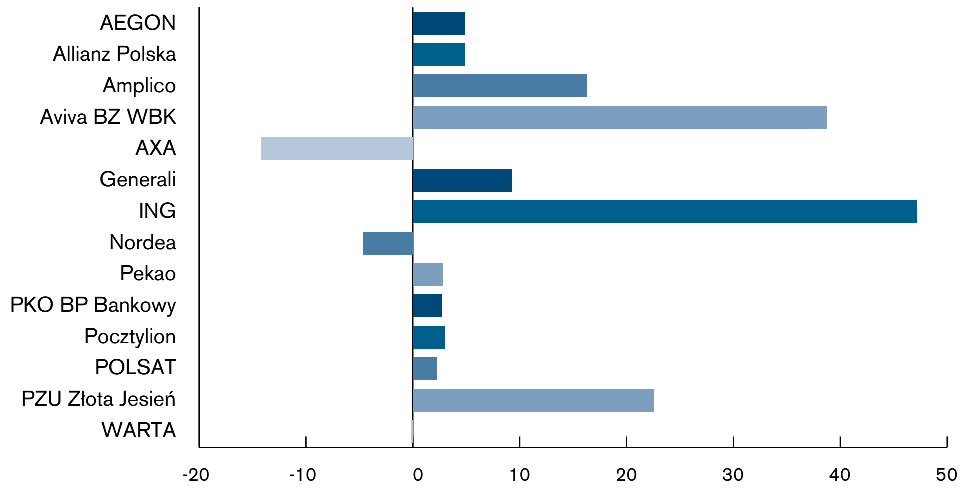
There is one clear leader in terms of transfers in 2010–AXA (in absolute values). The company has a large network of life insurance agents who are allowed to sell pension funds (and acquire pension fund transfers). AVIVA and ING have lost the most members through transfers. Both these companies have already reached the maximum management charge of PLN 15.5 million monthly (for companies with NAV exceeding PLN 45 billion), and as mentioned in the previous comment, it seems they have already resigned from active acquisition.

FIGURE 27: NET TRANSFERS IN 2010



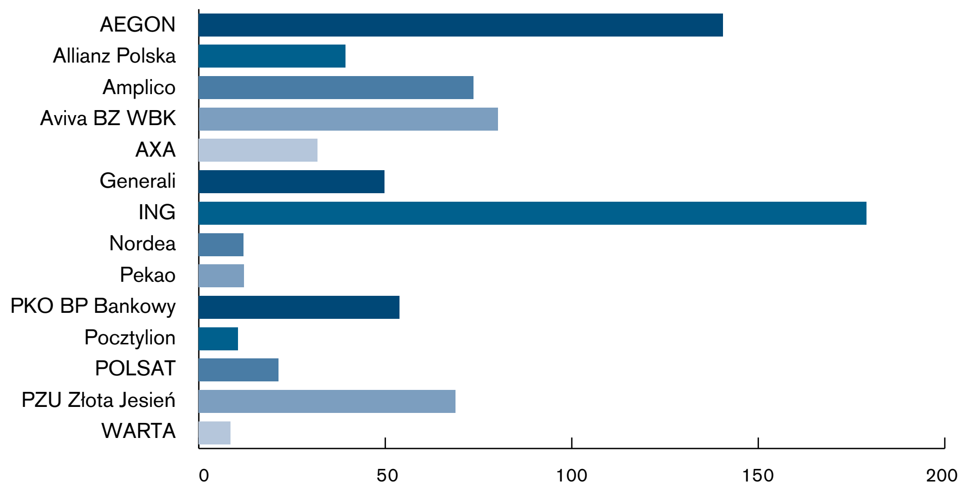
After 10 years of the system, in 2008, all but one pension fund management company broke even. The exception was AXA, which as a latecomer still incurred significant acquisition expenses. However, in 2010, there were three PTEs that incurred losses. The losses resulted from the combined effect of the legislative changes (reduction of the contribution fee) and increased acquisition expenses (companies tried to take advantage of the remaining period before the acquisition ban starting in 2012). After consolidation of the seven companies exiting the market, all PTEs have reached the threshold of 300,000 members, which was informally considered to be the break-even level for this business activity in Poland. However, because of the recent legislative changes (significant decrease of management charges and acquisition fees, decreased contribution rates), this threshold might need to increase significantly in order to maintain profitability, driving renewed consolidation.

FIGURE 28: PTE STATUTORY P&L IN 2010 (€M)



In most cases, the equity capital of PTEs is proportional to the size of the fund (with some economies of scale). The only exception to this general rule is AEGON, which has relatively high equity capital because of two previous M&A transactions.

FIGURE 29: PTE'S OWN CAPITAL AS AT 31/12/2010 (€)



Prior to the regulatory changes, acquisition costs varied significantly between companies, with the main players having an average of €150 per new member (including career starters and new entrants). The acquisition cost per new member for AVIVA was significantly higher in 2010 (€877 versus €343 in 2009). This may be explained by the analysis of the acquisition costs in comparison with transferred assets, which reveals that AVIVA has acquired portfolio of members with significantly higher account values than the general market.

FIGURE 30: ACQUISITION COST PER NEW MEMBER IN 2010 (€)

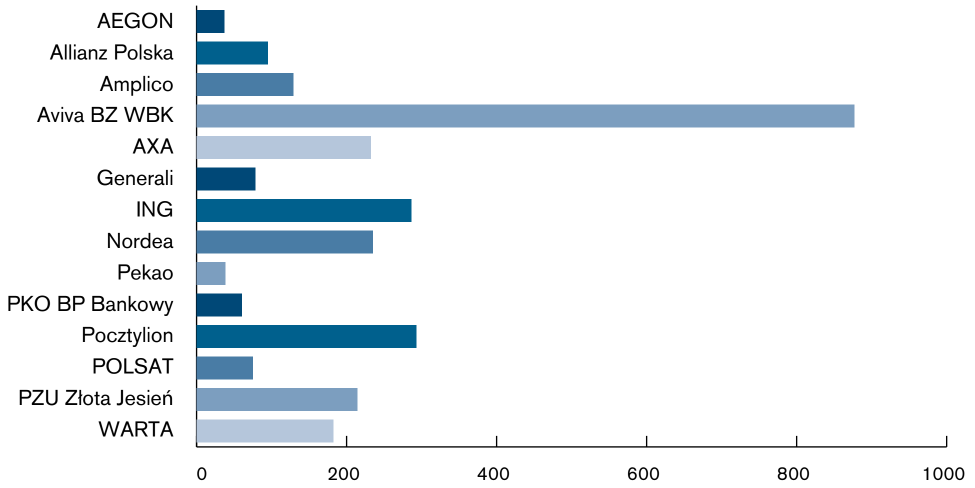
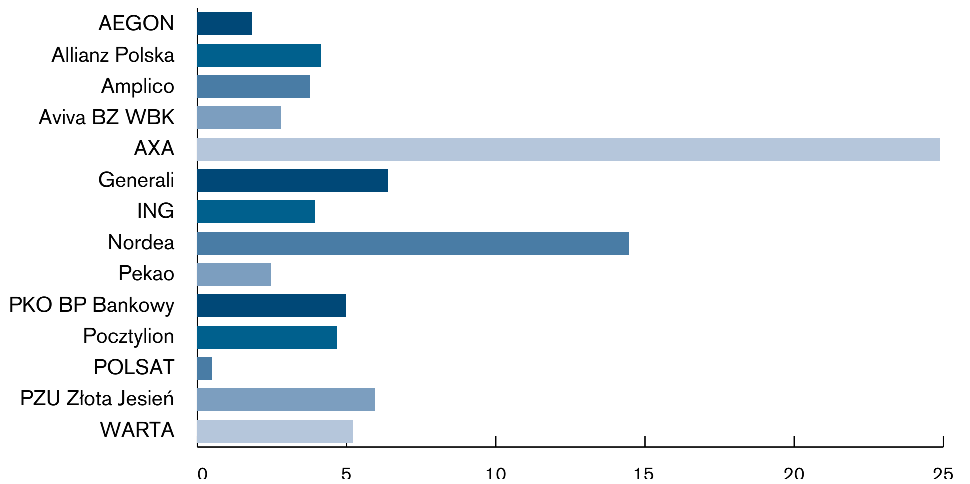
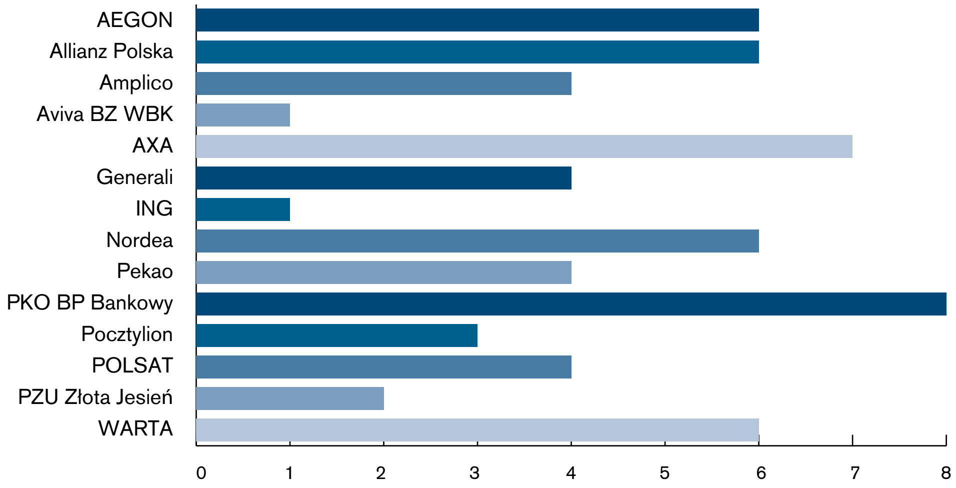


FIGURE 31: ACQUISITION COST PER €1,000 TRANSFERRED ASSETS IN 2010



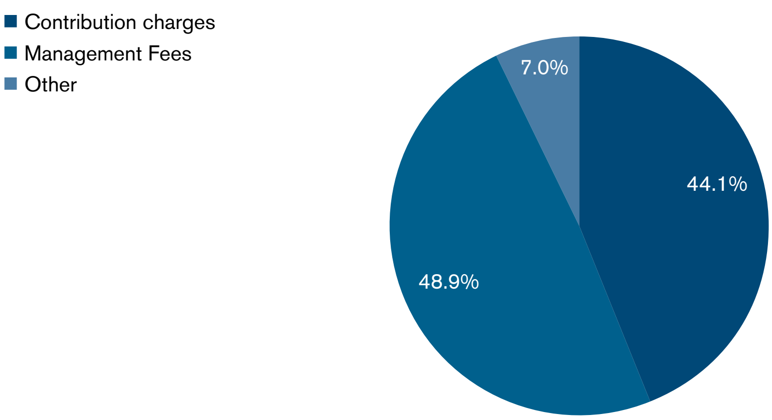
Current maintenance expenses per member show a considerable variation and range from €1 (ING) up to €8 (PKO BP Bankowy). In the majority of cases, the amount is linked to the number of fund members (and evidences economies of scale). However, because of the unclear accounting treatment of elements such as advertising costs, companies have some discretion in allocating expenses between maintenance and acquisition.

FIGURE 32: MAINTENANCE EXPENSES PER ACTIVE MEMBER IN 2010 (€)



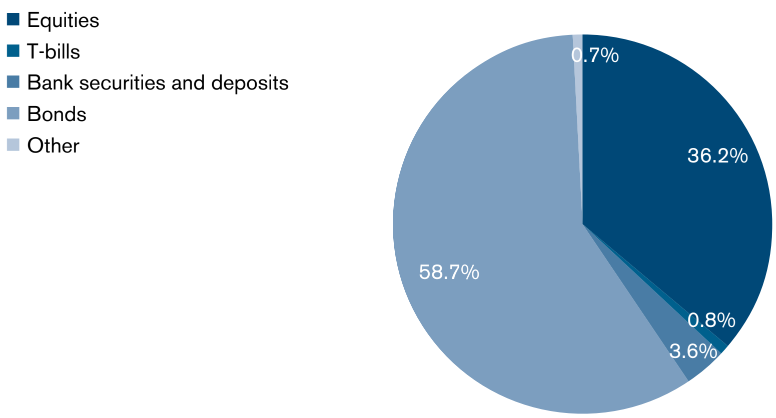
In 2010 almost 49% of the revenues of the PTEs was derived from management fees. In previous years the contribution charge used to be the main driver of the revenue of pension fund managers (65% in the year 2008). This has changed due to the natural increase of NAVs and the reduction in the charge rates applicable to contributions resulting from the change in legislation.

FIGURE 33: PTE REVENUE STRUCTURE IN 2010



The investment mix as of the end of 2010 is a result of the pension fund legislation. Funds are allowed to invest up to 42.5% of the NAV in the equities, with the percentage gradually increasing to 90% by 2034.

FIGURE 34: INVESTMENT PORTFOLIO STRUCTURE AS OF 31 DECEMBER 2010



ROMANIA

Overview of the system

Romania has a classic three-pillar pensions system, the mechanics of which are functioning well following the commencement of contributions in May 2007 (facultative) and May 2008 (mandatory).

Outcomes for the participants are limited by the relatively low levels of contributions going into the two private pillars.

The profitability of pension administrators in the mandatory system is marginal because of the low levels of fees that can be charged.

The system is subject to a range of guarantees and protection mechanisms, but capital requirements are somewhat incoherent.

There is little sales activity underway for mandatory pensions. Voluntary pensions are typically sold by tied agents and multi-level marketing (MLM) brokers as part of a life insurance offer, or by banks in the case of bank-owned administrators

Investment strategies are quite conservative because of guarantee requirements, although the proportion of assets held in shares has been rising gradually.

The Romanian private pensions system consists of two main components, mandatory pensions and voluntary pensions.

The private system functions alongside the pay-as-you-go universal state pension system as well as other forms of retirement saving such as life insurance.

Mandatory pensions

Participation

Participation in a mandatory pension fund is obligatory for all employees born after 31 December 1972. Employees born between 1 January 1963 and 31 December 1972 have the option to participate, while those born in 1962 or earlier are ineligible. As a result, membership is skewed towards the young and 59% of members are under the age of 35.

Participants choose which fund they want to belong to, and are free to transfer their money between funds.

Currently there are nine funds, four smaller funds having merged with larger rivals. Each administrator may manage only one fund.

Scheme metrics

FIGURE 35: MEMBERSHIP & ASSET STATISTICS

AS AT	MEMBERS (MILLIONS)	AUM (€M)	AVERAGE AUM PER MEMBER (EUR)	ANNUALIZED TRANSFER RATES
30/06/2011	5.3	1,269	238	0.0320%
31/12/2010	5.2	1,011	195	0.0266%
31/12/2009	4.9	564	115	0.0303%
31/12/2008	4.5	209	46	0.2388%

AS AT	AVERAGE MEMBERS PER PROVIDER	AVERAGE AUM PER PROVIDER (€ M)
30/06/2011	591,647	141
31/12/2010	576,263	112
31/12/2009	409,429	47
31/12/2008	323,704	15

The assets under management at 30 June 2011 represent approximately 1.07% of GDP[4] while at the end of 2010 the amount represented 0.84% of GDP.

Contributions

Contributions are mandatory and are collected through the income tax system alongside contributions to the state pension system.

The contribution rate is currently 3% of gross salary, but it will gradually rise to 6% by 2017.

The contributions are collected by the National Pensions and Social Insurance Authority, and then distributed to the privately administered funds.

In December 2010, 35.5% of fund participants failed to pay the scheduled contribution, for example due to a period of unemployment, due to absence from Romania, or due to their employer's failure to pay payroll taxes. By 31 December 2010, however, only 5.5% of participants had failed to make any contribution whatsoever.

Investment

Contributions received are converted into fund units, with the moneys being invested in a diversified portfolio of assets.

The unit price is dependent on the market value of the assets and the number of units on issue.

Benefits

The value of the units is paid out to the participant in the event of reaching the state retirement age or on becoming totally and permanently disabled.

In the event of the participant's death prior to retirement, the participant's account is paid out to the participant's legal heirs.

4 Source: GDP forecast for 2011 according to Eurostat.

In some cases, the benefit payment is required to be paid as an annuity, but enabling legislation is yet to be enacted.

Insured benefits may be available, if offered in the fund's prospectus by the administrator.

Approaches to actuarial risks and guarantees, reserving, and solvency

Guarantees

The mandatory pension system requires administrators to ensure that their returns are broadly in line with market averages. If, over a two-year period, the investment return is more than 4% below the average or less than 50% of the average, the administrator's licence will be withdrawn.

In the mandatory system, the account balance paid on retirement is subject to a minimum of contributions paid to date minus fees. In some interpretations of the law and regulations, the guarantee may be extended to transfer, death, and disablement benefits.

Prudential reserves

No solvency margin is required to be set up.

Administrators are required to establish actuarial reserves to provide for the *return of contributions* guarantee in the mandatory system. The reserve is essentially the amount required to be held now to fund at retirement any currently existing gap between account balances and guaranteed values.

No reserves are formally required for the market-relative guarantees, insured benefits, or any other risks faced by the funds and administrators.

A guarantee fund for the system as a whole is to be established as a separate legal entity. Administrators will be required to cover the funds expenses as well as making an actuarially determined contribution to enable the fund to build up the resources necessary to cover its obligations. The purpose of the guarantee fund is to protect participants when administrators are unable to fulfil their obligations.

Other safety mechanisms

The system has a dedicated regulator and supervisor, the Commission for the Supervision of the Private Pensions System (CSSPP).

A depository bank must be appointed to have custody over the fund's assets and to check the administrator's unit price calculations.

Every fund is subject to an annual audit requirement.

Every administrator must retain an actuary, who must complete a simple financial condition report annually.

Four million euros of initial paid-up capital is required for mandatory pension administrators, although there is no requirement that a particular level of own funds be maintained in the long term.

Role of insurers and other financial services companies

Pension administration companies are typically owned by large multinational financial services groups.

In most cases, the operations of the administration company complement and are tightly woven in with the other financial services operations of the group in question, in order to minimise costs and maximise revenue synergies.

Mandatory pension funds may only be managed by dedicated administration companies, which are not allowed to undertake any other form of business activity (the only exception being the management of facultative [voluntary] pension funds).

Drivers of profitability

The key driver of profitability is the asset management fee charged by the administrators, as over the long term this is by far the most significant item of revenue. The fee on contributions has a useful role in covering initial costs but it is not a major contributor to profitability.

Another key driver is the contribution rate, as this determines the volume of assets under management and hence the amount of asset management fees collected.

The contribution rate was supposed to rise to 2.5% in 2009 but was held down at 2.0% by the government in a move to restrict its budget deficit. It eventually rose to 2.5% in 2010 and 3.0% in 2011.

Expenses also play a critical role. Low charge levels render profitability very sensitive to small changes in expenses incurred.

Information from 2010 indicates maintenance expenses range from around €1.6 per participant for large administrators whose operations are tightly integrated within a financial services group to €7 per participant for small companies operating more independently. These costs have reduced significantly from 2008 levels.

Investment guarantees represent a significant hidden cost. These are not properly charged or reserved for at the current time, and hence are not well understood.

Pricing and restrictions on charges

Administrator fees levied on mandatory pension contributions are restricted to 2.5% of contributions paid.

Asset management fees are limited to 0.05% of assets per month.

Fees of up to 5% of account value are chargeable on transfer out of a fund during the first two years of membership.

Most administrators have established pricing at the maximum allowable level. This is because of the need to recover initial costs over the long term.

The only discounts offered on the maximum fee levels in the mandatory system have come in the form of a one- or two-year holiday from the asset management fee.

Administration systems

Romanian private pension funds are akin to mutual funds in their operations. Hence, client account management systems designed for the mutual fund industry may be reused.

A further option is to utilise administration systems designed for life insurance unit-linked products, although these need to be adapted to reflect the restricted benefit design and *off-balance-sheet* nature of the client's accounts.

Some administrators have chosen to reuse systems already in use by a sister company (i.e., life insurer or mutual fund operation).

Others have installed new systems designed for the purpose, typically by Romanian software houses.

For cost-minimisation purposes, administrative processes are tied as closely as possible to those of the sister company, while preserving any necessary legal separation of functions.

Distribution strategy and agent/broker remuneration

The initial adhesion campaign lasted four months, running from 17 September 2007 to 17 January 2008.

During the course of the campaign, 4.4 million prospective participants were signed up.

During the initial adhesion campaign, the following distribution methods were used:

- Tied agency forces
- Multi-level agency forces operated by brokers
- Bank branches
- Union organisations

The sales results produced by union organisations were extremely poor, while the passive approach of sales through bank branches delivered only moderate volumes of business (albeit at a low acquisition cost–less than €25 per case).

The most successful channels were those which use active sales approaches–tied agents and MLM brokers. Total commission costs per case for the former were in the range €24-€34, while for MLM brokers commission costs per case ranged from €50-€90 per case.[5]

Agent commissions were typically structured as a fixed amount of RON or euros per case, as it was impossible to tell how large a participant's contributions would be. Overrides were paid to the sales management structures in proportion to the underlying sales.

Deals between administrators and brokers would be struck on the basis of fixed amounts per case plus bonuses for achieving predetermined levels of sales.

Commission levels changed frequently throughout the course of the adhesion campaign as companies adapted their strategies in response to 1) their performance relative to budget, 2) the activities of competitors, 3) agent responsiveness, and 4) shareholder imperatives.

Because of the way in which cases were validated, commissions were paid on all adhesions submitted, but many were never validated and many others have become erratic payers of contributions.

From inception of the system through to 31/12/2010, 874,198 new participants were added through random allocation to funds. These were people who joined the workforce during that period, but who failed to make an application to join a fund. Another 155,850 new participants were added through active sales by administrators over the same period. The total inflow of new participants has therefore averaged 33,230 per month, a higher level than initially expected.

A high proportion of the *sold* participants have been won by bank-related administrators. Bank distribution has an advantage in capturing new entrants to the workforce, as these are typically graduating students who are finishing their studies, setting up bank accounts, and taking consumer and housing loans.

Investment strategies

The CSSPP classifies investment strategies according to levels of investment risk, and sets strict guidelines on allowable holdings by asset class for each classification.

5 Source: http://www.pensiileprivate.ro.

Low risk funds are essentially bond funds while *medium-risk* funds have a small degree of exposure to *risky assets* such as equities. *High-risk* funds can have up to 50% of their holdings in risky assets.

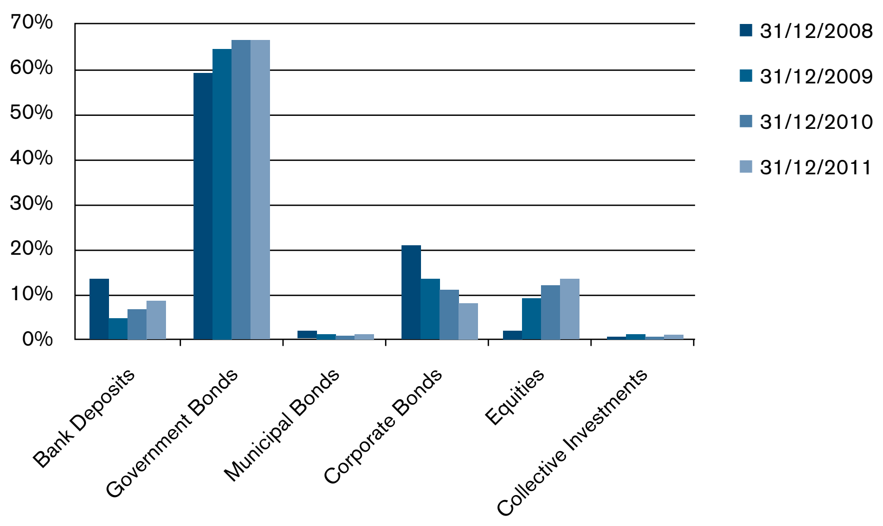
In the mandatory pension market, because of the *one-fund-per-administrator* restriction, most administrators have decided to follow a *medium-risk* strategy in the hope that this will provide both comfort and a moderately enhanced long-term return to their clients. Only one administrator has opted for a *high–risk* strategy.

Average holdings across the mandatory pensions market as of 31 December 2010 were: 7.2% bank deposits, 66.4% government bonds, 1.3% municipal bonds, 11.0% corporate bonds, 1.7% bonds issued by multinational organisations such as the World Bank, 12.2% equities, and 0.5% in collective investments.[6]

Holdings of equities were initially kept artificially low under a dispensation from the CSSPP in relation to recent economic volatility. In recent months and years, the percentage held in equities has been growing, however, at the expense of holdings in corporate bonds.

Changes in asset mix over the last three years are shown in the graph below:

FIGURE 36: FUND ASSET MIXES



Taxation of contributions and benefits

In the mandatory pension system, all contributions are deductible and are also not subject to social security levies.

Pension benefits are currently tax-free up to an amount of 1,000 lei per month, but this provision of the tax code was written with state pensions in mind and could be adapted for private pensions once they commence the pay-out phase.

Investment returns are not taxed.

6 The remaining -0.3% is an adjustment for amounts in the course of settlement.

Pensions in payment
A law governing the decumulation phase has been drafted. This envisages the licensing of specialised pension providers which will offer various forms of guaranteed life annuity in return for an asset-based fee of 2.5% per annum.

The law attempts to blend individual accounts with guaranteed pension payments and includes complex prudential mechanisms. Participants will transfer their accumulated lump sums from their in-service administrator to a pension provision fund of their choice, on the basis of an annuity quotation. The pension provider that administers the fund is required to maintain a financing ratio (fund assets divided by fund technical provisions) of at least 105%. Should the financing ratio fall below this level, the pension provider is required to top up the fund from its own resources. In the event that the financing ratio rises above 110%, the excess is required to be distributed to participants in the form of pension increases (although provider top-ups paid in previously can be recovered first.)

Voluntary pensions

Participation
Participation in a voluntary pension fund is possible for all employees who have at least 90 months remaining before they turn 55.

Participants choose which fund they want to belong to, and are free to transfer their money between funds.

As of 30/6/2011 there were 13 funds offered by 10 administration companies. Many of the administrators also offer mandatory pensions, and some are affiliated to life insurance companies as well.

Contributions
Contributions are voluntary and are collected directly from employers.

There is no fixed contribution rate; some participants set their contributions as a percentage of salary, while others use a fixed amount per annum (typically, this is the level of maximum deductibility). By law, a maximum of 15% of salary may be contributed to such a fund.

Investment
Investments regulations are similar to those for the mandatory system.

Benefits
The value of the units is paid out to the participant upon reaching age 55 or in the event of becoming totally and permanently disabled.

The voluntary pensions law provides administrators with more latitude in the development of additional benefits (as opposed to the mandatory pensions law, which enforces a rigid product design).

In other respects, benefit structures and payments are similar to the mandatory system.

Approaches to actuarial risks and guarantees, reserving, and solvency

Guarantees
The voluntary pension system requires administrators to ensure that their returns are broadly in line with market averages. If, over a two-year period, the investment return is more than 4% below the average or less than 50% of the average, the administrator's licence will be withdrawn.

Prudential reserves
Prudential reserves are largely the same as for the mandatory system.

Other safety mechanisms
A total €1.5m of initial paid-up capital is required for voluntary pension administrators, although there is no requirement that a particular level of capital (shareholders' funds) be maintained in the long term.

In other respects, safety mechanisms are similar to the mandatory system.

Role of insurers and other financial services companies

General
As with the mandatory sector, pension administration companies are typically owned by large multinational financial services groups.

In a most cases, the operations of the administration company complement and are tightly woven in with the other financial services operations of the group in question, to minimise costs and maximise revenue synergies.

Voluntary pension funds may be administered either by a dedicated company or by another financial services entity (i.e., a life insurer, asset manager, or bank).

In the latter case, the financial services entity is required to separately hold and account for assets, liabilities, capital, incomes, and expenses relating to its voluntary pensions.

Drivers of profitability
Drivers of profitability are the same as for the mandatory system.

Pricing and restrictions on charges
Administrator fees are restricted to a maximum 5% of contributions paid. Contribution charges for the funds currently on offer range from 2.95% to 5%.

Asset management fees are limited to 0.2% of assets per month. Fees for the funds currently on offer range from 0.091% to 0.195% per month.

Fees of up to 5% of account value are chargeable on transfer out of a fund during the first two years of membership.

The higher caps and greater flexibility in the voluntary system have resulted in a wider range of product designs and charging structures.

Some voluntary pension products include insured benefits, while others offer fee structures targeted at particular groups of participants (e.g., corporate clients).

Administration systems
Administration systems are the same as for the mandatory system.

Distribution strategy and agent/broker remuneration
Distribution arrangements for voluntary pensions are very different from those for mandatory pensions. This is because there is a wider range of potential contributors, because they are continuously on sale, and because they are funded out of participants' own resources.

One way of looking at voluntary pensions is as part of an employer-funded employee benefits package that may also contain life and health insurance components. This point of view leads naturally to the sale of the product by specialist corporate sales teams and by brokers who target the corporate market.

Voluntary pensions can also be sold as individual retirement plans by tied agency forces, who market them alongside life insurance products. They are also being sold by MLM networks, although success here has been constrained by the low levels of commissions available relative to life insurance products of a similar nature.

As the size of the annual contribution is known at outset, it is more usual for the commission to be set as a percentage of premium rather than be fixed in euros or lei.

Investment strategies

The CSSPP classifies investment strategies according to levels of investment risk, and sets strict guidelines on allowable holdings by asset class for each classification.

In the voluntary pension market there is more diversity with respect to investment strategies. This is because administrators are able to offer multiple funds, and because the CSSPP's investment limits are not as strict in this market.

Average holdings across the voluntary pensions market as of 30 June 2011[7] were:

FIGURE 37: VOLUNTARY PENSIONS ASSET MIX

	BANK DEPOSITS	GOVT BONDS	MUN BONDS	CORP BONDS	NGO BONDS	EQUITIES	MUTUAL FUNDS	DERIV.	TOTAL
LEI	25.7M	252.9M	5.9M	27.0M	14.2M	58.2M	4.8M	.4M	388.9M
%	6.6%	65.0%	1.5%	6.9%	3.6%	15.0%	1.2%	0.1%	100.0%

Taxation of contributions and benefits

For voluntary pensions, tax deductibility[8] is available to both employers and participants for contributions of up to €400 per annum each.

The taxation of pension benefits is as per mandatory pensions.

Investment returns are not taxed.

Pension companies

NB: Unless otherwise stipulated, the sources for all data used in this section are 1) the website of the Commission for the Supervision of the Private Pension System and 2) annual reports posted on administrator websites.

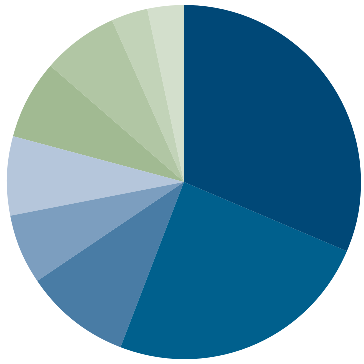
7 Source: CSSPP half-yearly report to 30 June 2011.
8 Including exemption from the social security levy calculation base.

Mandatory pensions

Market shares

FIGURE 38: SHARE OF PARTICIPANTS SEPT. 2011

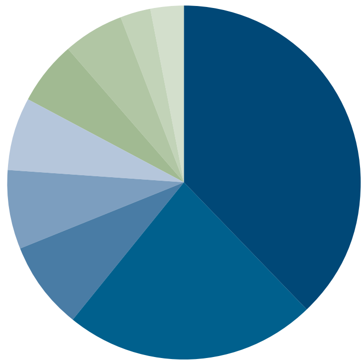
ING	31.4%
ALLIANZ-TIRIAC	24.6%
GENERALI	9.5%
ALICO	6.5%
AVIVA	7.3%
EUREKO	7.2%
BCR	6.8%
AEGON	3.6%
BRD	1.4%



The mandatory pensions market is dominated by two companies–ING, the local subsidiary of the international group, and Allianz-Tiriac, which is a joint venture between Allianz and Romanian businessman Ion Tiriac. A second echelon of market players is formed by local representatives of other international insurance groups, namely Generali, Aviva, AIG, and Eureko. Bancassurers BCR, Aegon, and BRD make up the remainder of the market.

FIGURE 39: SHARE OF CONTRIBUTIONS SEPT. 2011

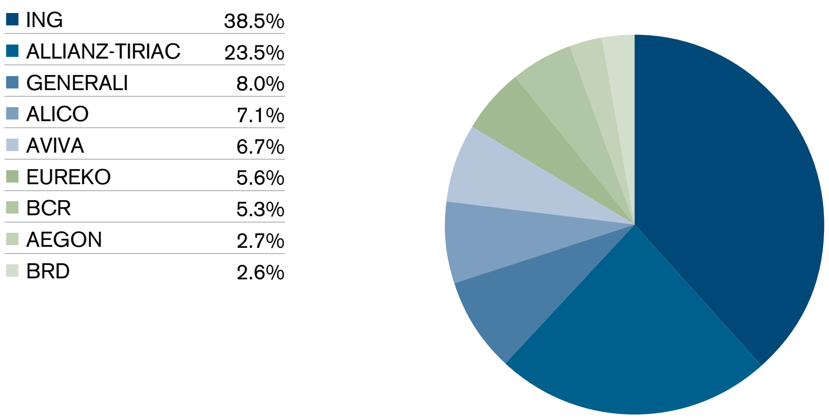
ING	37.9%
ALLIANZ-TIRIAC	23.1%
GENERALI	8.1%
ALICO	7.1%
AVIVA	6.8%
EUREKO	5.7%
BCR	5.6%
AEGON	3.0%
BRD	2.8%



ING's success in the initial sales campaign in 2007/2008 can be attributed to the size and preparation of its tied agency force, its large life insurance book, and its high level of brand recognition. Allianz-Tiriac also had high brand recognition, being the nation's largest non-life insurer. Its sales effort, however, relied on more costly broker sales, mainly through MLM arrangements.

Market share movements since inception have favoured the smaller players at the expense of the larger ones. This is due to two factors–1) the equal allocation of new members through the *lottery* and 2) mergers of funds.

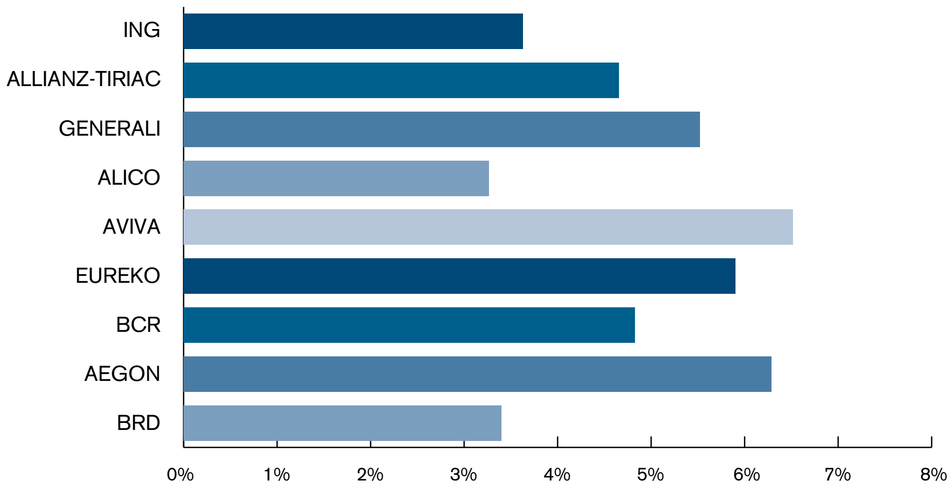
FIGURE 40: SHARE OF ASSETS, SEPT. 2011



It is interesting to note that market shares determined on the basis of annual contribution levels are quite different from those determined on the basis of member numbers. As contributions are a fixed percentage of salaries, it would appear that some companies (e.g., ING, AIG) have been able to attract participants with higher and more stable incomes. This may be due to their use of well-trained tied agents as their interface with clients.

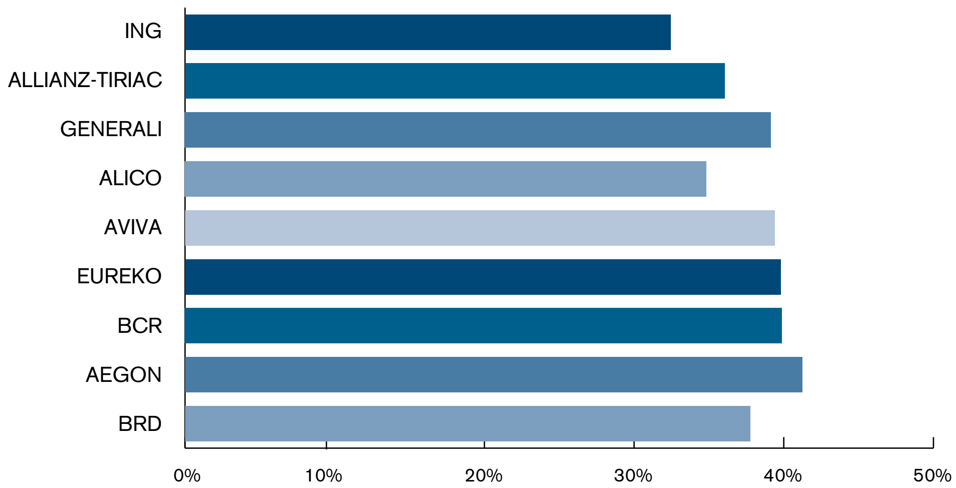
Fund metrics

FIGURE 41: EMPTY ACCOUNTS, SEPT. 2011



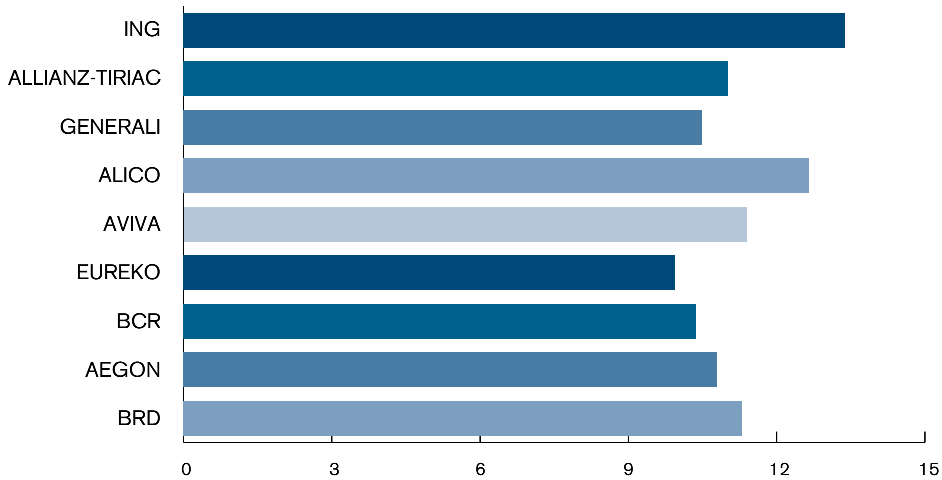
A peculiar feature of a mandatory pension system is *contribution dormancy* and *empty accounts*. Dormancy arises due to periods of unemployment, while empty accounts relate to people never employed, or, in the worst case, ineligible to participate in the pension system. The number of empty accounts in the Romanian system has reduced significantly since inception, as those out of work at that time have commenced employment and begun making contributions.

FIGURE 42: NON-CONTRIBUTORS, SEPT. 2011



A related measure is the percentage of enrolled participants who are not currently paying contributions. There may be many reasons for this, e.g., unemployment, emigration, self-employment. The non-paying percentage may give an indication of the quality of the sales process pursued by a provider's distributors, with some companies able to attract higher proportions of *paying* clients than others.

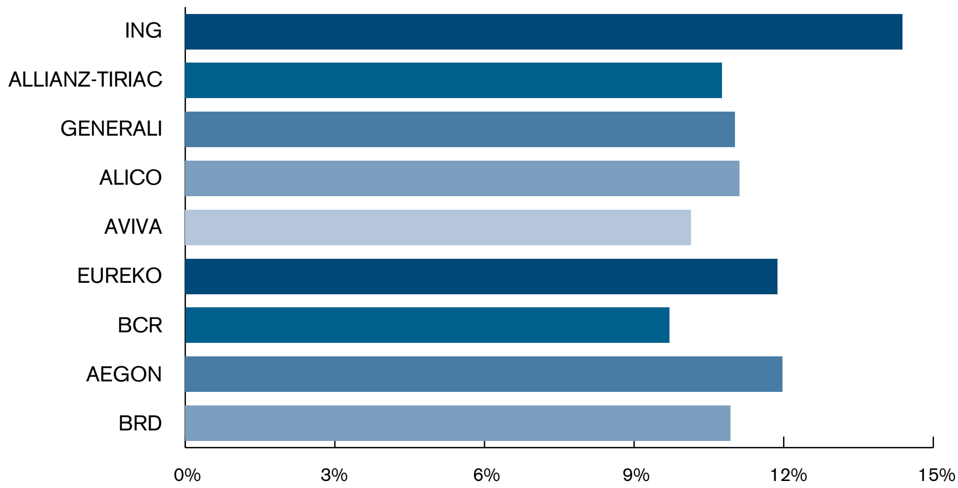
FIGURE 43: MEAN CONTRIBUTION SEP 2011 (€)



ING and Alico enjoy the highest average monthly contributions. Average contribution levels have approximately doubled since the inception of the system. This is mainly due to increases in the contribution rate; however, inflation, selection effects, and exchange rate movements have also played a role.

Investments

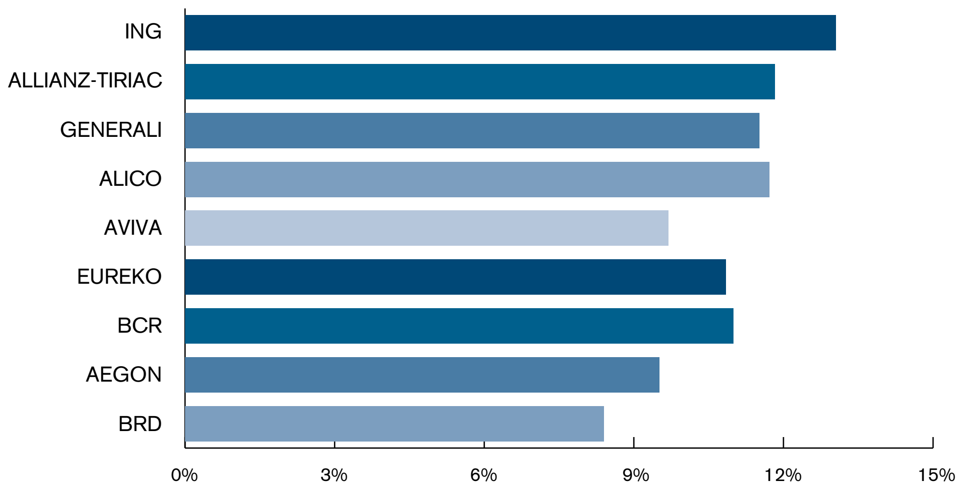
FIGURE 44: RISKY ASSETS, SEPT. 2011



In their prospectuses, most funds have established a *medium-risk* investment policy, with proportions in *risky assets* (defined as shares and mutual funds) supposed to be kept between 15% and 35%. One fund, Generali's Aripi, has a *high-risk* profile, allowing it to invest up to 50% in risky assets.

In practice, however, the funds have only slowly built up the proportion of risky assets, and still have some way to go before reaching their policy targets and ranges.

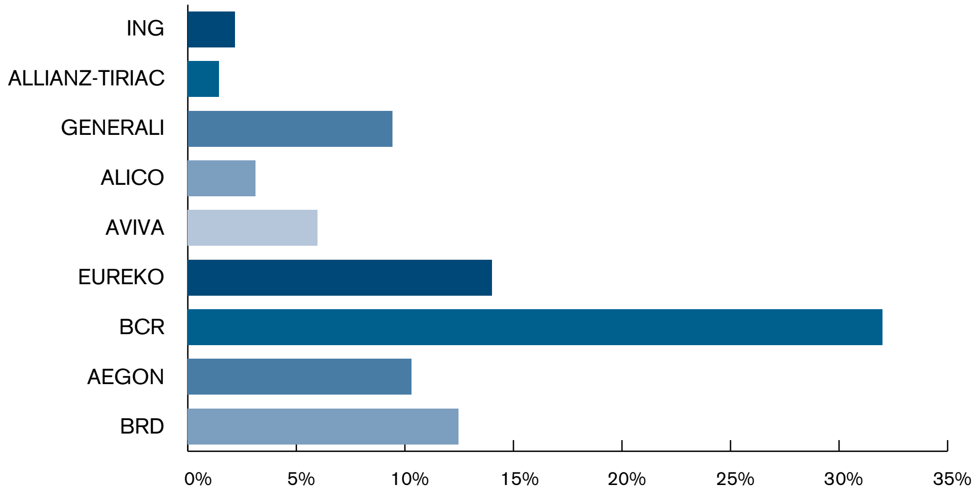
FIGURE 45: MEAN ANNUAL RETURNS



Time-weighted returns shown in the graph in Figure 45 have been determined using the ratio of the 30 September 2011 unit price to the initial unit price (10), and determining the geometric mean annual return. All funds' returns are well above the minimum legal return based on market averages. Interestingly, larger funds have tended to enjoy better returns.

Solvency

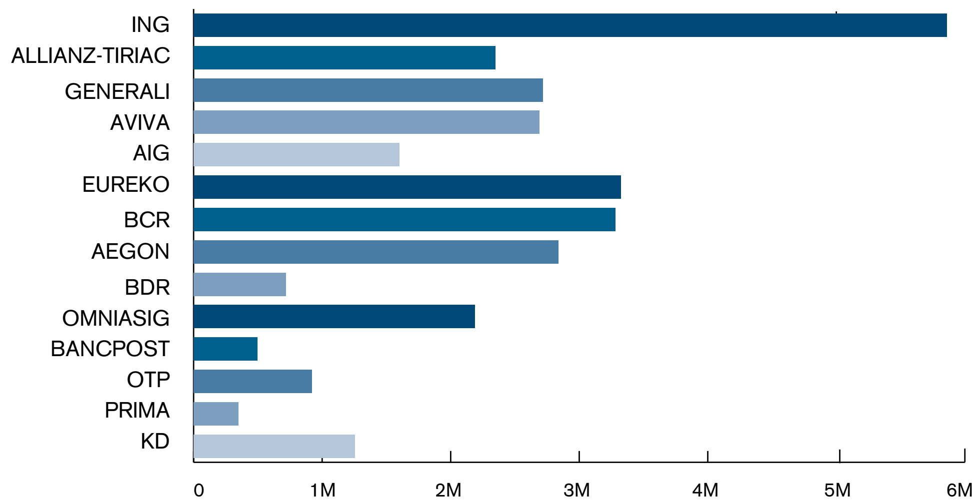
FIGURE 46: ADMIN. CAPITAL/FUND ASSETS



While the mandatory pension system contains a number of prudential devices (minimum initial capital, actuarial reserves, and a guarantee fund), there is no explicit solvency margin requirement. As a result, administrators have been relatively free to establish their own policies with respect to the level of capital they hold. The graph in Figure 46 depicts a crude measure of solvency–the ratio of administrator capital to funds under management. Note that a life insurance unit-linked product with an investment guarantee would generate a capital requirement of 4% of reserves under Solvency I.

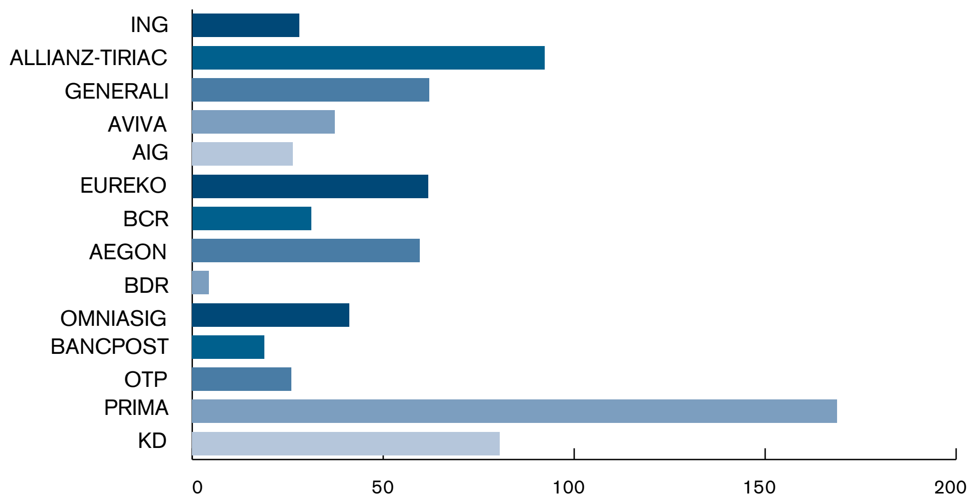
Expenses

FIGURE 47: INITIAL ADVERTISING EXPENSES (€)



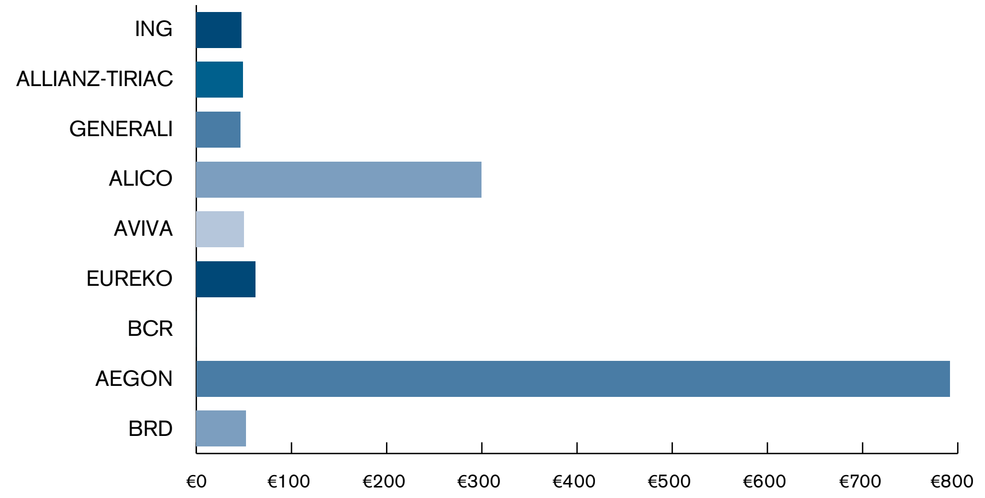
The initial adhesion period, running from 17 September 2007 to 17 January 2008 was accompanied by massive advertising expense in support of the sales process. In the graph in Figure 41 we have shown the total advertising expense incurred by administrators in financial years 2007 and 2008.

FIGURE 48: AVERAGE SALES COMMISSION 2007/2008 (€)



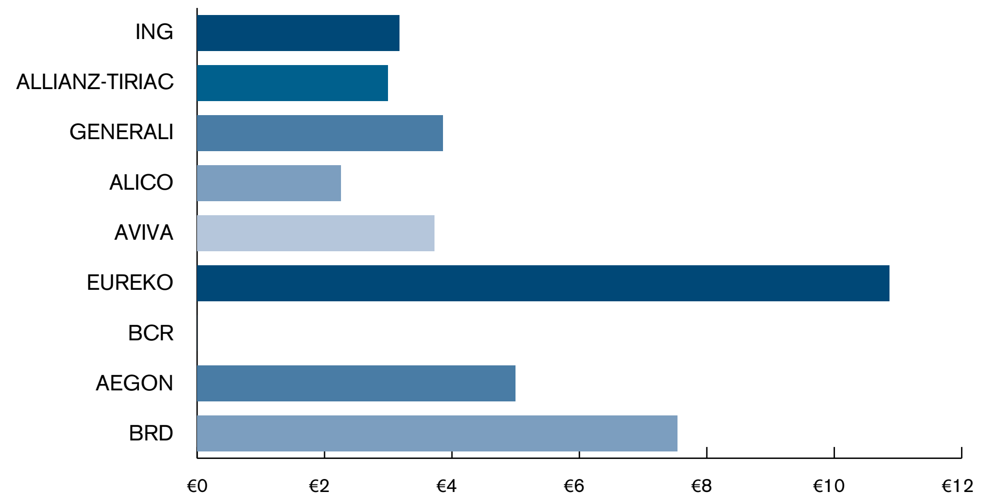
During the initial sales campaign, commission expense per member varied both as a function of distribution channel and as a function of brand recognition. Companies such as BRD, which distributed primarily through the branches of its parent bank, had very low commission costs. Companies with strong life-insurance tied agency forces (ING, AIG, Aviva) were also able to keep their commission costs moderate. Companies that relied on third-party distribution (mainly brokers using multi-level systems), such as Allianz and Generali, had to bear higher commission costs.

FIGURE 49: AVERAGE SALES COMMISSION 2010



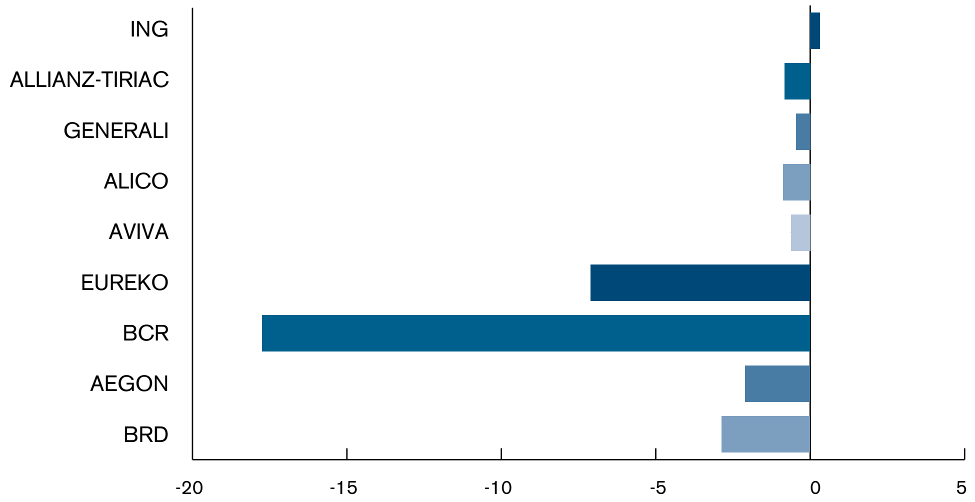
Sales commissions paid by most administrators have now stabilized at around the €50 mark (including any overrides). The figures shown in the graph were derived by dividing the commission expense for each company by the numbers of new clients who were not gained by portfolio transfer or lottery. The major sellers of new business in 2010 were Allianz-Tiriac and BCR Pensii, with about 21,400 and 13,600 cases, respectively. ING, Generali, and BRD also had significant sales activity.

FIGURE 50: MAINTENANCE EXPENSE PER MEMBER 2010



Maintenance expenses per member in 2010 settled at around €3 per member for the top five companies. The other administrators had weaker results due to lack of scale and, in two cases, significant asset write-off expense.

FIGURE 51: PROFIT PER MEMBER 2010 (€)

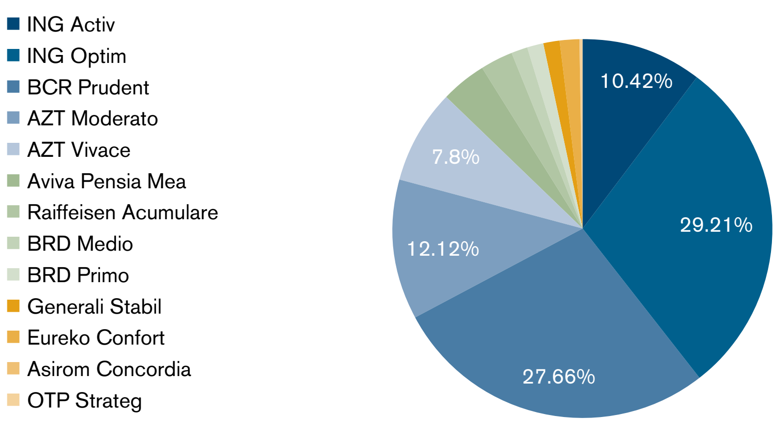


ING became the first pension administrator in the Romanian market to turn a profit, due to economies of scale and its ability to share costs with ING Life. Readers should note, however, that, even though administrators have improving profitability, it will be many years before the initial costs of 2007 and 2008 will be recovered and an adequate return provided to shareholders.

Voluntary pensions

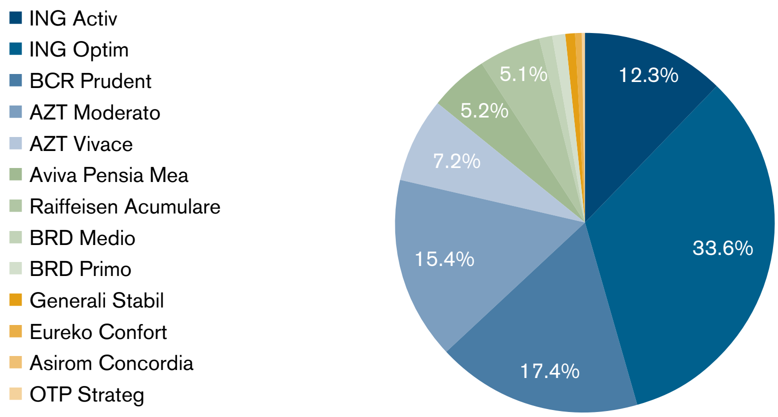
Market shares

FIGURE 52: SHARE OF PARTICIPANTS SEP 2011



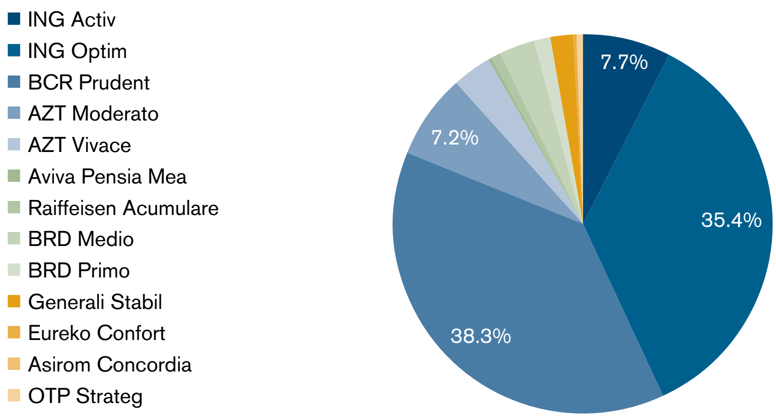
The voluntary pensions system is dominated by three players–ING, Allianz-Tiriac, and BCR Life, a subsidiary of Vienna Insurance–who control just under 90% of the market. The success of the three companies is largely built on cross-selling to captive bank, pension, life, and non-life customer bases that exist within their respective groups.

FIGURE 53: SHARE OF ASSETS SEP 2011



Market share by contributions and market share by assets are a little different than that by member numbers, and reveals varying asset accumulations per member. This may be due to either variations in market segments, dormancy levels or fund commencement dates.

FIGURE 54: SHARE OF NEW PARTICIPANTS SEP 2011



As the voluntary system is a year older than the mandatory system, and is open to new members of all ages, it is informative to also look at new business market share. New sales are dominated by ING and BCR, who, respectively, have Romania's largest agency and bancassurance distribution channels.

Fund metrics

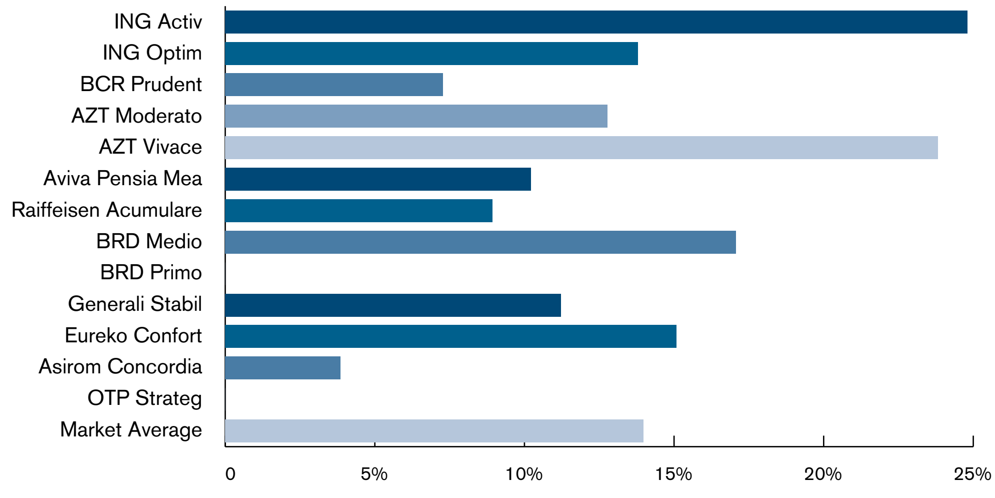
FIGURE 55: AUM PER PARTICIPANT SEP 2011

The voluntary pension system held net assets of €93.2m as of September 2011, shared among 249,649 members, resulting in an average account balance per member of €373. Among the various funds, however, there are significant variations due to distribution channels used and the resulting business mix, dormancy rates, fund commencement date, etc.

The average monthly contribution is just over €10 per member. This is higher than in the mandatory system, but lower than typical premiums for unit-linked life insurance and lower than the maximum deductibility ceiling (€250 per year).

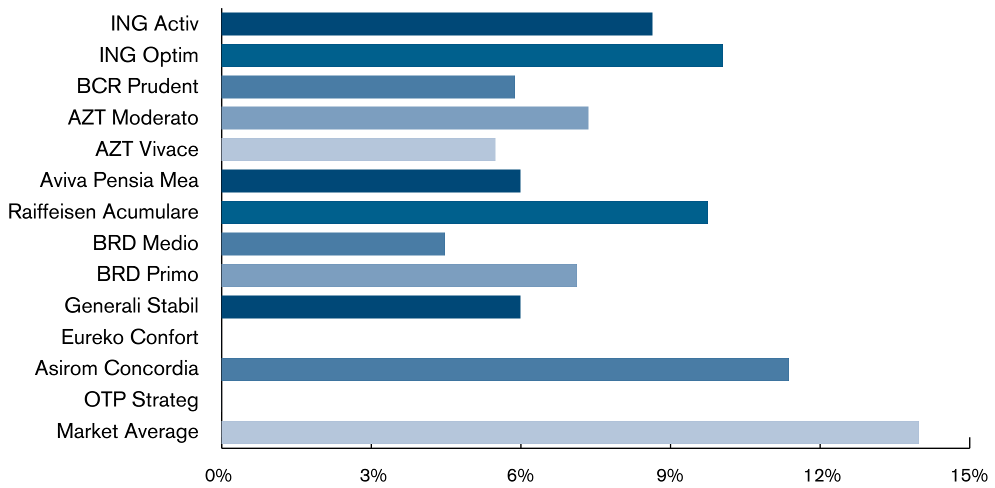
Investments

FIGURE 56: RISKY ASSETS PPN. SEP 2011



Risky assets (shares and mutual fund units) constitute a slightly higher proportion of assets under management than in the mandatory system, averaging 14%. There is quite a wide range of asset mixes available in the market, as voluntary funds have a high degree of freedom with respect to this and other aspects of product design.

FIGURE 57: AVERAGE ANNUAL INV. RETURNS



Time-weighted returns since inception have varied both as a result of each fund's investment policy settings, fee structures, and administrator investment management performance. Funds with higher proportions in shares have tended to underperform due to the economic malaise that has prevailed since the voluntary pension system was established. That being said, the returns which funds have provided to their clients are respectable. Note that no return was determined for Eureko Confort and for OTP Strateg due to uncertainty over the starting unit price for these two funds (all others started at 10; however, that does not appear to be the case for these two funds).

RUSSIA

Overview of the system

General

The Russian pension system operates according to a classic three-pillar system, with a voluntary Pillar 3 environment that started functioning in 1997 and a mandatory Pillar 2 system that commenced in 2002. However, active development of the mandatory pension system started only in 2004 when non-state pension funds were allowed to participate in the accumulation phase. Before that date all accumulation was done within the Pension Fund of Russia.

The mandatory pension system (Pillar 2), or *labour pension*, consists of three elements: basic, insured, and accumulation pensions. Private (i.e., non-state) pension funds (NPFs) participate in the accumulation pension component, where the pension is based on the contributions accumulated in the individual's personal account. Basic and insured components are handled by the Pension Fund of Russia.

The voluntary pensions market is dominated by large industrial groups operating pension funds for their own employees.

The private system functions alongside the pay-as-you-go universal state pension system and mandatory so-called labour pension, as well as other forms of retirement saving such as life insurance. Non-state pension companies operate in the voluntary Pillar 3 environment and the accumulation component of the mandatory system (Pillar 2).

Non-state pension funds can manage their investments in house or outsource to an asset management company.

Role of insurers and other financial services companies

Private pension funds currently dominate the long-term savings market, which is due to the favourable tax treatment compared to alternative saving vehicles and the compulsory nature of Pillar 2. Large corporations have established Pillar 2 funds, in addition to their existing Pillar 3 funds, in order to exploit the opportunities of compulsory contributions.

Other savings products offered by banks generally have a limited duration—deposits no longer than three years—which does not allow them to directly compete with pension funds.

Life insurance is a closer competitor in this sense, as its products can be structured in a way similar to pension savings. However, the majority of life insurance providers have chosen to launch their own pension funds in order to offer pure pension savings products in addition to life insurance. Insurers offer alternative saving mechanisms, which, however, are less tax-favourable and therefore not seen as directly competing with private pensions.

Details of the leading Pillar 2 and 3 providers at the end of 2010 are included in the tables in Figure 58.

FIGURE 58: PILLAR II AND PILLAR III LEADING PROVIDERS

PILLAR II	NET ASSET VALUE (€ M)	MARKET SHARE	CLIENTS	MARKET SHARE
BLAGOSOSTOYANIE	665.48	17%	1,042,696	13%
LUKOIL GARANT	599.40	16%	1,214,476	16%
NORILSKIY NIKEL	243.87	6%	472,609	6%
ELECTROENERGETICY	235.49	6%	434,018	6%
GAZFOND	207.58	5%	232,893	3%

PILLAR III	NET ASSET VALUE (€ M)	MARKET SHARE	CLIENTS	MARKET SHARE
GAZFOND	7175.90	45%	210,898	3%
BLAGOSOSTOYANIE	3371.31	21%	1,111,314	17%
TRANSNEFT	674.58	4%	147,980	2%
ELECTROENERGETICY	652.22	4%	685,680	10%
HANTY-MANSYISK	531.07	3%	225,803	3%

Source: FCSM (regulator)

Gazfond is a captive entity of Gazprom Energy Company servicing the companies belonging to the group. Due to its being a closed fund and serving one of the most well-paid industries, the average accumulations of its members are by far the largest, especially under Pillar 3.

Mandatory pensions

FIGURE 59 - SYSTEM METRICS

AS AT	NUMBER OF MEMBERS (MILLIONS)	AUM (€ BN)
31/12/2010	7.8	3.8
31/12/2009	5.7	1.8
31/12/2008	3.6	0.9

During 2010, 3.4 million members decided to transfer their funds from the Pension Fund of the Russian Federation (PFRF) to non-state pension funds (NPF). The total amount transferred to the non-state pension fund system was RUB 39 billion[9] (almost €1 billion). Almost half a million members transferred between individual NPFs.

The average return for 2010 was at the level of 10.7% p.a., compared to consumer price inflation of 8.8% p.a.

Participation

Only those born after 1 January 1967 are entitled to make compulsory contributions to the accumulation component of the labour pension. Older people are allowed to make voluntary contributions only, as they will not be able to accumulate sufficient assets by their retirement age. Both of these groups enjoy state matching of their contributions.

9 New Russian Ruble.

Contributions

There are several types of contributions allowed under the mandatory pension accumulation component: mandatory payments as a percentage of salary, additional voluntary payments by members, additional voluntary payments by employers, and state matching of individual additional contributions.

Following the introduction of the mandatory pension system, each working individual born after 1 January 1967 is charged a social tax equal to 14% of salary with 8% going to the insured component of the labour pension and the remaining 6% to the accumulation component, as described above. For individuals born in 1966 and earlier the entire 14% is directed to the insured component.

The single social tax has been replaced by individual taxes which are deducted from gross salary and are paid to individual funds, including to the Pension Fund of the Russian Federation. The amount of contributions to the accumulation component remained at the same level of 6% of gross salary. The maximum taxable annual income in 2011 for the purpose of the mandatory pension is fixed at RUB 463,000. This translates into maximum mandatory contributions of RUB 27,780 annually.

Individuals as well as their employers are entitled to make additional contributions for the benefit of a member's pension account. The amount and timing can be ad hoc.

All the contributions are transferred monthly by employers to the State Pension Fund of the Russian Federation, which acts as an intermediary and transfers annually the pension contributions received to the private pension funds specified by participants.

There is a state matching program that provides additional contributions to be paid to a member's account in case the member has made additional voluntary contributions of not less than RUB 2,000 (€48) during the year. There is a limit for government matching–RUB 12,000 annually. In order to participate in this program, individuals need to start making additional contributions before 1 October 2013. State matching will last no longer than 10 years. For working pensioners (members who have reached pension age–60 for males and 55 for females–but still remain in full employment), the ratio of state matching is increased to 1:4, meaning that for each ruble of additional contributions the state will pay four, with the cap of RUB 48,000 (€1,162) annually.

More than 5 million members accessed the benefits of the state matching program that provides additional contributions to be paid to a member's account in case the member has made additional voluntary contributions of not less than RUB 2,000[10] (€48) during the year. In 2011, more than RUB 1.8 billion has been transferred to NPFs as a state share of matching program.

Investment

Investments are made according to specific legislation, which places concentration limits on each asset class.

The funds of *pension accumulations* can be allocated only to listed asset classes and government securities (not subject to listing requirements), with some limitations imposed on and issuers of corporate bonds, etc.

Additionally, the following limits are imposed for asset classes:

- Russian government bonds: not more than 40% of investment portfolio
- Municipal bonds: not more than 40%
- Corporate bonds (subject to listing and concentration requirements): 80%
- Shares of Russian issuers: 65%
- Mortgage securities (according to appropriate Russian legislation): 40%
- Bank deposits: 20%
- Shares of foreign issuers: 20%

10 Old Russian Ruble.

There are also additional requirements on the concentration of funds in one issuer:

- Not more than 5% of assets are to be invested in one issuer (bonds, shares) except for government securities.
- Not more than 10% placed on deposit with one bank group .
- Not more than 5% can be invested in companies affiliated with an asset manager or a depository.
- A pension fund's share in any company cannot exceed 10% of the capitalization of that company.
- A pension fund cannot hold more than 15% of the bonds issued by a single issuer (except government securities).
- The maximum share of investment in any type of securities from one issuer is 30% of the market capitalization of such securities (e.g., shares, bonds, etc.).

Investment options for members depend on the investment strategy of each non-state pension fund (NPF), subject to limitations imposed by the law. As an alternative to selecting an NPF, members can also opt to have their accumulation pension managed by the Pension Fund of Russia but with their investments managed by an approved asset management company, allowing members to have some choice over their own investment strategies.

Benefits

Pensions are payable from age 60 for men and 55 for women. The benefit is paid by NPF. The amount of pension is calculated as the account value at retirement divided by the life expectancy of the insured defined in the legislation. Currently it is 19 years for males and females.

On 1 December 2011 a new law governing pay-outs from the mandatory pension system was passed. According to the new law on pay-out of pension savings, there are four main types of pay-outs possible:

1. Lump-sum payment: Individuals are now eligible to receive a lump sum pay-out from their personal account if they fulfil a certain set of requirements:
   - They are receiving benefits in case of disability or in case of loss of spouse, and have not reached the required number of years at work
   - The savings part of their labour pension is less than or equal to 5% of the labour pension (non-accumulating–basic and insured)
2. Term pension pay-out: Paid from accumulated additional contributions, employer contributions, state matching along with earned investment return. The pension is paid for a fixed term which cannot be less than 10 years. If insured dies before the end of the payout term, the remaining funds are paid to the legal beneficiaries.
3. Labour pension (Accumulation–savings component of Labour pension) paid for life.
4. Pay-out of the accumulated funds to the beneficiaries in case of death of the member during both accumulation and pay-out phases.

There are two options to receive the term pension and labour pension: to move accumulated savings to an NPF or let PFRF service the pay-out. In order to finance the pay-out of the labour pension PFRF will create a pay-out reserve within PFRF. The pension pay-out is indexed once a year based on investment return earned. The indexation will be performed only in case of positive investment return, effectively providing a 0% interest guarantee.

Approaches to actuarial risks and guarantees, reserving, and solvency

Guarantees
There are no investment guarantees for mandatory pensions in the accumulation phase. The benefit payment is dependent on the actual investment performance of the fund.

Prudential reserves
Reserves for mandatory pensions are simply the total value of the unit fund. No additional reserves are required by law or regulation.

Other safety mechanisms
Non-state pension funds are strictly regulated by the supervisory body (Federal Financial Markets Service). There are requirements for regular audits and the use of depository services.

The value of administrator assets backing operations must be greater than RUB 50 million.

The enabling legislation contains a provision allowing for the creation of special guarantee funds, but this has not yet been activated.

Drivers of profitability
A non-state pension fund is a non-profit organization. It can only charge clients' accounts to cover its operating expenses.

Charges can only be used to cover expenses; however, if synergies can be achieved between different legal entities within one group to which the pension fund belongs, this can create an opportunity for profit. A pension fund can also claim for expenses that are not directly related to pension fund activity (e.g., relating to the agency network or administration system), thereby at least partly covering expenses from other lines of business.

The main drivers for the profitability of mandatory pensions are:

- Assets under management
- Number of members

Pricing and restrictions on charges
Asset management fee (AMF): Funds are invested using an asset management company. The asset management company can receive a fee to reimburse its expenses of an amount not greater than 10% of investment income received in the given calendar year. No fee can be taken in the case where a fund's NAV per unit has decreased compared to previous year. In addition to the expense fee, the NPF can take up to 15% of investment income after the deduction of the AMF imposed by the asset management company, to cover its operating expenses. Additionally, the asset management company can reimburse its costs to a total amount not greater than 1% of the average NAV.

Other fees: The NPF needs to have a contract with a special depository that controls NPF activity. The special depository can cover its costs, but this charge cannot be greater than 0.1% of the average NAV for the given calendar year.

Administration systems
As products are quite simple, life insurance systems and even updated banking systems can cope with tracking individual pension accounts.

Distribution strategy
A wide variety of distribution networks are used for private pensions, namely: banks, brokers, agent networks, and corporate sales.

Investment strategies
Funds are invested largely in bank deposits and government bonds.

Taxation of contributions and benefits

Contributions
For mandatory pension funds, contributions were part of a single social tax calculated as percentage of gross salary. These are currently paid by the employer and not subject to personal income tax for employees. The single social tax has been replaced by separate taxes for pensions and other social security benefits. Additional voluntary contributions by the employer are currently deductible as an expense to the employer up to the limit of RUB 12,000 (€290) annually per employee.

Contributions to an NPF in the member's own name, or in the name of spouse, parents, or disabled child can be deductible for the purpose of the personal income tax (PIT) calculation. The total annual value of the deduction cannot exceed RUB 120,000 (€2,900); this amount also includes other deductible items such as education or medical expenses.

Benefits
Mandatory pension benefits are not taxed.

Voluntary pensions

Participation
Participation in non-state pension funds is voluntary. It can take the form of:

- Corporate pension funds: Established by employers for their employees
- Open pension funds: Individual pension contracts available to the general population

Contributions
Both defined benefit and defined contribution funds can be created. The particular form of pension provision is described in *pension rules*, which are to be approved by the regulator.

Investment
Investments are made according to specific legislation, which places limits on each asset class. Assets can be invested by the NPF or through an asset management company (AMC). The funds of *pension accumulations* can be allocated only to listed asset classes and government securities (which are not subject to listing requirements).

Investment in foreign assets is allowed for government securities–the country must be a member of the Organisation for Economic Co-operation and Development (OECD). For other securities, investment rating cannot be lower than BBB- (Fitch) or equivalent.

The following limits are imposed on particular asset classes:

- Russian government bonds: Not more than 70% of investment portfolio
- Municipal bonds: Not more than 70%
- Corporate bonds (subject to listing and concentration requirements): 80%
- Listed shares of Russian issuers: 70%
- Share in Russian enterprises: 70%
- Mortgage securities (according to appropriate Russian legislation): 20%
- Investment funds: 50%
- Bank deposits (only if the bank is a member of an insurance system for bank deposits): 50%
- Shares of foreign issuers: 30%
- Russian government securities of one issue: 35%
- Property: 10%

Concentration limits:

- Not more than 10% should be invested in one issuer or deposited in one bank.
- Not more than 25% in investment funds managed by one asset management company.

There are limitations on the instruments in which an NPF can invest by itself and (separately) through an AMC.

Benefits

Defined benefit and defined contribution schemes are possible. The pension pay-out can take the form of a single life annuity or a guaranteed term annuity. Lump sums are not allowed but partial withdrawals are possible and in this case the residual fund value is inherited by the beneficiaries on the death of the pension fund member. The provisions regarding the form of pension pay-out depend on individual pension fund rules.

Approaches to actuarial risks and guarantees, reserving, and solvency

Guarantees

Voluntary pension funds can offer an interest guarantee of up to 4% p.a. There is an additional requirement for the pension scheme that can be treated as an embedded guarantee: The pension pay-out cannot be less than 50% of the minimum pension payable by the state for the given individual.

Prudential reserves

Non-state voluntary pension funds must maintain reserves equal to the actuarial present value of the future liabilities of the fund to its members. These reserves are the actuarial present value (APV) of future benefits minus APV of future contributions. These calculations are performed by qualified actuaries and are subject to annual actuarial review.

In order to be able to cover their liabilities, non-state pension funds are obliged to maintain an additional insurance reserve. The insurance reserve is created by using pension contributions, the investment return of pension reserves, and additional *target* contributions by the owners of the NPF. This reserve is intended to cover the risk that the main reserve is insufficient to cover pension fund insurance liabilities. This reserve is used to cover:

- Shortfalls in claim pay-out reserve (pensions, cash values)
- Shortfalls that are due to a change in the actuarial assumptions used to value pension liabilities

There are minimum requirements for this reserve: The insurance reserve cannot be less than 5% of the minimum value of reserves held to cover pension liabilities at the beginning and end of a reporting period. The actual amount of insurance reserve is determined based on annual actuarial review.

Other safety mechanisms

Non-state pension funds are strictly regulated by the supervisory body (Federal Financial Markets Service). There are requirements for regular audits and the use of depository services.

The value of administrator assets backing operations must be greater than RUB 50 million.

Legislation envisages the creation of guarantee funds, but none have been created yet.

Drivers of profitability

A non-state pension fund is a non-profit organization. It can only charge clients' accounts to cover its operating expenses. As for mandatory pensions, however, there is scope for profit through synergies–for example, for NPFs that are related to other group companies.

The main drivers of profitability for voluntary pensions are:

- Premium charge
- Profit sharing
- Assets under management
- Number of members

Pricing and restrictions on charges
Fees and charges are according to rules of the scheme.

The following limits are imposed:

- Not more than 15% of investment return earned net of asset management fee and fee for depository services

- Not more than 3% of contributions

There seem to be no limits on asset management and depository fees.

Distribution strategy
A wide variety of distribution networks are used for private pensions, namely: banks, brokers, agent networks, and corporate sales.

Investment strategies
No market-level statistics on investments are available. The strategies can vary significantly between individual funds but generally the main investments are government bonds, deposits, and investment funds, i.e., low risk. Direct holdings in equities tend to be limited, although some investment funds have higher equity content.

Taxation of contributions and benefits

Contributions
Contributions to NPF are tax deductible and the same rules apply as for the mandatory system.

Benefits
For voluntary pension schemes involving:

- A pension payable to a former contributor: Not subject to personal income tax (PIT).
- A pension payable arising from employer contributions: Standard PIT applies.
- A pension payable arising from contributions paid by individuals: Standard PIT applies.
- Transfer amounts if paid as lump sums: Standard PIT applies on the excess of the cash value over contributions paid.

HUNGARY

Overview of the system

Hungary was an early embracer of pension reforms in the CEE region, introducing a mandatory second-pillar pension system with individual accounts in 1998. It ranks second in the region, in terms of the size of both the mandatory private pension (behind Poland), and the voluntary pensions market (behind the Czech Republic).

The Hungarian mandatory pension system comprises two pillars. The first is a public pension pillar, financed on a pay-as-you-go basis. The second is a mandatory private pension system, supplemented by a voluntary private pension system that forms the third pillar. The new second-pillar pension is mandatory for all new entrants, while those previously insured could opt for a mixed system.

The primary role of the mandatory pension system, known as private pension funds (PPFs), is to compensate for the drop in income upon retirement, based on the principle of self-provision.

The third pension pillar (introduced in 1993) consists of voluntary pension funds (VPFs), which operate on a defined contribution basis. Mandatory and voluntary funds may be established by employers and other specified organisations.

The fourth pillar, additional voluntary individual retirement accounts (NYESZ), was established in 2006 and offers similar tax incentives to voluntary pension funds.

The Hungarian Pillar 2 system underwent major changes in late 2010/early 2011. As part of a larger package of measures designed to increase revenue to the state budget (and thus contribute to the reduction of the budget deficit) the Pillar 2 pension system was effectively nationalized in the beginning of 2011. The legislation passed in December 2010 stated that, by 31 January 2011, all members in the mandatory pension system must opt to either return in the state system or remain in the mandatory system. The incentive for selecting the former option was that those who choose to remain in the private pension system no longer accrue rights under the pay-as-you-go system while still being subject to employer social security contributions.

Termination of membership in the Pillar 2 fund (for those who selected this option) became effective at 1 March 2011. As a result, 2.9 trillion forints (€9.5 billion, or around 92% of total assets held) were transferred back from Pillar 2 to state coffers.

Mandatory pensions

Participation

Career starters are defined as any person who joins a compulsory pension scheme in Hungary for the first time and is under the age of 35. Prior to the recent change, such people became members of a private pension fund on a mandatory basis; however, this is no longer a requirement of law.

During the transition phase in 1998, existing employees were given the option of voluntarily joining the mandatory tier, and about 50% did so. Those who chose not to participate remain enrolled in the first pillar only.

Generally, private pension fund membership cannot be terminated at the member's request. A fund member may only decide to transfer to another pension fund. On the member's death, the beneficiary decides on the future of the available amount. For older fund members with specific characteristics who would come off worse as members of the mixed system, the transitional provisions of the law allow them to return from the mixed to the state pension system.

No fee is required for joining the fund.

Contributions

During the accumulation period, private pension funds collect and invest contributions, while in the period of disbursement they provide life annuities from accumulated funds.

Mandatory second-pillar fund members pay contributions of 8% of their gross salary, which is transferred by their employer to the pension fund chosen by the employee. Additional contributions of an extra 2% of salary can be paid by the employee or employer. If an employer agrees to pay additional contributions, the employer's commitment covers each employee to the same extent.

Investment

Asset management, investment, and allocation

From 2009, pension funds offer three different investment portfolios (growth, balanced, and conservative) with varying risk profiles. Previously, each pension fund ran one fund for all of its members. The fund assigns members to one of the portfolios depending on the time to retirement. Pension funds voluntarily started offering these three portfolios from 2007. Members are allocated using the following rules:

Members with five years until retirement are assigned to the conservative portfolio with a maximum equity share of 10%.

Members who have between five and 15 years until retirement are assigned to a balanced portfolio with an equity share between 10% and 40%.

Members who will retire in more than 15 years' time are assigned to the dynamic portfolio, which has an equity share of at least 40%, with the possibility of putting 5% in derivatives and a maximum of 20% in real estate.

Fund members may switch from the category to which they are assigned. The only exception is the dynamic portfolio, which is not available during the last five years before retirement age.

Investment returns

The investment policy of mandatory pension funds in Hungary is fairly conservative. The (much reduced) investment portfolio of all mandatory pension funds at the end of 2008 consisted of around 51% in bonds (of which approximately 91% were Hungarian government bonds), 11% in shares, and 31% in investment funds.

The three largest providers of mandatory individual savings funds (ING, OTP, and Aegon) earned average annualised returns between 4.5% and 7.3% from 2000 to 2009, compared to an average inflation rate of 5.9% over the same period.[11]

Guarantees

A guarantee fund is operated in Hungary to protect the accumulated individual capital of pension fund members from insolvency. There are a number of indirect guarantees within this system: supervision of the funds, legislative measures for the management, investment, and creation of reserves.

The contribution to the guarantee fund is compulsory for all pension funds, based on pension regulations. The guarantee fund is a separate legal entity covering all pension funds and has tax-free status. It is the responsibility of the guarantee fund to represent the members of any fund in liquidation. The guarantee covers the total benefit for beneficiaries and the accumulated capital of contributing members, if a pension fund is closed. The contribution to the guarantee fund currently does not exceed 0.4% of the revenues from membership contributions of the quarter under review.

[11] Source: http://www.pszaf.hu/data/cms2165920/Investment_perf_pension_funds_Hungary_2009.pdf

The average annual value of the guarantee fund's assets may not be less than 0.1% or more than 1.5% of the total combined assets of the funds.

There is no direct guarantee for the amount of annuity.

It is also the task of the guarantee fund to provide financial cover in the annuity benefit payment period, i.e., to top up the benefit reserve of the fund if this is less than the amount of the claim determined for each eligible fund member, even after the utilization of other reserves that are required to be allocated.

Investment limits

The maximum limits for individual asset classes according to investment portfolio regulations are as follows:

- 50% for investment funds
- 30% for bonds (except government bonds)
- 25% for mortgage bonds
- 10% for real estate investment funds, unlisted equities, etc.

There are no portfolio limits for quoted equities, government bonds, and bank deposits. Pension funds are not allowed to hold loans in their portfolios.

Foreign investment is permitted for up to 30% of assets, but the maximum investment in non-OECD countries is 20%. Regulations concerning equity holdings have been relaxed. The 50% limit on equities was abolished in 2005 and options to invest in hedge funds and private equity introduced. Pension funds may not invest in businesses in which the founders of the fund or the members' employers own more than 10% of the shares.

Benefits

The second-pillar pension funds are defined contribution saving vehicles. The benefits fully depend on the amount accumulated and investment returns on the capital. The benefits can be provided as a lump sum or an annuity. Pensioners with membership shorter than 15 years can apply to receive a lump sum, whereas those with membership exceeding 15 years receive benefits as an annuity payment. A lump-sum benefit can also be claimed by a beneficiary if a fund member dies. Withdrawal of funds before retirement is not possible but contributions paid during the accumulation period can be inherited. Disability or survivors benefits are not provided by the second-pillar scheme, although in these cases there is the possibility to return to the first-pillar scheme.

After retirement, members receive pension benefits from two sources. Those who opted for the mixed system after the transition of the pension system in 1998 will receive 75% of benefits from their state pension (first pillar), plus benefits from the private pension fund corresponding to the amount they have accumulated, based on proportions of gross salary they chose to contribute (obligatory and optional part).

According to Act LXXXII of 1997 on Private Pensions and Private Pension Funds, mandatory pension benefits are paid out upon reaching retirement or if a member for more than 15 years in one of the following types of annuities:

- A pension payment (life annuity) paid to the fund member monthly in advance until the end of the fund member's life

- A life annuity that the fund shall pay to the fund member or his beneficiary for a specified period of time (period certain) from the beginning of the pension plan benefit, and on expiry of the set period, until the end of the fund member's life (life annuity with a fixed beginning period)

- A life annuity that the fund shall pay to the fund member until the fund member's death, and afterwards to the fund member's beneficiary, for a period of time (period certain) determined in advance in the benefit regulations of the fund (life annuity with a fixed end period)

- A joint survivorship life annuity, a pension plan benefit paid to the fund member and the fund member's beneficiary (or beneficiaries) as long as at least one of them is alive

Annuities can either be purchased from an insurance company or are provided by the pension fund.

Pricing and restrictions on charges

Allocation of the amounts paid by members

In accordance with the regulations introduced by the Hungarian Financial Supervisory Authority, the mandatory fund allocates the membership fees (contributions) received into three reserves:

- The funding reserve, which must be at least 95.5% of assets
- The operational reserve
- The liquidity reserve

The operational reserve is used to cover the operational costs of the pension fund, while the liquidity reserve provides for short-term investments as well as the smoothing of investment and demographic risks and the liquidity of the pension fund.

Fees and charges

Following regulatory changes, annual asset management charges excluding trading expenses may not exceed 0.8% in 2009-2010, 0.7% in 2011, 0.6% in 2012, 0.5% in 2013, and 0.4% in 2014. These percentages do not apply for pension funds that were registered in 2009 or in the previous three calendar years. The maximum front-end operational fees were reduced from 6% in 2007 to 4.5% in 2008. Members are also allowed to switch between funds provided that they have been with their current fund for at least six months.

Private pension funds in the second pillar are subject to a supervisory fee paid to the Hungarian Financial Supervisory Authority. The supervisory fee consists of a fixed and a variable part. The fixed basic part is HUF 2 million (€7,575) while the variable part amounts to 0.025% of the market value of the assets of the pension fund. The fee is paid quarterly.

Taxation of contributions and benefits

Tax incentives are granted to stimulate private pension savings. The prerequisite for the tax incentives is that the yearly income of the private individual does not exceed HUF 3.4 million (€12,878) in 2009.

Twenty-five percent of contributions paid on the basis of a contractual agreement concluded by a private individual to a mandatory pension fund are income tax-deductible.

Thirty percent of additional contributions in excess of the contractual member contributions paid by a private individual to a mandatory pension fund are income tax deductible.

The amount of tax relief cannot exceed HUF 100,000 (€378) annually.

Investment income on pension-related savings and benefits from mandatory pension funds are tax-exempt.

Fund reserves: Solvency

The legislation requires mandatory pension funds to create funding and liquidity reserves from their revenues. In addition to the mandatory reserves, the fund may create other reserves specified in the fund regulations. From its revenues, the fund accumulates its *own activity* reserves if it chooses not to outsource annuity payments. The own activity reserve shall be used to replenish the funding reserves after the secondary reserves become exhausted in the event of operational problems. The fund's own activity reserves should total HUF 100 million (€0.378 million) if the fixed assets of the pension fund are reported to exceed HUF 2 billion (€7.575 million).

Voluntary pensions

The system of voluntary pension funds (VPFs) was introduced by law in 1993 and started to operate effectively in 1994. Hungary was the first country in Central and Eastern Europe to introduce funded supplementary pensions–the so-called third pillar.

The VPF market has experienced major consolidation in recent years. The number of pension funds and their members initially grew dynamically and by 1999 there were some 250 funds in operation. This number had fallen to 63 by September 2011 with around 1.27 million participants. Assets under management of pension funds equalled 811.2 billion HUF (approximately €2.7 billion) as at the same date.

About half of the VPF entities operating on the market are single or multi-employer funds (with restricted membership); the remainder operate as pension funds open to all individuals. They can be considered as employer and commercial pension schemes, respectively. Both types of funds were designed to supplement benefits granted to their members under the mandatory social security scheme.

VPFs provide individual defined contribution accounts and their operations are based on the same institutional frameworks as mandatory pension funds. VPFs, which are operated by employers, must appoint a trustee to manage their assets.

VPFs are not required to yield a minimum rate of return.

Participation

Any person between 16 and 62 is eligible for fund membership and may contribute to voluntary pension funds. Currently the participation rate is around 30% of the labour force.

Apart from individual membership, an employer may become an employer member in a pension scheme under a contract concluded with the fund, in which an employer agrees to pay partial or full contributions on behalf of his employees.

Employees of an employer that operates its own employer pension scheme may join a commercial pension scheme.

Membership is terminated upon the member's death or when the member closes the account or switches to another fund.

Members are permitted to switch between funds without constraints.

Contributions

Contributions can be paid by the employer or the employee or both, with contribution levels set by fund regulations. There is no regulatory minimum.

An employer committing to pay the employee's contribution cannot exclude any employee who has been in employment for at least six months from its contribution. The rate of contribution should be identical in respect of each employee who is a fund member and cannot depend on which fund was selected by the employee. The employer must enter into agreement with the pension schemes of its employees, which will stipulate the contribution rate. However, the employer has a right to select a different rate of contribution per employee depending on the employee's age.

During the first three quarters of 2011, approximately 69% of contributions paid within the third pillar were made by employers on behalf of their employees.

Upon the termination of the membership because of the death of the member, the beneficiaries designated in the application for membership or their heirs become the owners of a member's individual account. The beneficiary may: collect their share in the full amount as a lump sum, leave it in accordance with fund's bylaws in the pension fund in their own name with or without continuation of the payment of the contributions, or transfer it to another fund of the same type.

Distribution strategy

Recruiting new members can be performed by natural or legal persons or unincorporated business associations under appropriate contracts.

Any remuneration provided for recruitment services shall be paid from the fund's operational reserves.

Taxation of contributions

VPFs benefit from a number of tax incentives.

A subsidy of up to 30% of individual payments made by the fund member (employee) and any employer contribution on the employee's behalf are credited to the member's pension account, up to €378 (HUF 100,000) annually (or €491 [HUF 130,000] if the employee retires before 2020). If membership contributions are paid by employers, they do not increase the gross income of the employees.

Employer contributions can be accounted for as expenditure incurred by the enterprise, and are exempt from social insurance. Employer contributions are tax-exempt up to 100% of the minimum wage.

Investment income is also tax-exempt. After 10 years of membership, the returns on investment may be withdrawn tax-free; in each of the following years, 10% of the capital can be withdrawn free of tax. After 20 years of membership, fund members may withdraw all benefits free of tax.

Any beneficiary payouts from the voluntary pension fund are exempt from tax.

Investment strategies

The investment regulations applying to VPFs are the same as those of mandatory funds with two exceptions: There is a maximum limit of 20% of bank deposits, and, unlike mandatory funds, VPFs can invest up to 5% of the funding reserve in loans.

Third-pillar pension funds have had the right to offer different portfolio strategies to their members since 2001. However, only a few funds offer their members different investment portfolios. The majority of members remained in the default portfolio of the funds, which are usually low-risk portfolio strategies with an average 10% equity share.

Benefits

The compulsory benefit waiting period is at least 10 years. Fund members can withdraw the amounts registered in their individual retirement accounts at the end of the waiting period or have access to pension benefits after attaining the retirement age.

A member of a pension fund may take a loan from the VPF of up to 30% of his or her savings account. The sum of the loan, its duration (at the most 12 months), and other conditions should be stipulated by internal regulations of the fund. If the member fails to repay the loan, the fund has a legal right to deduct the overdue amount together with all expenses from the retirement account of the member within 180 days from the redemption date.

Any fund member, following the waiting period or after reaching retirement age, is allowed to pledge a maximum of 50% of the balance on an individual account as collateral security in a contract concluded with a credit institution, if at the same time the member authorizes the fund to register the individual retirement account as *frozen* on the member's instruction.

Upon reaching the retirement age, the VPF's benefit may be paid out as a lump sum, an annuity with no further payment of membership contributions, or a partial lump-sum withdrawal with an annuity paid out from the remaining part.

Taxation of benefits

A member who withdraws before attaining retirement age and after the 10-year waiting period may withdraw all or part of the savings accumulated in the account. In this case, the contributions paid are subject to tax, whereas capital gains are tax-exempt. If the withdrawal occurs in the second year after the waiting period has elapsed, 90% of the principal is a subject to tax. The tax base decreases by 10% each year. If the member remains in the fund for 21 years, the member will be eligible to withdraw the whole amount accumulated in the account tax-free.

Upon attaining retirement age, the lump sum benefit is tax-free only if fund membership is longer than three years.

Upon attaining retirement age, annuity benefits are tax-exempt if, during the first three years of receiving payments, the amount of benefit is not decreased by more than 15% of the previous year's remittance.

Other safety mechanisms

The fund creates safety, operational, and liquidity reserves from its revenue. The safety reserve is used for the funding of services, the operating reserve is used to cover operating costs, and the liquidity reserve is used for the collection of surplus liquid assets and, as a general reserve for the other two reserves, for ensuring the fund's liquidity. After 1 April 2008, 1.5% of all contributions are credited to the operational reserves.

The contributions paid both by members and employer members, the proceeds from the sale of assets, and other contributions shall be put to safety, operating, and liquidity reserves according to the stipulations of the fund's bylaws.

Drivers of profitability

Providers may charge fees for people who wish to join, leave, or switch pension funds. In 2007, the limit on operational fees was introduced. The maximum limit amounted to 6% in 2007 and was reduced to 4.5% starting from 2008.

Costs

The annual asset management charge depends on the agreement between the VPF and the asset management company. However, the annual charge may not exceed 0.8% of the average daily market values of the assets under management.

In the case where a pension fund manages all or part of its own assets, the annualized pro-rata costs of the investments that the fund manages may not exceed 0.8% of the average daily market values of the assets under management.

Funds are also subject to a supervisory fee taken from their operating reserves.

Other types of costs borne by the VPFs include fees for administration and record-keeping services, auditing fees, actuarial service fees, marketing and promotional fees, and other expenditures for operational activities.

Costs of pension benefit pay-outs are also borne by the VPF (although, to date, the majority of members have chosen the lump-sum form of benefit).

Fourth pillar

In 2006, another form of saving for pension was introduced as the *fourth pillar*. These voluntary individual retirement accounts (NYESZ) can be operated by banks or stockbrokers. They were created in order to promote long-term savings in equities and to encourage people to increase their retirement savings.

A subsidy of up to 30% of contributions paid by members to qualifying fourth-pillar accounts are credited to the member's pension account up to a maximum of €378 (HUF 100,000) annually (or €491 [HUF 130,000] if the member retires before 2020). Investment gains are tax-free.

The annual limit for charges is €7.6 (HUF 2,000), the maximum asset management fees are limited to 80 bps (as of 2008), and operational charges are limited to 6%.

The investment policy of the fourth pillar is mainly in investment funds (approximately 40%), shares (about 30%), government securities (about 20%), and deposits and other (about 10%).

SLOVAKIA

Overview of the system

Slovakia has a classic three-pillar pension system, which is subject to indirect guarantees and protection mechanisms.

The Slovakian private pension system consists of two main components: mandatory pensions (second pillar), introduced as part of major reforms in 2005, and voluntary pensions (third pillar).

The funded private system functions alongside the pay-as-you-go universal state pension system (first pillar), as well as other forms of retirement saving such as life insurance.

The second pillar funds are managed by pension asset management companies (Starobné dôchodkové sporenie, DSS, PAMC).

As of 15 December 2010 there were six pension savings companies and five supplementary pension asset management companies based in Slovakia. We present a summary of pension fund size for each pillar in the tables below.

Key data for the six providers (pension savings companies) as of the end of 2010 are shown in Figure 60.

FIGURE 60: SLOVAKIA SECOND PILLAR PROVIDERS

	NET ASSET VALUE (€ M)	SHARE	PARTICIPANTS	SHARE
ALLIANZ - SLOVENSKÁ, D.S.S., A.S.	1 176	32%	442 694	31%
AXA, D.S.S., A.S.	1 004	27%	372 779	26%
VÚB GENERALI, D.S.S., A.S.	539	14%	195 893	14%
ING, D.S.S., A.S.	411	11%	147 263	10%
AEGON, D.S.S., A.S.	381	10%	184 682	13%
ČSOB, D.S.S., A.S.	208	6%	93 659	7%

Source: NBS

The third-pillar funds are managed by supplementary pension asset management companies (Doplnkové dôchodkové sporenie, DDS, SPAMC).

Key data for the five providers (supplementary pension asset management companies) as at the end of 2010 are shown in Figure 61.

FIGURE 61: SLOVAKIA THIRD PILLAR PROVIDERS

	NET ASSET VALUE (€ M)	SHARE	PARTICIPANTS	SHARE
ING TATRY - SYMPATIA, D.D.S., A.S.	432	38%	322 485	38%
DOPLNKOVÁ DÔCHODKOVÁ SPOLOČNOSŤ TATRA BANKY, A.S.	344	30%	197 110	23%
STABILITA, D.D.S., A.S.	218	19%	192 923	23%
AXA D.D.S., A.S.	148	13%	132 464	16%
AEGON D.D.S., A.S.	3	0%	4 795	1%

Source: NBS

Mandatory pensions

At 31 December 2010 the pension system in Slovakia comprised six pension savings companies managing a total of 18 pension funds and five supplementary pension asset management companies managing 15 funds.

Scheme metrics

FIGURE 62: ASSETS UNDER MANAGEMENT - MANDATORY PENSIONS

DATE	€ BN	GROWTH (%)
2011-06-30	4.13	11.00%*
2010-12-31	3.72	28.18%
2009-12-31	2.90	30.00%
2008-12-31	2.23	N/A

Source: National Bank of Slovakia (NBS)
(*) Growth rate for the first half of 2011 only.

Participation

The second-pillar pension system is a defined contribution scheme. Initially, younger workers could decide whether to remain in the old system or join the new pillar, but new employees were automatically enrolled in the second pillar. As a result of legislative changes introduced in 2007, however, membership is no longer compulsory for new entrants; existing memberships transitioned from mandatory to voluntary participation between 1 January 2005 and 31 December 2007.

Following 31 December 2007, individuals born after 31 December 1986 who enter into a contract with the pension asset management company (DSS) within six months since their first employment are allowed to become members.

The DSS is a joint-stock company required by law to manage three types of pension funds having varied risk/return profiles (i.e., a multi-portfolio system).

The retirement age for the second pillar is currently 62 years for males and females.

Contributions

During the accumulation phase, which lasts for at least 15 years, the contributions of the second-pillar members are credited to their personal pension accounts managed by the DSS.

The contribution rate amounts to 9% of gross salary, which is 50% of the total social security deduction from gross salary. The other 9% is credited to the first-pillar pension system.

The contributions are collected by the Social Insurance Agency (SIA, Národná Rada Slovenskej Republiky), then distributed to the privately administered funds.

The new pension system has also introduced new elements that allow pensioners to retire before the retirement age set by legislation. In that case, the old-age pension is reduced by 6% per year of early retirement. In cases where pensioners work past the minimum retirement age, the pension is increased by 6% per additional year of age. It is also permitted to simultaneously work and receive pension benefits from the second pillar.

Investment

Contributions received are invested in a diversified portfolio of assets. The three possible profiles of funds are growth, balanced, and conservative.

The investment regulation for pension funds is rules-based, prescribing detailed investment limits for each type of pension fund. These are:

- Growth fund: Up to 80% of assets may be invested in shares.
- Balanced fund: Up to 50% of assets may be invested in shares and at least 50% of assets must be invested in bonds and money market.
- Conservative fund: The assets must be invested only in bonds and money market and the entire holdings must be insured against a currency risk.

Each individual has a right to choose the type of fund in which to enrol. The individual can be a member of only one fund at a time. Individuals with less than 15 years to their retirement age may not join the growth fund. Additionally, seven years prior to reaching the retirement age, members are obliged to switch their account balance to the conservative fund.

FIGURE 63 - ASSETS UNDER MANAGEMENT IN THE SECOND PILLAR PENSION SYSTEM, AS OF 30TH JUNE 2011

FUND TYPE	IN € M	% OF TOTAL
CONSERVATIVE	193.1	4.68%
BALANCED	1 244.7	30.14%
GROWTH	2 692.5	65.19%
TOTAL	4 130.3	100.00%

Source: National Bank of Slovakia (NBS)

FIGURE 64 - INVESTMENT STRUCTURE AS AT 31/12/2010 IN MILLION EUROS

INVESTMENT PRODUCT	€ M	% OF TOTAL
BANK ACCOUNTS	1 146.9	30.85%
BONDS	1 518.3	40.84%
TREASURY BILLS	1 051.2	28.27%
EQUITIES AND INVESTMENT FUND SHARES / UNITS	2.0	0.05%
OTHER CLAIMS	9.6	0.26%
PAYABLES	-10.1	-0.27%
TOTAL	3 717.8	100.00%

Source: NBS

Guarantees

The state does not directly require pension funds to guarantee any minimum investment return, nor the principal value of paid contributions. The law does, however, impose strict investment limits on private pension funds and regulates them closely, while requiring some minimum performance relative to competitors. Moreover, the state guarantees 100% of the pension granted in the case of fraud or malfeasance. Similarly, during the benefit payment phase of the mandatory pension system (paid by a life insurance company) the state does not provide any guarantees.

Minimum investment return requirements

Pension asset management companies (DSS) must achieve a minimum return for each of the three funds (split by risk profiles). The regulation does not require absolute performance goals or the value of paid-in capital, but a performance guarantee relative to the returns achieved by other market participants.

Under legislation in force from 2009, Pension Fund Managers (DSS) are required to create a separate guarantee account for each pension fund that will contain all of that fund's earnings. If the DSS investment yield is a positive rate of return over a six-month monitoring period, it is allowed to charge 5.6% of the appreciation of pension assets (performance fee) for that time period. The remaining 94.4% is distributed to the individual account holders. However, if a fund managed by a DSS has a negative rate of return over the six-month monitoring period, the DSS is responsible for making up the difference to ensure that workers' accounts do not fall below the principal amounts they have contributed. The first six-month monitoring period began 1 July 2009, with DSSs permitted to start charging this second fee on 1 January 2010.

Benefits

The net asset value is paid out to the participant in the event of reaching the state retirement age or in cases where the member suffers total and permanent disability. The retirement pension, including on early retirement, can be paid out in the form of a programmed withdrawal with a life annuity or just a life annuity. Survivors pensions such as widow's, widower's, and orphan's pensions are also offered.

Pensions post-retirement are value-adjusted according to a ratio adding 50% of the increase in the inflation index and 50% of nominal wage growth.

Drivers of profitability

In both second and third pillars, the main driver of profitability is assets under management, as the largest source of revenue is the asset-management charge.

Contributions play a less vital role for profitability, as the limits set for contribution charges are fairly low (for Pillar 2 the charge is not higher than 1% of monthly contributions).

Effective asset management with higher investment returns is another good source of profit, as second-pillar fund management companies can also charge a performance fee based on the level of investment return (fee introduced on 1 July 2009).

Pricing and restrictions on charges

In the second pillar, the monthly management fee charged by the management company must not exceed 0.025% of net asset value.

Charges for maintaining personal pension accounts are limited to a maximum of 1% of contributions for each fund. The Social Insurance Agency also charges 0.5% of the monthly contributions it transfers to the individual account fund manager.

There is a performance-based fee depending on the size of positive investment return over a six-month period. On 1 July 2009, a new fee was introduced of 5.6% charged semi-annually from investment returns. Any negative returns are compensated from own funds within six months balancing intervals of time—every six months, investment performance is measured and negative returns are compensated from own sources.

Members are free to change to a different PAMC every two years. If they do so, they must pay a fee of €16 to the Social Insurance Agency.

A PAMC may not charge any other fees (e.g., for switching funds or PAMCs).

Investment strategies

Investment management in the pension funds is governed by the rule *the highest possible yield at the minimum risk*, and so the state has introduced strict investment limits, requiring every pension fund to invest in a wide range of securities in a diversified portfolio of companies and countries.

The investment limits stipulate that the pension funds may invest only in liquid and public marketable securities with an investment-grade rating. The investment limits set by the law are supervised by the depository organisation and by the National Bank of Slovakia.

The state has introduced a mechanism for benchmarking the required investment return for all pension funds. The procedure requires funds to maintain a specified level of yield below which the investment return should not fall significantly.

It is stipulated by law that, 24 months after a pension management company begins to operate a pension fund, the average yield of the pension fund must at all times be at least equal to the lower of two values (depending on the type of fund):

- Conservative funds: 90% of the average aggregate market yield (for all risk levels combined) in the last 24 months or the average market yield minus one percentage point

- Balanced funds: 70% of the average aggregate market yield in the last 24 months or the average market yield minus three percentage points

- Growth funds: 50% of the average aggregate market yield in the last 24 months or the average market yield minus five percentage points

The law requires all pension fund companies to guarantee that there will be a positive return over the period. If the return is negative, the pension fund company has to pay the difference from its own assets.

Taxation of contributions and benefits

Second-pillar mandatory pensions in the Slovak Republic are not taxed. Contributions are currently tax-exempt, as well as investment income and paid-out pension benefits.

Approaches to actuarial risks and guarantees, reserving, and solvency

Guarantees

The state guarantees the amount saved in the individual accounts of the members of the pension funds. The Social Insurance Company (on behalf of the state) is obliged to compensate the loss of funds caused by a decision, procedure, or other action of a PAMC or a depository that has violated the current law through fraud, resulting in a loss of funds saved in individual accounts.

In the case of a below-average performance of a fund (lower yields) compared with its competitors, the PAMC is obliged to pay the difference arising from its own sources.

Prudential reserves

No formal solvency margin is required by law. The state does not provide direct guarantees (except against fraud, as above). Only indirect guarantees exist for monitoring whether positive investment returns can be observed over each six-month period.

Other safety mechanisms

The system has a dedicated regulator and supervisor, in the form of the National Bank of Slovakia.

Each pension asset management company (DSS and DDS) must have a depository bank, which is supervised by the National Bank of Slovakia (NBS). The depository bank maintains the accounts for every pension fund managed by a PAMC. If the depository bank learns that a PAMC has exceeded the investment limits set by the law, it must not execute investment instructions and it must report this fact to the NBS. The depository institution also verifies that the PAMC is setting management charges properly. The operation of the depository is also subject to the inspection of the NBS.

The accounting records of the PAMC must be verified by an independent auditor every year, who checks that the accounting practices of the PAMC are in accordance with the law.

Every PAMC must have an internal audit unit, separated from the company operations, that monitors the company activities alongside the external auditor.

Future changes foreseen in the second-pillar pension system

According to a draft law proposed by the Slovak Ministry of Labour, a number of changes are envisaged to the second-pillar system. The changes to the pension system will be applied in 2011 and in 2012. The proposed changes include:

- Introduction of mandatory participation in the second pillar for people entering the labour market, with the possibility to leave the system within two years of entry.
- Introduction of an index fund whose performance will aim to replicate the movements in the global stock market indices.
- The 0% investment return guarantee introduced in 2009 will no longer be applicable to the growth and balanced funds (which will be renamed as stock fund and mixed fund, while the conservative fund will be renamed as bond fund) and members will be allowed to invest in two different funds .
- The introduction of success fees for superior investment performance to improve the expected level of returns.
- A change to the mechanism of switching of future pensioners to the bond fund platform in years prior to attaining the retirement age, which will implement more gradual change.

Voluntary pensions

Participation

Any individual of age 18 or older is eligible to become a member of the system.

Participation in the system is voluntary for both employers as well as employees. However, certain categories of employees working in a risky environment or under a physically demanding condition are required to be members of the system. In these cases, their employers must contribute.

The retirement age for the third pillar is currently 55 years for both men and women.

Contributions

Contributions are voluntary and are remitted by employers and participants directly to SPAMCs.

Investment

Contributions received are invested in a diversified portfolio of assets.

The split of investments for third-pillar assets between euro and foreign currency investments at the end of 2010 are shown in Figure 65.

FIGURE 65: INVESTMENT STRUCTURE OF THIRD PILLAR ASSETS AS OF 31/12/2010

CLASS	€ M	MIX
BANK ACCOUNTS	149.1	33%
BONDS	76.3	17%
TREASURY BILLS	7.5	2%
EQUITIES AND INVESTMENT FUND SHARES / UNITS	232.1	51%
OTHER CLAIMS	82.0	18%
PAYABLES	-88.6	-19%
TOTAL	458.4	100%

Source: NBS

Benefits

The net asset value is paid out to participants in the event of reaching the state retirement age or on becoming totally and permanently disabled. The possible pension benefits on reaching retirement age are life annuity, partial life annuity and partial lump sum settlement, fixed-term annuity, fixed-term annuity with partial lump-sum settlement, and a termination settlement.

In the event of the participant's death prior to retirement, the participant's account is paid out to the participant's legal heirs.

Pensions post-retirement are value-adjusted with the ratio equal to the sum of 50% of the increase in the inflation index and 50% of nominal wage growth.

Pricing and restrictions on charges

In the third pillar, the management fee may not exceed 2.5% of NAV, charged by the supplementary pension company for the administration of assets. The maximum limits have been lowered from 3% since 1 January 2010. The fee will be decreasing gradually in the future to the level of 1.98% by 2019.

There is a fee of a maximum of 1% of NAV, which is kept by the pension company for the administration of assets.

The fee for switching SPAMCs (DDS) may not be higher than 5% of the member's account balance within the first three years of membership. After this period, the maximum switching fee was equal to 1% of NAV and since 1 January 2010, transfers have been free of charge.

A new fee was introduced on 1 January, 2010, to be charged by the pension companies. The fee is equal to 10% of attained returns and by 1 January 2020 it will be gradually increased to 20% of attained returns.

On 1 January 2010, the broker's fee was also regulated. The supplementary pension companies can pay a maximum of 10% of the average wage for every pension agreement written.

Other safety mechanisms

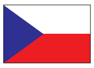
For the third pillar, the legislation states that the supervisory board of a supplementary pension asset management company is obliged to require the managerial employee directing the internal control unit to perform a review of the supplementary pension asset management company. This employee reports to the National Bank of Slovakia on an annual basis.

Taxation of contributions and benefits

In the third pillar, the employee contributions to the voluntary pension pillar are tax-free up to a limit of €323 per year, while employer contributions can be deducted from the income tax base up to 6% of the employee's salary. Investment income is taxed at 19%. Benefits are currently tax-free.

OVERVIEW OF PRIVATE PENSION SYSTEMS IN OTHER MARKETS

CZECH REPUBLIC



The voluntary pension fund market (third pillar) in the Czech Republic is well developed, covering about 4.5 million people at the end of 2010, some 60% of the working population. Approximately 25% of members receive contributions from their employers. Unlike most other countries in the region, however, there is currently no mandatory second pillar.

Voluntary pension funds were introduced as legal entities in 1995 as part of a major reform of the retirement system. Employees obtain personal tax relief on contributions within defined limits, and a state subsidy is also payable. More recently, tax relief was introduced on employer contributions and the share of employers who contribute to their workers' pension schemes has increased to around 25%.

Contributions remain low, however—employee contributions are around 2% of average gross salaries and this is one of the main problems for the system. The minimum monthly contribution is €4 (CZK 100) and the total contribution level is ultimately defined in the contract with the pension fund managing company. The state contributes a monthly amount of minimum €2 (CZK 50) and maximum €6 (CZK 150). On average, the monthly contribution translates into an amount of approximately €16 (CZK 400).

The amount of a benefit is defined in a pension contract and in most cases is paid out as a lump sum.

There has been extensive consolidation among pension fund companies, with the number falling from over 40 in the early days of the system to 10, managing total assets of just under €9.3 billion. The conservative investment policy of pension funds, with around 84.5% of investments in bonds and only 4.5% in equities, has decreased the negative impact of the financial crisis. This also reflects the guaranteed returns that pension funds are required to provide under legislation—any losses in their annual performances must be made up by shareholders.

Proposed reforms to the third-pillar system include:

- The introduction of a second version of the current voluntary third pillar with multi-funds (lifecycle portfolios) but without a guarantee
- Similar to Pillar 2, the transformation of providers from pension funds to pension companies
- The introduction of the separation of the shareholders and participants' assets
- Change in the coverage rate through the encouragement of higher contributions

The changes to the voluntary pension scheme are planned to be enacted by the parliament at the beginning of 2012. The first contracts should be then signed in July 2012 and the amended system should be effective from January 2013.

For the newly created second pillar, the following structure will be introduced:

- Maximum age of entry will be set at 35 years old.
- As a special offer, only during the period of the six months between January 2013 and July 2013, there will be no age limit.
- Contributions will be set at 2% of salary from each member's pocket plus 3% diverted from the first pillar.
- Pension funds will become pension companies.
- Benefits will take the form of lifetime annuity, annuity with guarantees, or term annuity.

SLOVENIA

Pension legislation provides for several types of pension vehicles in Slovenia, but these mainly operate on a voluntary basis–there is no mandatory second pillar, other than for public employees or employees in jobs deemed to be hazardous.

Voluntary supplementary pension schemes are provided by mutual pension funds, pension companies, and insurance companies licensed to provide supplementary pension insurance. Tax relief is available on employee and employer contributions. Mutual pension funds can operate on an individual or collective basis and may be open or closed.

In 2009, the Slovenian government proposed a reform of the Slovenian pension system, some of the goals being the establishment of the principle of dependence of payments on contributions and the increase of the pension age to 65 for both sexes. However, in June 2011 Slovenians rejected the proposed reform in a national referendum.

Total pension fund assets were some €1.8 billion at the end of 2010, with around 540,000 members covered. There are currently 11 pension fund operators in the market. There is a special role of the state-owned *Kapitalska družba* (Capital Company), which keeps a monopoly for the Mandatory Supplementary Fund (SODPZ, with approximately 42,000 members and €0.3 billion in assets) and the Public Employees Fund (ZVPSJU, with approximately 200,000 members and €0.5 billion in assets).

CROATIA

Croatia has a three-pillar pension model, with a mandatory second pillar and voluntary third pillar introduced in 2002. The second pillar is mandatory for younger workers under age 40 at the time the reform was implemented in 2004, while those between 40 and 50 could choose either the first or second pillar and those over 50 remained in the first pillar.

There were four second-pillar mandatory pension funds at the end of 2008. Detailed quantitative investment limits apply to pension fund managers, who also have to guarantee a return based on the average fund performance.

The third pillar consists of open voluntary pension funds and occupational pension funds that are sponsored by individual companies. Taxation incentives are available to encourage participation. There were six open and 15 closed third-pillar funds at the end of 2008.

In response to the financial crisis, the government stated that it was considering possible changes to the pension system, including allowing individuals to switch out of the second pillar, but to date no major changes have been introduced.

Some 1.6 million individuals are covered under the second- and third-pillar systems in Croatia (out of a workforce of 1.7 million), although take-up in the third pillar is very limited with just 144,000 individuals. Total assets of the mandatory funds were €3.2 billion at the end of 2008, making Croatia one of the mid-sized pension markets in the region.

ESTONIA

The second pillar covers some 600,000 individuals with assets totalling €1.07 billion (6.88% of GDP) managed by six pension companies in as of the end of 2010. The government in Estonia suspended contributions to the second pillar for two years from 1 June 2009 (only 2% employee contributions remained), aiming to restore full contributions at 6% (2% for employee and 4% for employer) starting in 2012. Contributions are obligatory for members 20 years of age at the moment of product launch and for new members of the work force. They are optional for persons between 20 years of age and 60 years of age. There is separation between the fund and the administrator. The retirement age is 60 for women and 65 for men. Estonia has the concept of multi-funds, where an administrator can offer more than one fund varying by risk type.

The maximum investment limits are 1) less than 35% must be invested in bank deposits (with not more than 5% in one institution), 2) less than 50% must be invested in shares, 3) less than 20% must be invested in real estate with not more than 10% in one object, and 4) not more than 30% may be invested in other funds. The maximum commission on surrender is 1% of net assets. Asset commission is variable based on market value of assets, but cannot be greater than the state limit, which also varies.

There are no minimum guarantees and no major restrictions as far as international investments are concerned. There is a national pension guarantee fund. Pension management companies are obliged to make single (at fund registration) and quarterly contributions to the guarantee fund. The amount of quarterly contributions is not more than 0.1% of NAV. The guarantee fund is aimed to compensate pension fund members in case of losses (this includes all losses except those caused by the violation of investment restrictions).

The administrator must constitute a reserve which is a maximum of 2% of the value of assets of the fund. If the reserve is not sufficient, own funds and then the assets of the guarantee fund are used to compensate the shortfall.

The voluntary third pillar was launched in 1998 and can take two forms, 1) pension insurance policies provided by life insurance companies or 2) voluntary pension funds managed by asset managers. Public policy does not promote occupational pension provision. Employers can make contributions for their employees in the third pillar, but unfavourable tax treatment is an obstacle.

Employees are given tax incentives to participate; contributions can be deducted from taxable income up to 15% of the annual income. Pension benefits are taxed at the reduced rate of 10%. Benefits can be paid out as lump sums or life annuities. Life annuities are exempt from income tax, provided that they are paid periodically in equal or increasing amounts. Investment income is not taxed.

Investment restrictions for voluntary pension funds are not as strict as those for mandatory funds. For example, there are no maximum limits for equity investments and there are no limits for securities issued by low-rating issuers. Limits for securities by a single issuer and real estate investments are also less strict. Fees for voluntary pension funds are not regulated, but there are certain information requirements.

At present, four pension fund management companies offering 15 voluntary pension funds are operating in Estonia. Employees can also choose from 11 pension insurance products.

Participation in the voluntary pension funds increased steadily: There were 24,000 members at the end of 2006, representing 4% of employees. In 2006, 75,000 people purchased life insurance. The number of of participants increased to more than 42,000 participants in 2007 and reached 50,000 (7% of the workforce) in 2010.

Assets can only be withdrawn after the age of 55. If members withdraw their assets before retirement, income tax advantages are lost.

LATVIA

The second pillar covers 1.1 million individuals with assets totalling €858 million managed by 10 pension administrators as at the end of first-quarter 2011. The Latvian government decided to cut contributions from 8% to 2% in 2009 until 2010, increasing to 4% in 2011 and 6% in 2012.

Of the total members, 58% joined the second-pillar system on a compulsory basis and 42% voluntarily. It is mandatory for new employees, but also for employees under 30 years of age at the moment of product launch. It is optional for those between ages 30 and 49. People older than 50 years of age are not allowed to join. It has been functional since 2001. Retirement age is 62 for both men and women.

The Latvian system does not offer minimum guarantees.

The products have three levels of risk, 1) maximum 30% in shares, 2) maximum 15% in shares and 3) 0% in shares and 100% in fixed income instruments. Commissions are calculated as percentage of net assets, but they are not regulated. There is no transfer penalty.

The voluntary third pillar consists of open and closed pension funds offered by private pension fund companies. It was launched in 1998 and includes occupational schemes and individual schemes. Pension plan assets can be managed by credit institutions, life insurance companies, investment firms, and asset management companies. Both defined contribution and defined benefit forms are offered and there are six private pension funds operating. Contributions of up to 10% of annual income are tax-deductible. Investment income is taxed, while benefits are tax-exempt up to a certain limit. Investment rules are more relaxed than Pillar 2; investment in real estate is permitted up to 15%.

LITHUANIA

The second pillar (which is optional as there is no obligatory system) was launched in 2004. As at the end of 2010, it covered more than 1 million participants, with assets totalling €1.12 billion (4.1% of GDP) and seven administrators. At the beginning of 2009, the Lithuanian government decided to cut contributions from 5.5% to 2% for two years. The market is concentrated; market share is 56% for one company and the first two own 90%. Lithuania has a multi-fund system and the retirement age is 62.5 for men and 60 for women.

There are no minimum guarantees and no major restrictions in terms of international investments. Administrators must offer at least one fund with conservative investment (i.e., a majority of investments in government bonds).

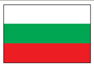
Investment limits are 1) at most 20% in real estate and 2) no limit on shares investment. The maximum administrator commission is 10% of contributions (the actual market average is around 3%), 0.083% per month (1% per year) of assets, and up to 2% of the value of the first transfer each year (4% for subsequent transfers).

The third pillar (also voluntary) consists of individual pension accounts managed by private pension fund companies. It was launched in 2004. Third-pillar pensions are not well developed in Lithuania. Individuals and their employers can contribute to voluntary pension funds. Contributions are tax-free up to 25% of annual income, and any amount above that level is taxed at a reduced rate of 15% (rather than the regular rate of 27%). At the end of 2010, 23,900 participants had joined supplementary voluntary pension funds; assets under management amounted to €28.7 million. As is the case for second-pillar funds, the market is greatly concentrated. The two leading pension providers (Finasta Asset Management UAB and SEB VB investiciju valdymas UAB) account for 94% of total third-pillar assets. The bulk of assets is invested in mutual funds (50%), followed by government bonds (15%), equity (13%), and corporate bonds and deposits (8% each).

In 2006, the Lithuanian parliament passed a law that enables the creation of occupational pension schemes and group life contracts. It is envisaged that many aspects of the occupational pension plan, including fee levels, can be negotiated through collective bargaining and laid down in collective agreements. This could become something of a fourth pillar in the future, but a scheme has yet to be created.

There is draft legislation which aims to reduce the maximum allowed charges applicable for Pillar 2 pension funds: Contribution charges are proposed to gradually decrease to zero by 2016 starting from 2% in 2012; asset management charges would drop to 0.5% for conservative funds and to 0.8% for non-conservative by 2017.

BULGARIA



Bulgaria adopted a three-pillar pension model following a new pension law in 2000, although private voluntary pension funds existed before that. All second- and third-pillar pension funds are established and managed by pension insurance companies.

There are two types of mandatory pension funds in Bulgaria, universal (UPF) and professional (PPF). Employees and self-employed persons born in 1960 or later must become members of a UPF. Those in hazardous jobs must also become a member of a PPF. A pension insurance company may establish and manage only one UPF and one PPF. UPF contributions are paid by both employers and employees, while for PPFs they are paid by employers.

The second pillar has contributions of 5% of gross salary. The retirement age is 63 for men and 60 for women.

The second pillar covers 3.16 million participants in funds offered by 10 administrators containing €1.34 billion in assets (3.97% of GDP). There is a minimum guarantee relative to competitor performance (the minimum guarantee rate for Pillar 2 is the minimum between the average rate minus three percentage points and 60% of the average rate annualized of all pension funds in the last two years). The minimum rate is determined separately for universal and the occupational funds.

The investment limits are a minimum 50% in instruments guaranteed by the state, a maximum 20% in shares, a maximum 30% in mortgage bonds, and a maximum 20% foreign instruments. Maximum administrator commissions are 5% of contributions, 0.083% per month of net assets (1% per annum), and about €10 for transfer between funds.

The third pillar consists of supplementary voluntary pension funds (VPF) (launched in the middle of the 1990s), and supplementary voluntary pension funds with occupational schemes (VPFOS), which is essentially a fourth pillar launched in 2007.

MOLDOVA

There is no obligatory pension scheme in Moldova. A draft law issued on 13 April 2011 aims to regulate the legal framework regarding constitution, activity, and fusion of facultative pension funds, as well as organisation and functioning of administrators and depositories of facultative pensions. This law becomes in force six months after its publication, the date on which the law regarding non-government pension funds, nr. 329-XIV from 25.03.1999, is annulled.

Participants can contribute part of their salaries (contribution is tax deductible up to 15% of annual salary and no contribution limit is proposed) towards the facultative pension system. A percentage (4% proposed) of gross contributions is deducted, representing administrator income, the remainder being converted into units. The unit price is modified to reflect investment activity. The updated unit price is then used to calculate the personal asset, which added up represents the net assets of the fund, out of which a proposed 2.5% asset charge is taken out as administrator income.

The facultative pension system is very similar to the one proposed by the Romanian legislation, with a few important differences:

- The proposed contribution charge is different between the two countries. The contribution charge in Romania is 0.5% modified in norm 6/1020 from 5% in the original pension law, whereas in Moldova it is 4%.

- There is no limit on the amount of contributions allowed in Moldova, whereas in Romania there is a limit of 15% of gross salary allowed.

- There are differences with respect to deductibility. In Moldova, there is a 15% maximum which is tax deductible, whereas in Romania, there is a €400 limit for both the employer and the employee.

- The Moldovan law allows for EU-registered companies to participate.

- The Moldovan law introduces a requirement for a solvency margin which is missing in the Romanian law. The Romanian law relies primarily on the guarantee fund.

- There is no specific norm in Moldova for technical reserve calculation (in Romania the relevant law is 1/2008), so the technical reserve calculation is principle-based. The calculation is left to the actuary.

UKRAINE

Currently, Ukraine operates with only two pillars of the classical three-pillar system. The pay-as-you-go system was complemented in 2004 by the voluntary third pillar. The second pillar has not been implemented yet at this stage, although the government has stated 1 January 2013 as a possible launch date.

Voluntary system

The third pillar of the Ukrainian pension system commenced in 2004 after the law governing the system came into effect. The system works in a similar manner to third-pillar systems in other markets. Individuals have a right to open a personal account in a non-state pension fund (NPF). NPFs can be of three distinct types: corporate, professional, and open. Participation in these funds is voluntary.

NPFs are financial institutions which accumulate funds and make payments of additional voluntary pensions to their members. Other participants in the system are administrators of the pension funds and asset management companies.

The system works as a defined contribution system where final pension payout is determined based on funds accumulated until retirement age. The pension can be paid out in the following form: fixed-term annuity, lump sum (only in case of permanent invalidity, critical illness, death of the member or when the member permanently leaves Ukraine), or life annuity.

The charging structure of voluntary system allows for the following costs to be covered from the assets of the NPF:

- Administrator charge – Set by the Financial Services Markets Regulator – up to 6% of contributions for open funds, 5% annually for corporate and professional funds[12]

- Asset management charge – Set by the Securities and Exchange Commission – up to 4.2% annually of average assets under management[13]

- Depository charges – Set by the Securities and Exchange Commission – up to 0.5% annually of average assets under management[14]

- Other charges

[12] Source: Р О З П О Р Я Д Ж Е Н Н Я 22.06.2004 N 1102 Про затвердження граничних тарифів на оплату послуг адміністрування недержавного пенсійного фонду

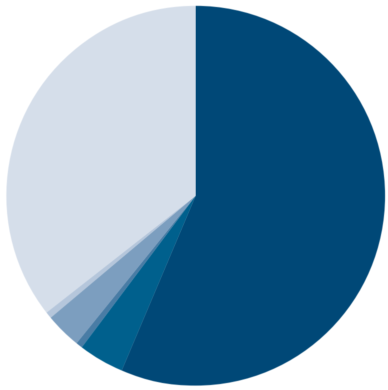
[13] Source: Р І Ш Е Н Н Я 11.08.2004 N 336 Про затвердження Положення про здійсненнядіяльності зберігача недержавного пенсійного фонду щодо операцій з активами недержавного пенсійного фонду, порядок обчислення тарифів за послуги зберігача та їх граничний розмір

[14] Source: Р І Ш Е Н Н Я 11.08.2004 N 336 Про затвердження Положення про здійсненнядіяльності зберігача недержавного пенсійного фонду щодо операцій з активами недержавного пенсійного фонду, порядок обчислення тарифів за послуги зберігача та їх граничний розмір

Charge limits are set quite high. Given current market conditions, NPFs make good use of these high limits – on average total charges during 2010 were around 5.6% of total pension funds' assets. At the same time, the average investment return achieved by the asset management companies was 17.2% (with the CPI being 9.2% for the same period). The structure of the charges by type is shown in the graph below:

FIGURE 66 - NPF CHARGING STRUCTURE

Asset management charge	56.6%
Depository charges	3.9%
Fees for NPF Audit	0.5%
Other charges by third parties	3.0%
Other charges	0.5%
Administrator fees	35.4%



The non-state pension funds system has been quite actively developing in recent years, which can be seen in the system metrics below:

FIGURE 67 – MEMBERSHIP AND ASSETS OF NPFS

				CHANGE	
	2008	2009	2010	2009/2008	2010/2009
PENSION FUND MEMBERS (THOUSANDS)	482.5	497.1	569.2	3.0%	14.5%
ASSETS (MILLION UAH)	582.9	754.6	925.4	29.5%	22.6%
ASSETS (€ MILLION APPROX.)	53.7	65.9	87.5		

Source: State Commission for the Financial Services Markets Regulation of Ukraine

Mandatory system

The mandatory system has not yet been launched. There are several draft laws suggesting what the system may look like, so the main characteristics of a potential Pillar 2 system for Ukraine are based only on draft legislation and may change during actual implementation.

Below is the summary of main features of the proposed system:

- The effective date for the second pillar is set to be the first January 1 after the state pension fund closes the previous year without a deficit.
- Members – All individuals who are younger than 35 at the time of system being effective.
- Contribution level – 2% in the first year of implementation with annual increase of contribution rate by 1% until the rate reaches 7% of gross salary.

- During the first two years, the state pension fund will be the administrator of the system. From the third year onwards, members will be able to transfer their funds into NPFs.

- Asset management during the first two years will be carried out by asset management companies selected by the state pension fund using a tender process. From the third year onwards, assets will be managed by asset managers selected by each NPF.

- The system will be defined contribution in nature.

- The NPF will be able to charge up to 5% of AUM to cover its expenses.

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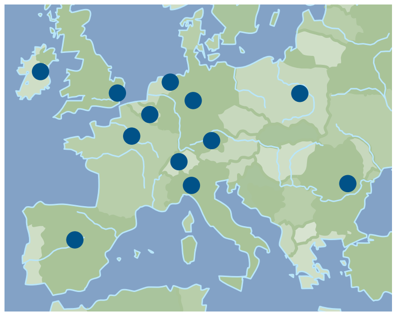

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