



Architectural Digest

Ten years have passed since the initial discussions on introducing private pension plans in Romania. The long wait ended last year with the enactment of proper legislation and the appearance of the first private pension funds. The voluntary pension system (third pillar) was launched in June 2007, followed by the start of the signup period for mandatory pensions (second pillar) in September 2007. That period successfully concluded in January 2008, then, in May, the mandatory pension funds began to accept contributions. The story continues...

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Romania was the last CEE country to leap into private pension reform using the World Bank multi-pillar model. In this lucky position, Romania managed to avoid the usual pitfalls in putting the system into place — thereby becoming “the success story of Eastern Europe” in that regard. Following is a concise recap of the implementation of the system, with the main focus on mandatory pensions.

Master plan

Romania's private pensions system is fully-funded and based on personal accounts, using the defined contribution (DC) philosophy. At one point in the discussions, the possibility of applying occupational pension schemes was considered, but the final product does not contain any occupational features. The second pillar was made mandatory for all employees under 35 years, and voluntary for all employees aged 35-45. The third pillar was made voluntary for all individuals earning income — both employees and the self-employed.

Collection is centralised in the second pillar, and is managed by CNPAS (The National House of

Pensions), while it is decentralised in the third pillar, where employers must funnel contributions into the funds. In all the other cases (self-employed, etc.), voluntary plan participants may direct their own contributions.

Pension funds are managed by newly defined entities — specialised pension companies (second pillar only), while the third pillar legislation also allows life insurance and asset management companies to manage voluntary pension funds.

In the mandatory system, the contribution level starts at 2% of gross monthly income (increasing by 0.5% per year, and reaching 6% in 2016), while in the voluntary system the contribution level is flexible and ranges up to 15% of monthly gross income. Payout phase legislation is slated for adoption in 2009.

Compulsion in brief

As many as 18 funds lined up for the start of the four-month, promotional sales campaign for mandatory pensions that took place from September 17, 2007 to January 17, 2008. Initial estimates saw a market potential of 2.5 million participants opting into the system, with the most optimistic estimates projecting just under 2.8 million pensioners.

Yet, the 2.5 million-participant mark was reached in just two and a half months, thanks to a massive sign-on of employees in the voluntary age cohort (35-45). Over 3,800,000 participants were validated by the end of the signup campaign, with another 333,000 added in the lottery re-allocating participants under 35 who failed to choose a pension fund. Thus, a total of 4,150,000 participants entered the system, which, all in all, exceeded even the most optimistic expectations. The reason cited was that over 90% of participants in the voluntary age group opted in – demonstrating that the system gained the trust of the general population.

Looking at it from the other side, a participation level of 4,150,000 means that only 42% of the total working population bought into the mandatory pensions system, which represents the lowest coverage under second pillar schemes among all ten of the CEE countries employing the system. In those countries, the average level of second pillar schemes among working populations is 65%, according to research conducted by *PRIMM Insurance & Pensions Magazine*. In Latvia, the coverage is 84%, while in Poland, it is 78%, and in Hungary – 65%.

The battle for clients during the initial campaign was fierce: over 261,000 marketing agents were deployed as a sales force for both pension companies (company agents) and pension brokers (external sales force). The brokers represented about 33% of the total sales force, managing to bring in 22% of the total participants (nearly one million participants). To compare, last year's intermediation ratio (brokers' contribution to the market) in the Romanian insurance market was 29% of total gross written premiums.

ING, Romania's life insurance market leader, took the biggest slice of the pie, with 1,380,000 participants

(33.2% market share) by the end of the campaign, followed by Allianz-Tiriac, Romania's general insurance market leader, with 1,066,000 participants (25.6%) and Generali (390,000, 9.4%). The ranking is completed by Aviva (Commercial Union), Interamerican (Eureko), AIG, BT Aegon, BCR (Erste), BRD (Societe Generale), Omnisig (Vienna Insurance Group), Bancpost (EFG Eurobank), OTP, Prima Pensie (Prva Group) and KD.

The market was, and is, highly concentrated: a third of the funds (the six largest) amassed 88.3% of the total number of participants, while the top ten funds (out of 18 in total) boast 98.3% of the total participants. That makes the mandatory pensions market the most concentrated financial market in Romania.

Following the initial promo campaign, only 7,914 clients had opted into the system during January-June (recent entrants into the labour market and voluntary-age-group-eligible employees not having previously opted in), which demonstrated that no major changes in the market would be forthcoming. Each year, about 80,000 new participants are expected to join the system. In addition, four funds have already withdrawn from the market, having managed to attract a mere 5,000 participants among them.

The next step was the collection of contributions, beginning on the 20th of May. This proceeded smoothly at first, with very few problems and the IT system working perfectly. The initial collection also brought the first shift in market rankings and clarified the 'quality' issues of the accumulated portfolios, as distinct from their 'quantity'.

The first three collection rounds that have taken place since then (May-July) have shown even more light on the market. The fund managed by ING, the market leader, has increased its lead over its rivals,

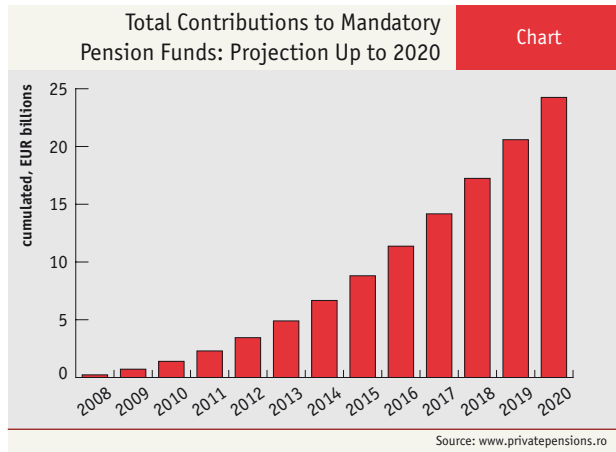


Putting Pillars into Place

Table 1

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|---|
| Autumn, 2005: the CSSPP, Romania's pensions supervisory body, is formed |
| May 2006: Voluntary pensions law adopted |
| December 2006: Mandatory pensions law adopted |
| January 2007: First voluntary pension companies and funds begin the licensing process |
| April 2007: First mandatory pension companies and funds begin the licensing process |
| June 2007: Voluntary pension funds begin collecting contributions |
| September 2007: Four-month initial signup period for mandatory pensions starts |
| January 2008: Initial signup period ends, with over 3,800,000 participants added. Regular signup procedures then go into effect |
| March 2008: Lottery held to re-allocate 333,000 pensioners among the 18 funds |
| April-May 2008: Four funds withdraw from the mandatory pensions market |
| May 2008: Contributions to the mandatory pensions system begin. |

reaching a market share of 38.6% in contributions received during the three month period, against a market share of 33.2% in terms of number of participants. As well, AIG, which ranked sixth by number of participants (table 2), climbed to fourth place in contributions received, jumping from 6.3% to 7.3% of market share. The other winner was BCR, eighth by participants, which climbed to the seventh position in contributions, and from 3.0% to 3.2% in terms of market share.



During the first three collection rounds, four funds consistently maintained contributions per participant above the market average (about EUR8.1): ING, AIG, BCR and BRD. Two things can be inferred from this: the highest paid participants in the market were quickly snared by pension funds supported by banks within their financial group (BCR, the banking system leader

in Romania, BRD – second largest bank, and ING – also a top ten player) – or had large life insurance portfolios right from the start (ING – the life insurance leader, and AIG – the number two life insurance company in the Romanian market).

All together, the 14 remaining market funds received contributions amounting to EUR79.5 million during those first three months of operation, with a monthly average of EUR26.5 million. Market concentration increased further after the start of the collection process: the top five funds jumped from a cumulated market share of 81.8% in participants to 83.9% in terms of contributions received. The first transfers between pension funds will take place in August 2008.

Old schooling

The mandatory pension funds began their investing very prudently. Their investment strategy was also offset by a six-month derogation regarding the 20% ceiling on investments in bank deposits and money market instruments. That derogation was instituted by the CSSPP days before the start of the collection process.

Thus, at the end of May, only ten days after receiving first contributions from their participants, the funds had the following investment structure: 45.2% in bank accounts, 42.1% in state bonds (T-bills and T-bonds), 9.5% in listed shares, 2.9% in corporate bonds and 0.3% in mutual funds. Also, 1.7% of the total assets had already been invested abroad – within a few days of the start of collection.

| Mandatory pension fund | Contributions, EUR millions | Participants | Market share, % | |
|------------------------|-----------------------------|------------------|------------------|-----------------|
| | | | by contributions | by participants |
| ING | 30.7 | 1,380,923 | 38.6 | 33.2 |
| Allianz-Tiriac | 18.5 | 1,067,348 | 23.3 | 25.6 |
| Generali | 6.3 | 391,523 | 7.9 | 9.4 |
| AIG | 5.8 | 261,764 | 7.3 | 6.3 |
| Aviva | 5.4 | 306,824 | 6.7 | 7.4 |
| Interamerican | 3.8 | 264,994 | 4.8 | 6.4 |
| BCR | 2.6 | 126,383 | 3.2 | 3.0 |
| BT Aegon | 2.2 | 131,597 | 2.8 | 3.2 |
| BRD | 2.1 | 99,665 | 2.7 | 2.4 |
| Omniasig | 0.9 | 63,776 | 1.2 | 1.5 |
| BANCPOST | 0.5 | 23,737 | 0.6 | 0.6 |
| OTP | 0.4 | 20,607 | 0.4 | 0.5 |
| Prima Pensie | 0.2 | 17,510 | 0.3 | 0.4 |
| KD | 0.1 | 7,579 | 0.1 | 0.2 |
| Total | 79.5 | 4,164,230 | 100 | 100 |

Source: www.privatepensions.ro

By the end of June, the funds' investment structure had become even more conservative: 43.1% in bank accounts, 43.8% in state bonds, 6.1% in listed shares, 6.7% in corporate bonds and 0.33% in mutual funds. The Romanian stock exchange suffered a massive blow from the financial crisis, the market index having lost 35% from the start of 2008, and 40% year-on-year (data valid as of the 25th of July). For all practical purposes, the funds began operating in the red and thus avoided exposure on stocks and mutual funds.

My little giant

The market is expected to become more concentrated and consolidated, as a result of both mergers and acquisitions. Some

two to three mergers are expected to take place this year, which should hasten exits from the market by the smallest funds. In three years' time, the reform legislation will force all funds with less than 50,000 participants to cease operating and come under new ownership. The total number of funds still operating in the market in mid-term period years is estimated at nine, compared to the current 14, and the 18 funds that started the pensions race.

The mandatory pension funds will collect about EUR226 million in contributions this year, but the level of collection will rise exponentially in the next few years, surpassing EUR1.4 billion in 2010, EUR6.6 billion in 2014, EUR11.3 billion in 2016 and EUR24.2 billion in 2020. The funds' assets under management could thus exceed EUR30 billion by 2020.

Moreover, the mandatory pension funds' assets are predicted to exceed the volume of gross written premiums in the Romanian insurance market by the year 2015, according to research conducted by *PRIMM Insurance & Pensions Magazine*.

Pay, if you will

There are currently eight authorised voluntary pension funds (third pillar) in the Romanian market: two from ING, two from Allianz-Tiriac and one each from Aviva, BCR, OTP and Raiffeisen Asset Management. Participation has developed slowly in these funds: only 55,000 participants had entered the system by the end of 2007. That number had doubled to 110,000 by the following June. Assets under management by these funds reached EUR12 million in mid-July (against EUR4 million in 2007).

Enrollment was done mainly through tied agents, with brokers' contributions amounting to less than 5% of total participants. There are currently 11,000 agents authorised to sell voluntary pensions. The fund's investments are also quite conservative: at the end of June of this year, asset allocation for the voluntary pensions market was: 69% – state and municipal bonds, 16% – bank accounts, 9% – listed shares, and 6% – corporate bonds.

Fund investments limitations

- up to 20% of assets in bank accounts;
- up to 70% in state bonds & securities issued by RO, an EU or a European Economic Area (EEA) state;
- up to 30% in municipal bonds issued by RO, an EU or an EEA state;
- up to 50% in shares on stock markets in RO, EU or an EEA state;
- up to 15% in state securities issued by other states;
- up to 10% in municipal bonds issued by other states;
- up to 5% in listed foreign private bonds;
- up to 5% in mutual (investment) funds in RO or other countries.

As well, four more voluntary pension funds are in the licensing pipeline, awaiting market entry by the end of this year. CSSPP estimates for the end of this year are a total of 200,000-250,000 participants and net assets of EUR25 million. In the next few years, additional sustained growth is expected, including an increase in the number of operational voluntary pension funds. ●

| Romania's Private Pensions System | | |
|-----------------------------------|---|---|
| Feature | Mandatory pensions (2nd pillar) | Voluntary pensions (3rd pillar) |
| System design & architecture | based on World Bank's multi-pillar model, fully-funded, personal accounts, defined contribution | |
| Date of launch | 2007 | |
| Start of contribution collection | June 2007 | May 2008 |
| Participation | mandatory for employees aged under 35 and voluntary for employees aged 35-45 | voluntary for all individuals gaining income (employees, liberal professions, etc). Employers can contribute |
| Contribution level | fixed, 2% of gross monthly income (2007), goes up 0.5 pp a year, to reach 6% in 2016 | flexible, up to 15% of gross monthly income |
| Collection model | centralised, by CNPAS (The National House of Pensions) | decentralised, employers pay contributions directly to funds |
| Fiscal deduction | yes, full | yes, up to EUR200 per year (for employee and employee each) |
| Tax system | EET (exempt, exempt, tax) | |
| Pension fund managers | Specialized pension companies – one fund per company | Specialized pension companies, life insurance companies, asset management companies - several funds per company |
| Transfer between funds | Fully allowed at any time (participants pay 5% fee to switch funds within the first 2 years after adhesion) | |
| Fund merger | Funds can merge, legislation recently adopted | Legislation not yet in place |
| Foreign investments restrictions | None: in theory, pension funds can invest all their assets abroad | |

Source: www.privatepensions.ro