



# INTERNATIONAL PENSION NEWSLETTER



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## INTERNATIONAL TRENDS:

### REVIEWING FEE POLICY

The lower returns of financial placements are pushing participants to scrutinize where exactly their invested money is going. A major issue is administrative fees. While in the good times participants had little leverage over the fees they are charged by managers and administrators, now investment and pension funds are being asked to explain the fees they are receiving for their services. Are the fees justified? Are they transparent? Should they be reduced to mirror reduced returns? These are some of the questions being asked by regulators and participants of both defined contribution and defined benefit schemes (see IPN #3) the latter's administration often being difficult to understand for a layman).

Governments and investment management companies around the world are reviewing fee policy and structure to inject flexibility into the way pension fund administrators are being paid for their services.

#### Global: Report Indicates Fees Likely to Decrease

A report by pension consultancy Mercer found that asset management fees remained stable in 2008, but are likely to be under serious pressure in 2009. Mercer predicts asset managers will show greater willingness to negotiate fees downwards this year and beyond, under pressure from the economic downturn. The survey – analyzing fee data of 19,000 asset management products from 3,400 investment management firms around the world – found alternative investment strategies had the highest fees for each dollar of investor capital allocated. The report found the most expensive mainstream asset category is global emerging markets equity, with median fees in the sector averaging around 0.9% of assets under management.(Mercer)

#### Slovakia: Parliament Slashes Fee Rates

The Slovak Government passed a draft law cutting the fixed fee that pension fund management companies can charge in the second – or capitalized individual accumulation account - pillar of the pension system. According to the Government's proposal, the payment made to pension management companies for the administration of pension savings should consist of a fixed and variable part. The change will be effective as of beginning of next year. The monthly fixed requital will be decreased from current 0.065% to 0.025% of assets



under management; the rest of the payment will be tied to the increase in new value added to pension assets. The pension fund management companies will have to launch a special fund for each of their investment funds which will collect the yields. If the yields are positive, then the management companies are allowed to take a percentage of the yield as administrative fees. Some asset management companies consider the measure a short-sighted anti-crisis measure, arguing that the planned fees are too low and that the six month time frame does not make sense in the context of pension investments' long-term logics. (The Spectator)

### **U.S.: High Court to Hear Suit over Fee Differences Among Clients**

The U.S. Supreme Court has agreed to hear a case over management fees. Investors in Harris' Oakmark mutual funds are accusing Harris of charging excessive fees because it was charging them more to manage their mutual funds than to manage pension funds. Critics have long complained that investment firms charge much higher fees to individual mutual fund investors than to pension funds and other institutional investors for the same services. Critics say that mutual fund companies incur little additional costs when adding mutual fund investors. In fact, they argue that the levies charged to newcomers "represent almost pure profit" to fund managers. Fees have become a highly charged subject in recent years as Americans have come to rely on 401(k) plans to finance retirement and assets shrank last year in the stock market collapse. The willingness of fund managers to lower fees will depend largely on the Supreme Court ruling, experts say. (LA Times, Baltimore Sun, Investment News)

### **U.S.: Pension Middlemen's Fees Scrutinized**

In the United States, asset management firms compete to gain the right to manage the enormous pension funds of individual states' pension funds. Asset managers are ready to pay well-connected middlemen millions of dollars to cinch an investment contract with funds like the California the state public employees retirement system (CalPERS) that holds US176bn dollars in assets, or the state employee pension fund of the state of New York (122bn dollars). For instance, in the state of New Mexico middlemen received over US30 million in fees. While the practice of hiring placement agents is not reprehensible per se, a number of scandals have shown that this system is riddled with abuse: the unregulated nature of the business makes it vulnerable to fraud and corruption schemes. Middlemen often fail to register with a broker-dealer as required by law, and there are no clear rules on disclosing fees to intermediaries. State officials are now trying to get these "placement agents" under control. 30 attorneys general are setting up a task force to share information to prosecute wrongdoing and to push for increased transparency. In California, CalPERS adopted a new policy obliging asset management firms they work with to disclose fees paid to placement agents. It appears the industry is beginning to get the message. The Carlyle group, one of largest private equity funds, has agreed to pay 20 million dollars following an investigation into an alleged kick-back scheme to secure pension money. Carlyle also pledged to adopt a "code of conduct" that would regulate its fees to middlemen. New York's influential prosecutor general Andrew Cuomo said that

Carlyle's acceptance is important because if "they accept this level of conduct, it says it is feasible for the entire industry". (www.stateline.org, the Financial Times)

## **POLICY:**

### **GOVERNMENT POLICIES REFLECT CONCERN ABOUT CRISIS**

#### **Hungary: "13th Month" Solidarity Pension Scrapped to Limit Budget Deficit**

Hungarian Parliament adopted a series of drastic measures to try to keep the budget deficit in check at less than 3% GDP according to conditions attached to an IMF loan it began receiving last year. The plan includes higher taxes, and reduced state spending, including most notably scrapping the practice of paying pensioners a "13th month" of pensions. (Guardian.co.uk/Reuters)

#### **Romania: Government Plans to Do Away with Special Pensions**

The Romanian Government has pledged to prepare a draft law on a single public pensions system by June 30 to cancel the special and privileged pensions for certain professional categories. At present, 350,000 persons receive a "special" (higher) pension. In the future, these pensions will be calculated on the basis of the individual's contribution. The reform may introduce a parallel occupational pension system through which each group of professionals will have their own system for getting a pension. The new system will 'be applicable to everybody, be they magistrates, spies, diplomats or ordinary workers', a Romanian newspaper explained. The state news agency Agerpress devoted a special press review to the coverage of the pension reform. One daily newspaper, Gandul made a strong case in favor of the reform, arguing that it was a condition for receiving a much-needed loan from the IMF. "Absolutely all international financial institutions ... have noticed the huge hole driven in the state budget by our parallel pension systems. [International organizations] don't want to put [money] into a broken bucket." (mediafax.ro/agerpres)

#### **Romania: Towards a Life Cycle Model and Reserve Fund?**

The Government is considering two important measures to improve its pillar II and pillar III pension schemes. First, the creation of a reserve fund out of the assets of the fund managers (not of the participants' contributions). This reserve would be used to cover payments to members in case of difficulties due to increase in longevity. The other new measure to be introduced in 2010 would be to have pillar II funds offer more than one portfolio with different risks and exposure depending on the age of a member. (IPE.com)

#### **Ireland: Workers Want Better Protection Against DB Fund Insolvency**

Benefit protection for DB fund participants has become an on-going issue since companies are closing down or declaring insolvency in the wake of the recession. The Government has announced a series of measures to reduce the effect of company insolvencies on DB pension benefit payments,



including the creation of a Pensions Insolvency Payment Scheme (PIPS) to protect workers. However, this new regulation does not cover solvent companies that close down or sell their business. SIPTU, a major trade union representing over 200,000 Irish workers, says regulation and enforcement of DB funds is insufficient. The union argues that the regulator and other authorities have little power in cases when the company is solvent. In the UK the regulator can make a solvent company fund a deficit in its pension fund. However, SIPTU claims the Irish “Government never set up the safeguards that exist in other [EU] member states.” The union asked that the Irish Pensions Board receive the same powers as the UK regulator to address pension deficit before the company is sold. For example, SR Technics, a company in the process of closing down its business, was allowed to walk away from a € 26 million funding deficit, possibly leaving many participants with just a fraction of the pension they were promised after contributing for years. A labor court had recommended part of SR Technics debts be settled, but the company maintained that its financial situation did not allow it to. An Irish European deputy Prionsias De Rossa said SR Technics pension deficit “reinforces the calls for a properly funded occupational pension scheme in Ireland.” (SIPTU press release, Fingal Independent)

#### **Finland: Self-Employed “Under-saving” for their Retirement**

Finland’s self-employed are not contributing as much as they should be according to their income. Self-employed are under the obligation to contract a “self-employed persons pension insurance (YEL), however, workers have certain flexibility in deciding how much to contribute. According to the guidelines laid down by the Finnish Centre for Pensions, the central organ of the statutory pension scheme, these provisions should be equivalent to those an employee would pay. But in reality, self-employed workers’ pension insurance is about 1/3 less. (IPE.com). *Editor’s note: The good news is that the self-employed appear to be contributing about 2/3 of the amount they should be contributing. This is much better than in nearly any other country where the income of the self employed is self-declared.*

#### **OECD: Guidelines on Using Funds to Finance Recovery**

The OECD warned against using pension reserves for other purposes than the ones they were set up for in a paper on *Private Pensions and Policy Responses to the Crisis*. Governments throughout Europe are considering using pension reserves to finance a variety of anti-crisis measures, whether to recapitalize banks like in Ireland (IPN#1), to finance infrastructure projects (IPN#4), or to let households that are in several financial difficulty to access funds head of time to pay back loans (Iceland IPN#3, Australia, Spain). The OECD warned such measures could endanger retirement income in the future. The organization nevertheless suggested ways of improving the security of DC schemes through the “careful design of default investments and payout options” including lifecycle funds (like those being considered in Poland IPN#4, and Romania see this issue) but admitted that a “timing risk” still existed when moving from one type of scheme to the next. (IPE.com, OECD)

## **STRATEGY:**

### **DIFFERENCES IN STRATEGY SHOW NO SINGLE SOLUTION**

#### **United States: Top Companies Continue Shift to DC Plans**

A majority of Fortune 100 companies (top ranking US companies by gross revenue) stopped offering Defined Benefit plans to new salaried employees. Instead, they are offering Defined Contribution or hybrid schemes with a mix of defined benefit (DB) and defined contribution features. This illustrates growing concern by employers that the costs and risks linked to defined benefit pension plans are becoming too serious a liability. Because in DB schemes companies pledge to paying out pre-determined amount until the pensioner’s death, longer life expectancy and volatile markets are putting increasing pressure on employers. While in 1985 traditional DB plans outnumbered DC plans 89 to 1, in 2005 there were 34 traditional DB plans for every 37 DC plans (and 29 hybrid plans). By 2009, DC plans outnumbered DB plans 45 to 1. (Watson Wyatt)

#### **Thailand: State Fund Reduces Foreign Equity Holdings....**

The Government Pension Fund, the country’s largest money manager cut overseas equity holdings from 9.1% down to 6% despite a slightly more optimistic performance of international stocks, according to the Fund’s Secretary General Visit Tantisunhorn. He told Bloomberg news agency that the fund is waiting to see if there’s a “sustained comeback” and would, in the meantime, remain conservative on equities. He said that the fund would want “more bonds in the market”. The state retirement fund lost 5.1% last year its first annual decline since it was set up in 1996. Thailand is South East Asia’s second largest economy. (Bloomberg)

#### **.... while Norwegian Fund Buys Up Equity**

Norway’s central bank managed Pension Fund has been buying up equities to take advantage of low valuations. Up to 40% of all the stock it owns was bought last year when prices were falling. The bank’s Deputy Governor Jan Qvigstad said that the fund’s investment strategy states that more equities are to be purchased when equity prices are down. Its exposure is going from a 40-60 split in favor of investment in fixed-income instruments to 60-40 in favor of equities. He argued that the fund’s long term views justified high equity allocation, enabling it to ride out fluctuations.

#### **United Kingdom: Top companies’ Funds Make Switch to Bonds**

100 most highly capitalized UK companies listed on the London Stock Exchange, defined as the FTSE 100, are increasing and accelerating their shift from equities to bonds, according to a study by a JP Morgan Cazenove subsidiary, Pension Capital Strategies. The report finds that the average pension scheme has increased its asset allocation to bonds to 47% from 40% over last year. “This represents the largest 12-month shift in investment strategy for more than 20 years, and comes on top of a very significant shift from 34%” in bonds



already the year before. the Financial Times wrote. The pension schemes of the FTSE 100 companies are currently facing a total deficit of £50bn - down from a positive £86bn on the schemes' position just one year ago. The shift towards bonds reflects not only the effect of financial turmoil but also Government pressure to make pension schemes safer, PCS director Cowling told the newspaper. The analyst says that this trend will continue as companies will try to "wind up pension schemes." *Editor's note: to wind up a pension scheme means to terminate it. At a minimum, the companies will probably try to close the schemes to new entrants.* Estimates in January indicated that 14 companies in the FTSE 100 had a market value lower than the future liabilities of their pension funds. Even if they don't necessarily show a pension fund deficit this could indicate that the economy is not growing quickly enough to finance defined benefit schemes. Not only market instability but also increased life expectancy is putting pressure on DB schemes. In 2008, data from 30 companies in the FTSE 350 showed increases in life expectancy assumptions by an average of six months in 2007. This added about £8 billion to pension liabilities. (IPE.com, Financial Times, com, Times.online)

### **Bahrain: State Fund Plans Switch to Equity**

Bahrain's state-owned Social Insurance Organisation (SIO), the country's only pension fund with US\$4.5 bn in cash, is expected to invest about half of it in European and US stocks and bonds. At present more than 80% of its total allocations are in the local economy, including a large chunk in land. However, 50% of its assets are held in cash, an exposure that the managers plan to reduce to 30% of total assets by investing in "solid equities and bonds across the US and Europe" where market pricing "looks very attractive", CEO Shaikh Mohammad Eisa Akl Kharifa explained last month. SIO plans to entrust a separate asset management company with the management of the funds under strict supervision by the country's central bank. More than 45,000 Bahraini employers are registered with the SIO. For Bahrainis' pension, the employer pays 9%, Bahraini employees pay 6% and the government makes an equal contribution. (Gulfnews.com, Gulf-daily-news.com)

## **MARKETS:**

### **DC FUNDS SHOW OPTIMISM**

#### **Slovakia: Slight Positive Growth for Pillar II Funds**

Slovak pension companies managing second pillar funds showed positive returns in their activities performed from the beginning of January through the first week of April. The increase of pension assets was 0.5%. These 6 companies are managing 2.44bn euro in total assets compared to 2.23bn euro at the end of 2008. Rating agency Fitch states: "Reform of the public pension system has placed Slovakia in a stronger position than many euro area members to cope with the long-term costs of an ageing population." Nevertheless, there is a risk that this strength can be undermined because of continuing government attempts to support policies that are lowering participation in the second pillar pension system. Slovakian prime-minister Robert Fico tries to encourage Slovaks to opt-out of the second pillar and, thus, intends to cut basic fees for pension funds from 0.065% to 0.025% (see above) and add a performance-related fee. (IPE.com)

#### **Austria: Funds Show Better Results**

For the first time this year Austrian pension funds (pensionskassen) turned their performance indicators into positive figures in April. Fritz Janda, head of the association of pension funds in Austria FVVK, claimed: "The experts in the pensionskassen have drawn their conclusions from the financial crisis and changed the asset allocation accordingly. The average equity quota of pensionskassen was 25% at the end of 2008 compared to 35% in June 2008, and allocation to bonds was 73% while exposure to real estate made up 2.3% of total assets compared with 1.8% in 2007. Pension funds issues have also entered EU election campaigning in Austria. Social Democratic candidate for the European Parliament has blamed the EU for "taking away" old people's money by "recommending they rely on funds rather than state pension provision for their retirement." (IPE.com)

#### **Ireland: Funds Boast Second Month of Positive Returns**

Irish managed pension funds showed positive returns with an average yield in April of 8.7%. But it will take a long time for pension funds to recover from losses they went through the last 18 months experts from Hewitt, a market consultancy, say. Hewitt's Managed Fund Index which measures funds' performance lost 34% in 2008, plus another 5.5% in the first quarter of 2009. Due to recoveries in global equity markets Hewitt explains the improved returns through the recovery in global equity markets. In fact, the Irish equity market performed best with a return of 19.6% in April, the Eurozone 13.3%, the UK 12.9%, Asia Pacific region 12.9% and North America 10.3%. Brian Delaney, investment consultant at Hewitt Associates, showed careful optimism: "We believe any extended recovery will take time to develop and expect economic data over the next 12 months to show continued weakness. However, there are initial indicators that the pace of the decline across global economies is decelerating." (IPE.com)

#### **Romania: New Pension Fund Gets Green Light**

There are now 12 funds operating on the voluntary pension market and 10 administrators. The scheme has 162,220 participants and accumulates almost 110,5 million lei (US 36.8 million) of net assets. The 12<sup>th</sup> one – Aviva Pensia Max - appeared in Romania at the end of April and it has a high risk profile meaning that medium and high risk instruments make up 35-50% of all the fund's assets. (wallstreet.ro)

## **SURVEYS:**

### **HOUSEHOLD SAVINGS AND CONSUMER BEHAVIOR**

#### **India: Two-thirds of Households Say Saving Top on List**

According to a recent survey, Indian households see saving and paying back loans as top priorities: Nielsen Global Consumer Confidence study shows that for 66% of Indians putting extra resources into savings after covering essential living expenses is most important. Paying off debts/credit cards/loans is the second most popular thing to do with spare cash (38 % of Indian votes). The study, held twice a year, tracks consumer confidence, major concerns and spending habits of Internet users in 50 countries. India ranked No. 3 in its Consumer



Confidence Index (CCI) with 99 points, behind Indonesia which topped the rankings (104 points) and Denmark (102 points). (Televisionpoint.com)

### **Germany: Households Confident about Retirement Savings**

According to a study conducted by JP Morgan Asset Management, Germans have continued to save for their retirement, despite the uncertainties on the stock markets. At least 40% of those questioned said they save privately for their retirement. About 40% also said they did not save for their retirement. Of those who save for their retirement, 7% put aside between 1 euro and 49 euro per month, while 8% save between 50 euro and 99 euro and 7% use the money to pay off a mortgage. In its analysis, JP Morgan said “there was no evidence of panic among savers and retirement funds were not being emptied.” (IPE.com)

### **Lithuania: Survey Shows Saving Becomes More Popular**

Saving is gaining importance with Lithuanian households, according to a survey of the resident opinion carried out in February – March 2009. Although Lithuanians’ ability to save has been negatively affected by the financial crisis, about half (51%) of the respondents indicated they spent all or most of their monthly income and had no money to save (as compared to 44% in late 2007), the idea of saving was approved by an absolute majority of respondents. “The economic crisis seems to have enforced the attitude of saving. People are experiencing severe feelings of uncertainty about their tomorrow, therefore to a much higher extent they accentuate the importance of saving”, says Vaidas Cibas, the Vice-Chairman of the Securities Commission. For 49% of the respondents the main purpose of saving is to ensure financial security for unforeseen events, 22% were seeking to save for children’s education, 17% for their retirement and inheritors, the rest seek to increase their income and assets and to secure the accumulated funds. The most popular means of saving are bank deposits (26% of the residents) and keeping deposits at home (24%), followed by having consumer loans or leasing agreements (20%). ( the official website of the Securities Commission of the Republic of Lithuania – www.vpk.lt )

### **U.S. Survey Shows Retirement Confidence at Its Lowest**

The Employee Benefit Research Institute, a leading U.S. institute on social and consumer issues, says their Retirement Confidence Survey indicates that economic uncertainty has driven Americans’ retirement confidence to record lows. The percentage of workers who believe that they have enough money for a comfortable retirement hit the lowest level (13%) ever recorded in the annual survey since 1993. These workers are not only reporting that they have reduced their expenses (81%), but also that they are changing the way they invest their money (43%), 38% are working more hours or a second job, 25% are saving more money, and 25% are seeking advice from a financial professional. Retiree confidence in having a financially secure retirement also dropped to a new low, with only 20% now saying they are very confident (down from 29% in 2008 and 41% in 2007). Workers also expect to work longer. 89% say they have postponed retirement with the intention of increasing their financial security and 28% say their retirement

age has already changed. The median worker expects to retire at 65, while 21% plans to work into their 70s. (www. ebri.org)

## **THIS MONTH’S ANALYSIS: LICENSING REQUIREMENTS FOR FUNDS MANAGERS IN SIX COUNTRIES**

Editor’s Note:

*This month we examine how 6 countries--Poland, Croatia, Latvia, Estonia, Bulgaria, Chile – attempt to protect Pillar II funds through requirements for fund managers. All of these countries have funded accumulation accounts as their Pillar II and III schemes. These are the types of schemes already existing (Non-State Pension Funds – NPFs) and proposed for Pillar II in Ukraine. International experience in this area is relevant when resolving issues related to improving the way NPFs operate and to implementing Pillar II in Ukraine.*

The institutional frameworks of pillar II schemes vary from country to country. But for every country, the actual introduction of mandatory individual contributions schemes is fraught with key institutional and regulatory issues that must be resolved before going forward. The central issue is how to protect these assets – the pension savings of future generations – which raises a number of critical questions: how can the state, as guarantor of this system, make sure that these savings are safe? Who should be allowed to manage these funds? Should the accumulation account scheme be managed by a single accumulation fund or by private funds? Investment risks aside, how then to protect these funds against mismanagement? The following examples below show the diversity of choices made by transition countries – from South America, Central Europe, and the new EU member states.

The rules these countries impose on those managing pillar II funds have a number of points in common.

First of all, whoever wishes to manage second pillar pension funds is required to produce documents proving their competence as managers and investors (business plans, detailed portfolio plans etc.), the reputation and qualifications of their managers, and information on possible sources of conflicts of interest (shareholders’ other investments, family ties, other appointments, etc.). Also, the assets of the pension fund and those of the management company are strictly separated. Then, in many countries asset managers need to fulfill additional conditions to be allowed to touch pension assets. Finally, the management companies are held personally responsible for losses and lost profit (through reserves made up of their own funds, and by risking bankruptcy if they do not fulfill their obligations.)

### **Poland**

Mandatory individual accounts are set up in Open Pensions Funds (OPF). OPFs are specialized pension fund companies. OPFs are independent legal entities created and managed by a joint-stock company called a pension fund society. The assets of the OPF are separate from the assets of the pension fund society that manages them. The OPF management board manages the investments of the fund assets. The assets are kept by a custodian.



### Licensing is in two steps:

1. Creating a pension fund society: Authorization is from the Insurance and Pension Funds Supervisory Commission (KNUiFE). The candidate applying to become a pension fund society must submit a number of documents describing its financial plans, describing the founders (and their relationships), and proving that the interests of future members are sufficiently protected.

The pension fund society must have share capital of at least EUR 5 million which cannot be from a loan or credit at its establishment, and the share capital must be at least 2,5 million at all times.

The KNUiFE must reject the application if any of the shareholders of the future pension fund society has a tax arrear. The pension fund society has two boards, a management and a supervisory board whose members need to fulfill certain conditions – for instance, education, experience, not interested parties of brokerage firms etc...

2. Creating an Open Pension Fund: Each pension fund society is allowed to run two open funds (one conservative, one more heavily invested in equities). The pension fund society has to apply for a separate authorization to create an OPF and MAY NOT undertake ANY other business than that of managing the funds.

3. Guarantees: The pension fund society creates a reserve account for the OPF from its own resources - about 0.3% or 0.4% of the funds net assets. This reserve account is used to offset eventual deficits (returns below the mandatory minimal return). If the reserve can not cover a deficit, then the pension fund society must cover it with other resources of its own; if the pension fund society can not cover the deficit, it is declared bankrupt. Then a national guarantee fund jumps in (the resources of which may not exceed 0.1% of the cumulative NAV of all OPFs). If the guarantee fund can not cover deficits, then the deficits that are not covered by the guarantee fund are offset by the Polish treasury.

### **Croatia**

Mandatory pension funds are created and managed by Pension Fund Management Companies (PFMCs) that are joint-stock companies or limited liability companies. A PFMC may only create and manage one fund. The fund itself is not an independent legal entity.

### Licensing in two steps:

1. Establishing the PFMC is through a license by the Croatian Financial Services Supervisory Agency (HANFA). Minimum paid in capital of HRK 40 million (more if more than 10 0000 members) is required. There is a guarantee deposit that is kept in a separate account in a custodian bank. Documents to be submitted to HANFA include audited financial statements of the founders for the last 3 years and a business plan, along with other information. The PFMC then registers with the Commercial court.

2. Operating license to operate a mandatory pension fund is also from HANFA. The PFMC must submit a management board with details of the members professional qualifications, non-interested parties, and they must hold a special HANFA license.

The PFMC is responsible for the capital accumulation phase. Then a pension insurance company pays annuities. The pension insurance companies run a single purpose business – providing pension annuities. The insurance company also needs a license from HANFA and must meet a minimum capital requirement.

Within 2 years of their establishment, a mandatory pension fund has to have 50,000 members. *Editor's Note: There is a trend toward specifying a minimum number of members for the pension fund to remain in operation. Slovakia has a much higher requirement.*

### **Latvia**

The mandatory second pillar was introduced in 2001 but for the first 18 months, only the State Treasury was allowed to manage second pillar assets. From 2001 to 2007, private asset managers were gradually allowed into the system. As private institutions could increasingly be entrusted with pension assets, the state pulled out of the pension asset management activity. The Latvian regulator, the Finance and Capital Market Commission, is in charge of supervising the performance of the private providers (whereas the Latvian Treasury was supervised by the ministry of finance).

Licensing: An investment management company needs to receive a special license from the regulator allowing it to manage second pillar assets. The conditions to receive this special permit are particularly stringent for asset managers who have not managed pension assets in the past. Assets are held independently of the resources of the management companies in a holding bank that it is also submitted to close supervision by the regulator.

The Fund manager has the obligation to reimburse in full scheme participants for all losses caused by himself, his employees or officials violating the provisions of the contract.

### **Estonia**

As is standard and best international practice, the participants of a pension scheme actually own the assets of the fund that are pooled and invested collectively by the respective pension management companies.

Pension management companies must have a minimum share capital of EUR3 million.

Assets are held independently of the resources of the management companies.

Conditions for pension management companies to manage mandatory pension funds include receiving a special operating license from the regulator, the Financial Supervisory Authority (FSA). The pension management company may establish several funds if the investment policies of the funds differ significantly. A least one needs to be investment conservatively.

The appointment of a fund manager (who must prove a certain number of years experience and hold a Ministry of Finance certificate) is subject to approval by FSA.

Protection of assets: the assets of a mandatory fund must be kept separate.

Each pension management company must by means of its OWN funds establish a reserve of 2% of the value of the funds under management. This reserve is used for compensation for



loss of assets due to violations of legal requirements, to fraud, and to mismanagement. If the reserve fund is not sufficient, the management company has to use its other own resources. If that is still insufficient, then they are compensated by the Guarantee Fund whose funds are composed of contributions by funds. It also guarantees assets of deposits and investment institutions. Compensation covers 90% of losses of over 10,000 Euros equivalent (up to 10,000 of losses are compensated in full).

### **Chile**

Pension Fund administrators (AFP) must be established as public companies with the exclusive aim of managing open pension funds. Each AFP must establish four funds and may optionally open a fifth.

#### Licensing:

To establish an AFP, an authorization must be received from the Superintendence of Pension Fund Administrators (SAFP). Among other conditions the management needs a minimum capital that is calculated in special accounting units (units with constant purchasing power realigned daily with the Consumer Price Index).

#### Management:

An AFP can manage the funds themselves or contract the management to an asset management company that is established for the sole purpose of managing pension fund assets. The asset management company must be authorized by the regulator and comply with minimal capital requirements.

90% of assets of each fund need to be held by a custodian.

Protection: Pension fund administrators (AFPs) must establish two types of reserves in order to compensate for low investment returns: (i) A return fluctuation reserve for each fund that is funded by returns on investment exceeding certain limits and (ii) a general reserve that is funded with the AFPs OWN assets and must be equal to 1% of value of assets under management.

If both funds are not sufficient, the government covers the remaining deficit, which the AFP has to pay back. If it cannot pay back the State within a certain time period, the AFP is closed down.

### **Bulgaria**

Pillar II is managed by Universal Pension Funds which are independent legal entities created and managed by a licensed joint stock company called a pension insurance company. The same company can manage three funds (one occupational, one universal, and one voluntary).

Licensing: For a license the pension insurance company must apply to the regulator, the Financial Supervision Commission and obtain permission to manage a universal fund (also to manage an occupational fund). After receiving permission it must file an application with the responsible district court for registration of the pension fund.

(sources: ISSA/IOPS “Complementary Pensions throughout the World”, 2008. Allianz Global website; Latvian Finance and Capital Market Commission)

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The USAID Capital Markets Project (CMP) was launched in October 2005, and is a five-year program designed to assist the country in developing a vibrant and effective financial sector. This effort will promote sustained economic growth and reduce the costs and risks to a sound pension system. You can find out more on the CMP website [www.capitalmarkets.kiev.ua](http://www.capitalmarkets.kiev.ua) or on the website about pension reform in Ukraine: [www.pension.kiev.ua](http://www.pension.kiev.ua)

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