The Private Pension System in Romania

- short presentation -
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The Reform of the Pension System in Romania

Why do we need a reform?

- **THE DEMOGRAPHIC CHANGES** of the last two decades, respectively the fact that the population is getting older, as well as the birth rate decrease and the financial pressures on the private pension systems caused by these changes have led to the search for alternatives to the old public social protection system.

- In **2020**, 30% of the total population will be over 65 years old, while nowadays this percentage is approximately 18%. In the year 2050, half of the population will exceed the age of 65 years, according to the UN Fund Report for Population (2006).

- **IN THE CONTEXT OF AGING** of the population, the states of the world, including those economically developed ones with a tradition of social security systems in place have implemented sustained reforms for the insurance of an average and long term financial stability and for the insurance of higher pensions.
The Reform of the Pension System in Romania

What does reform mean?

- **REFORM** of the pension system means the extension of the basis of the pension systems by adding other two pension sources (pillar II and pillar III), in addition to the public state pension (pillar I).

- **PILLAR II** is the name given to the privately managed pensions system with defined, mandatory contributions for the persons of a certain age.

- **PILLAR III** is the name given to the pension system with voluntary contribution, privately managed and based on individual accounts.

- **AS COMPARED** with the old pay as you go system (Pillar I), the new pension funds are made up by the participants’ individual contributions, being administrated by private companies and correlated with the life expectancy of the contributors.
The Reform of the Pension System in Romania

PENSIONS SYSTEM

PILLAR I
- defined contributions,
- mandatory for persons of a certain age
- optional
- privately managed

PILLAR II
- defined contributions,
- mandatory for persons of a certain age
- optional
- privately managed

PILLAR III
- defined contributions,
- mandatory for persons of a certain age
- optional
- privately managed
Evaluation of the impact of the implementation of the private pension system on the financial market in Romania

- **Effects of funds’ entry on the financial market:**
  - Increase in liquidities and stock market dynamics,
  - Increase in the volume of the bank investments
  - Cheap average and long-term financing source.

- **Estimate of the level of assets collected in the privately managed pensions funds in the last year, as well as number of contributors:**
  - In the first 5 years of functioning of the privately managed pension system (with the two components: voluntary and mandatory) it is estimated that the volume of assets will reach ca. 3 billion Euro (over 1% of the GDP),
  - At the same time, the number of participants / contributors will be around 3.5 million according to the data supplied by the National Pensions House and Other Departments of Social Insurance
Evaluation of the impact of the implementation of the private pension system on the financial market in Romania

- Financial instruments at reach for the administrators of private pension funds:
  - In the first years of functioning, more than 70% will be invested into low-risk financial instruments (state stocks, average and long-term bank deposits and accounts, fixed income instruments), for reasons of prudence and in order to cover the technical provisions and warranties imposed by law.
  
  - A relatively reduced proportion of the capital will be invested in transactional movable assets to be traded on the markets regulated and supervised in Romania, the European Union’s Member States or in the states belonging to the European Economic Area. These placements with a higher associated investment risk give the possibility to reach superior performances, and they differentiate the investment performances of the administrators.
Evaluation of the impact of the implementation of the private pension system on the financial market in Romania

- **Optimal allocation of a portfolio to a private pension fund:**
  - An optimal portfolio is the one ensuring a diversity of the financial instruments according to the economic conjecture, guarantees imposed by law and the degree of risk associated with the pension plan.
  - In all cases portfolios must contain the financial instruments with high liquidity so as to cope with the engagements assumed by means of the pension plan.

- **The importance of investments’ legal limitations in types of financial instruments:**
  - Limits imposed by law are reasonable and offer flexibility in the contents of the investment portfolios.
  - The reduced limit of investments in participations to investment funds is motivated by a still low level of assets within these funds.
Reform of the Pension System in Romania

When was this reform launched?

- The reform of the pension system in Romania started with the adoption of law no. 19/2000 concerning the public pension system and other insurance rights:
  - Introduces major reforms in the state pension system, type PAYG (Pillar I)
  - Offers improved social protection for approximately 6 million retired persons
  - Brings up significant changes in the field of pensions for a professional category

- The Romanian Government, by means of the governmental program for the period 2005-2008, has undertaken to implement new components, voluntary and mandatory, privately managed pensions in the context of a transparent and efficient public control of their administration. This strategy has been materialized until now by:
  - The adoption of the legal framework concerning voluntary and privately managed pensions,
  - Establishment of the Commission for the Supervision of the Private Pension System
  - Access to pillar II and launch of contributions to pillar III

- The first contributions to voluntary pension funds (pillar III) were collected in May 2007.

- September 17th 2007 has marked the beginning of the period of access to the privately managed pension funds (pillar II).
Legal framework of private pensions (1)

The Status of the Commission for the Supervision of the Private Pension System

- C.S.S.P.P. is the autonomous administrative authority for prudential regulation and supervision, under control of the Romanian Parliament, established by E.G.D. No. 50/2005, the establishment, organization and functioning of CSSPP being licensed by law no. 313/2005.

- The mission of C.S.S.P.P.:
  - Regulation, coordination, supervision and control of the activity of the private pension system,
  - Protection of the participants’ interests by insuring an efficient functioning of the private pension systems and information about it

- C.S.S.P.P. is lead by a council made up of 5 members, of which one holds the function of the president and another one of vice president, appointed by parliament.
  The executive management of C.S.S.P.P. is insured by a general administrator appointed by the Council of the Commission.
Legal framework of private pensions (2)

Privately managed legal framework - pillar II

Law 411/2004, concerning the privately managed pension funds, republished, regulates:

- The establishment, organisation and functioning of the privately managed pension funds system;
- Organisation and functioning of the administrators of the privately managed pension funds, as well as coordination of activities of other entities involved in this area.

Standards issued by C.S.S.P.P. (secondary legislation)

The standards concerning the authorisation of the administrators in the private pension systems, the standard concerning the prospect of the private pension plan, the standard concerning the initial accession and the evidence of the participants to the privately managed pension funds, the standards concerning the depositary and the auditor of the financial assets of privately managed pension funds, the standard concerning the marketing of the privately managed pension fund, standards concerning the accounting regulations, the standard concerning the accession and evidence of the participants to privately managed pension funds, the standard concerning the collection of individual contributions of participants to the privately managed pension funds, the standard concerning the transfer of participants between the privately managed pension funds, the standard concerning the requirements of reporting and transparency, the standard concerning the protection of participants in case of fusion of privately managed pension funds.
Privately managed pension funds (cont.)

The aim of privately managed pension funds system

- The insurance of a distinct private pension to complete the pension granted by the public system based on collections and investment in the interest of participants, of a part of social insurance individual contribution.

- The contributions are paid for the whole period in which the person is a contributor in the public pension system (there is no possibility of stepping out of the private pension system, but the transfer between funds is allowed)
- The fund is set up by a contract with civil society, concluded between the participants according to the provisions of the Romanian Civil Code concerning the particular civil society and the legal dispositions in the field.
- Privately managed pensions are mandatory for persons up to 35 years old and optional for those between 35 and 45 years old.
- The administrator of a pension fund is a newly established pension company with a capital of at least 4 million Euro, authorized by CSSPP to carry out this activity.
- The investment in these funds takes place according to the classes and percentages established by law.
- The administrators shall make up a guaranteed fund
- Other guaranteed elements: separation of funds’ assets from the administrator’s, depository of assets, financial auditor, technical provisions, reporting requirements to participants and to CSSPP
Privately managed pension funds (cont.)

- The right to a privately managed pension is granted upon the retirement in the public system.
- The total amount of money for the private pension may not be smaller than the value of the total contributions paid minus the transfer penalties and legal fees.
- The payment of the pension as a unique payment or as deferred payments for a duration of maximally 5 years under the following circumstances:
  - The persons whose net personal assets at the moment of the retirement are too small to enable them to receive a private pension.
  - To persons retired due to disability for affections which no longer allow them to work, according to the law, and to the persons whose net assets upon retirement are too small to enable them to receive a private pension.
- The payment of the pension will be made by a pension provider, and the pension is calculated based on the actuarial calculation and the net personal asset according to the amount of money coming from contributions and their investment by the pension funds’ administrator.
- The initial accession to privately managed pension funds took place between 17.09.2007 – 17.01.2008.
- Subsequent to the initial accession, the persons obliged to adhere and who have not chosen a pension fund within the respective period, were assigned at random.
Evolution of the number of participants between 31.05.2008 - 30.06.2008

- May 2008: 3,194,961
- June 2008: 3,458,452

Millions of lei

- May 2008: 86,447,017
- June 2008: 187,120,165
Structure of net assets per pension funds at 30.06.2008

Bank deposits and instruments of the financial market: 6%
State stocks and municipal bonds: 7%
Shares and other movable assets: 0%
Corporate bonds: 44%
OPCVM stocks: 43%
Legal framework of private pensions (2)

Voluntary pension funds - pillar III

- **Law 204/2006 concerning voluntary pension's funds establishes:**
  - The principles of elaboration and authorisation of the prospect pension plan and the voluntary pension fund;
  - Principles of organisation and functioning of the administrators of voluntary pension funds, as well as coordination of activities of other entities involved in this field
  - Regulation and prudential monitoring of the administration of voluntary pension funds.

- **Standards issued by C.S.S.P.P. (secondary legislation)**
  Standards concerning the building authorisation of pension funds, standards concerning the authorisation of the administrators of voluntary pension fund, the standard concerning the prospect voluntary pension plan, the standard concerning participants, standards concerning the depositary and financial assets’ auditor of voluntary pension funds, the standard concerning marketing of the prospect voluntary pension plan, standards concerning accounting regulations, the standard concerning the participants’ transfer between voluntary pension funds, the standard concerning reporting and transparency requirements, concerning the usage of personal assets from a voluntary pension fund in case of disability and in case of decease.
Voluntary pension funds – pillar III (continued)

- The participants to the system as employees: freelancers, office clerks, persons appointed to hold public positions, any person having an income from a professional activity subject to tax,
- The fund is settled by a civil society contract, concluded between the participants according to the provisions of the Romanian Civil Code concerning the private civil society and according to applicable legal provisions.
- The contribution to voluntary pension funds is of up to 15% of the income or assimilated to the income, and the employer may contribute, on behalf of his employee, to the selected voluntary pension fund.
- In both cases, should either the employee or the employer contribute to it, the law sets up a tax deduction of up to 200 Euro per fiscal year.
- The right to a voluntary pension is obtained starting with the age of 60, the same age for men and women with a minimal period of contribution of 90 months and in case the amount of money in the individual account is sufficient for a minimal pension, set up by the secondary legislation in the field of voluntary pensions.
- The unique payment or deferred payments for a duration of maximum 5 years - in case no 90 monthly contributions were paid and the personal asset is not equal to the amount necessary to obtain a minimal voluntary pension, they shall get the amount in the participant’s account.
In case of disability for affections which hinder them from working in the future, as settled by law, the participants shall get either the voluntary pensions, if his personal asset is at least equal to the amount necessary in order to receive a minimal voluntary pension, established by CSSPP, or the amount of money in their account (as unique payment or as deferred payments for a duration of maximum 5 years if their personal asset is not at least equal to the amount of money necessary in order to receive a voluntary minimal pension, as settles by CSSPP).

In case of decease, the amount shall be paid to the beneficiary chosen by the participant, respectively to the legal heir, defined according to the Civil Code.

Participants may, at any time, modify, suspend or stop to pay the contributions to the voluntary pension fund, informing the administrator and the employer, specifying that in case of stopped payments their rights are maintained.

Contributions are accumulated in a voluntary pension fund, being included into individual accounts, property of the participants and of their legal beneficiaries.

The administrator of such a fund is a newly established voluntary pension company, an insurance company or an investment management company with a joint stock of at least 1.5 million Euro, authorised by CDDPP to carry out this activity— the competent authority in the supervision and control of the private pension system.

According to the law, the administrators are compelled to make up a warranty fund, but the legislation settles a series of other guaranteed elements, such as: the separation of the fund units from the administrator’s, the depositary of the units, the financial auditor etc.

The investments of amounts coming from these funds are made according to the classes and procedures established by law.
Objectives of C.S.S.P.P. for the period 2008 – 2010 (1)

CONSTRUCTION OF THE SYSTEM
- Finalisation during the year 2008 of a first stage of the process of pillar II implementation of private pensions – finalisation of the procedure if initial adhesion by random assignment of participants to privately managed pension funds.
- The second stage consists in the final definition of the legal framework and in the initiation of the collection activity of contributions to the privately managed pension funds.

LEGISLATION
- The participation to the elaboration process of the primary legislation in the field of private pensions, respectively the collaboration with the Ministry of Labour, Family and Equal Opportunities for the elaboration of at least two new normative projects:
  - The law concerning the organisation and functioning of the payment system of private pensions
  - The law concerning the establishment and functioning of the Guarantee Fund
- Continuation of the process for the elaboration of the secondary legislation for both laws:
  - The procedure of adhesion to the privately managed pension funds continues
  - The procedure of cancellation of the administration authorisation
  - Mergers and separation of administrators
  - Mergers of voluntary pension funds
  - Usage of the net personal assets of the participant in case of disability / death
  - Special administration, etc.
- The elaboration of the secondary legislation in collaboration with the Council for Competition in order to avoid phenomena of massive market concentration, a consequence of merger/acquisitions between the administrators, in order to protect the interests of the participants to the privately managed pension funds.
SUPERVISION AND CONTROL

- The main challenge for the year 2008 – the initiation of the collection activities from contributors within pillar 2 and implicitly the debut of the reporting activities for the entities of the pillar of privately managed pensions

- Activities of supervision and control which will protect the interest of the participants in the private pension system as well as their beneficiaries:
  - Prudential supervision of the activities developed by the entities in the system, by monitoring the way they fulfill their liabilities towards the Commission and towards the participants according to the applicable legislation,
  - Initiation of controls of the funds based on the annual control, in order to avoid and/or sanction possible breaches of applicable legislation in the field, the control activity taking place according to themes of control, according to the provisions of the secondary legislation elaborated by CSSPP during the previous year.

INTER- INSTITUTIONAL COLLABORATION

- The encouragement of the institutions present on the Romanian capital market in order to create and diversify financial instruments with good investment results, necessary to attract available funds in the private pension system and for the establishment of well balanced investment policies by the administrators of the private pension funds.

- The collaboration with the Ministry of Economy and Finance (MEF) in order to issue state stocks and the collaboration with the Bucharest Stock Market in order to attract new issuers and to launch new investment instruments on the stock market.

- The continual collaboration with MEF, BNR, CSA, CNVM and other authorities with which CSSPP has concluded collaboration protocols in order to insure protection of the interest of the participants and beneficiaries of the private pension system.

- Extension of the cooperation area to include other institutions /authorities.
Objectives of C.S.S.P.P. for the period 2008 – 2010 (3)

COMMUNICATION AND PUBLIC RELATIONS
- The finalisation of the initial campaign for the promotion of the private pension system for the public's information and education in connection with the organisation and functioning of the voluntary pensions and the privately managed pensions in Romania.
- Information and permanent education of the public, including usage of the web page of CSSPPP, as well as collaboration with other institutions / authorities in this regard.
- Consolidation of mass media relationships.
- Development and perfecting of public relations / consumer protection.

EUROPEAN INTEGRATION AND INTERNATIONAL RELATIONSHIPS
- Active participation of CSSPPP to the activity of the committees and work groups of CEIOPS:
  - The Committee for Occupational Pensions – the continued participation to the drawing up of reports and documents’ concerning the implementation of guideline 41/EC/2003, the review of the Budapest Protocol concerning cross border activities, to solving some problems concerning internal control or risk management and according to the new orientation established by the European Commission, to the activities of Solvency II in the field of occupational pensions.
  - The „Personnel Exchange Program”[3] (delegations and assignment of personnel) organised by the Supervision Authorities within CEIOPS in collaboration with CESR and CÉBS.
  - The program concerning consumer protection, concerning the three areas of activity at CEIOPS: consumer information, behaviour of market entities and means of solving the claims of consumers.
  - The committee for financial stability, as well as other 3L3 level committees whose activities contribute to the convergence of the supervision on the single market of the EU.
- Participation to activities specific to IOPS.
Campaign of public information concerning the privately managed pension system

The promotion within the population of trust in the private pension system is one of the strategic goals of CSSPP.

- This campaign took place in the initial adhesion period to the privately managed pension funds, between September 2007 – January 2008

- The goals of the public information campaign organised by CSSPP, together with MMSSF,
  - Supply of information concerning the organisation and functionality of the system in order to facilitate adhesion to privately managed pension funds
  - Increase of the degree of knowledge concerning private pensions in general
  - Information concerning the authority capable of managing this new field - CSSPP
Campaign of public information concerning the privately managed pension system (continued)

Results of the evaluation of the public information campaign (survey):

• High level of information of the respondents concerning the private pension system
  ➔ ca. 78% of the interviewed persons know that alongside the public pension, they can receive another type of pension, a private pension
  ➔ Ca. half of these (52%) are aware of the fact that in the new system, the level of the pension is strictly compliant with the investment politics of the private pension fund selected by every individual.

• The notoriety of voluntary pensions is high: 73% of the respondents have heard of this type of pensions

• The degree of notoriety of CSSPP is high enough, in the conditions in which the institution supervises a system at the beginning of the road
  ➔ Almost half of the respondents (47%) have heard of the CSSPP

• The need for information concerning CSSPP is fairly high among respondents
  ➔ only 6% of them did not answer the question

• As a means of information in future campaigns, respondents mentioned: ca. 35% - TV campaigns, 20% - campaigns in written press, 18% - brochures, 10% - radio campaigns and 9% - flyers