Long-Term and Pension Savings

The Real Return

2020 Edition

BETTER FINANCE

The European Federation of Investors and Financial Services Users

Fédération Européenne des Épargnants et Usagers des Services Financiers

Pension Savings: The Real Return

2020 Edition

A Research Report by BETTER FINANCE

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Acronyms

AIF	Alternative Investment Fund
AMC	Annual Management Charges
AuM	Assets under Management
BE	Belgium
BG	Bulgaria
Bln	Billion
BPETR	'Barclay's Pan-European High Yield Total Return' Index
CAC 40	'Cotation Assistée en Continu 40' Index
CMU	Capital Markets Union
DAX 30	'Deutsche Aktieindex 30' Index
DB	Defined Benefit plan
DC	Defined Contribution plan
DE	Germany
DG	Directorate General of the Commission of the European Union
DK	Denmark
DWP	United Kingdom's Governmental Agency Department for Work and Pensions
EBA	European Banking Authority
EE	Estonia
EEE	Exempt-Exempt-Exempt Regime
EET	Exempt-Exempt-Tax Regime
ETF	Exchange-Traded Fund
EIOPA	European Insurance and Occupational Pensions Authority
ES	Spain
ESAs	European Supervisory Authorities
ESMA	European Securities and Markets Authority
EU	European Union
EURIBOR	Euro InterBank Offered Rate
EX	Executive Summary
FR	France
FSMA	Financial Services and Market Authority (Belgium)
FSUG	Financial Services Users Group - European Commission's Expert Group
FTSE 100	The Financial Times Stock Exchange 100 Index
FW	Foreword
GDP	Gross Domestic Product
HICP	Harmonised Indices of Consumer Prices
IBEX 35	Índice Bursátil Español 35 Index
IKZE	'Indywidualne konto zabezpieczenia emerytalnego' – Polish specific Individual pension savings account
IRA	United States specific Individual Retirement Account

IT	Italy
JPM	J&P Morgan Indices
KIID	Key Investor Information Document
LV	Latvia
NAV	Net Asset Value
Mln	Million
MSCI	Morgan Stanley Capital International Indices
NL	Netherlands
OECD	The Organisation for Economic Co-Operation and Development
OFT	United Kingdom's Office for Fair Trading
PAYG	Pay-As-You-Go Principle
PIP	Italian specific 'Individual Investment Plan'
PL	Poland
PRIIP(s)	Packaged Retail and Insurance-Based Investment Products
RO	Romania
S&P	Standard & Poor Indexes
SE	Sweden
SK	Slovakia
SME	Small and Medium-sized Enterprise
SPIVA Scorecard	Standard & Poor Dow Jones' Indices Research Report on Active Management performances
TEE	Tax-Exempt-Exempt Regime
TCR/TER	Total Cost Ratio/ Total Expense Ratio
UCITS	Undertakings for the Collective Investment of Transferable Securities
UK	United Kingdom

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Country Case: Romania

Rezumat

Populaţia României emigrează, scade şi îmbătrâneşte într-un ritm accelerat, ceea ce pune presiune semnificativă asupra sistemului de pensii publice.

Deşi contribuţiile la fondurile de pensii ocupaţionale sunt obligatorii (Pilonul II), fără a distinge forma de angajare (salariaţi sau liber-profesionisti), cetăţenii români trebuie motivaţi să investească mai mult în planuri voluntare de pensie (Pilonul III).

Evoluţia randamentelor reale ale planurilor de pensii din România a înregistrat o evoluţie pozitivă până la sfârşitul anului 2017, moment din care tendinţa s-a inversat, ceea ce este de natură să genereze preocupări asupra capacităţii administratorilor de a menţine performanţele pozitive ale primilor 10 ani de funcţionare ai sistemului de pensii administrat privat din Romania.

Compunerea portofoliilor ambelor tipuri de scheme administrate privat este aproape identică şi, prin urmare, generează randamente brute similare. Cu toate acestea, randamentul net al Pilonului III este influenţat în mod semnificativ de structura comisioanelor substanţial mai mari (aproape de 4 ori mai mari) şi astfel, pe termen lung, va genera randamente mai mici decât cele aferente Pilonului II. Per total, randamentele produselor de pensie din Pilonul II şi Pilonul III au ramas pozitive şi deasupra nivelului inflaţiei.

Asociaţia Utilizatorilor Români de Servicii Financiare (AURSF), membră a BETTER FINANCE, a criticat vehement decizia autorităţilor de a reduce contribuţiile virate în contul participanţilor de la 5,1% la 3,75%, precum şi intenţia de a renunţa la Pilonul II de pensii. De asemenea, AURSF consideră că trebuie identificate măsuri care să încurajeze opţiunea asumată a participanţilor pentru unul dintre fondurile administrate privat (în prezent, numărul celor care optează este extrem de redus, participanţii fiind distribuiţi printr-un mecanism aleatoriu).

Summary

Romania’s population is rapidly decreasing, aging, and migrating, which puts considerable pressure on the State pension system. In 2019, new changes on calculating old-age pensions from PAYG pillar have been adopted effective since September 2021. All old-age pension will be recalculated in 2021 and no pensions will decrease, because changes will be made to pensions only if the recalculated amount is more favorable.

Although occupational pensions are mandatory regardless of the work form (employees and self-employed), the Romanian households must be incentivised more to save in voluntary pension plans (Pillar III).

Private pension schemes in Romania recorded a solid performance in 2019, recording positive average returns of 11.89% for Pillar II funds and 10.81% for Pillar III funds.

Both schemes (occupational and private) have almost identical portfolio structures and thus generate similar gross returns. However, Pillar III net performance is significantly influenced by the high fee structure (almost 4-times higher) and will, in the long-run, deliver lower returns than Pillar II peers. Overall, the real return of pension funds in Pillar II as well as Pillar III are still positive and above the inflation.

The Romanian Financial Services Users' Association (AURSF), a BETTER FINANCE member, has firmly criticised the public authorities' decision to reduce the contribution transfer rate to Pillar II from 5.1% to 3.75%, as well as the intention to "give up" Pillar II. In addition, AURSF considers that measures to incentivise an active choice of savers with regard to mandatory privately administered pension funds must be found (currently, the number of those making an active choice is considerably low, the rest being randomly assigned).

Introduction

The Romanian old-age pension system is based on the World Bank's multi-pillar model, which consists of three main pillars:

- Pillar I – State pension organized as a mandatory Pay-As-You-Go (PAYG) scheme;
- Pillar II – Organised as a mandatory, funded and defined contribution pension scheme,
- Pillar III – A supplementary pension scheme, based on the principle of voluntary participation with the defined-contribution characteristic.

Romania's multi-pillar pension reform began in 2007, when Pillar III was added into the pension system (collecting the first contributions) and became voluntary for all persons earning any type of income. Pillar II was put into place in 2008 (collecting the first contributions) and became mandatory for all employees aged under 35.

Table RO1. Pensions system in Romania		
National House of Public Pensions	Private Pension System Supervisory Commission	
PILLAR I	**PILLAR II**	**PILLAR III**
State Pension	**Funded pension**	**Voluntary pension**
Law no. 263/2010 on the unitary public pension system	Law no. 411/2004 on the privately managed pension funds, republished, including subsequent amendments and additions	Law no.204/2006 on the voluntary pensions, including subsequent amendments and additions
Mandatory	Mandatory	Voluntary
Publicly managed	Privately managed pension funds	
PAYG	Funded	
DB (Defined Benefit scheme)	DC (Defined Contribution scheme)	
	Individual personal pension accounts	
The possibility of early and partially early retirement, contingent upon the fulfillment of the age conditions and the contribution stage provided by the law and the accumulated points.	Withdrawal from the system is only allowed through retirement.	The participant can, at any time, suspend or stop the contribution payment (they remain members in the system until retirement).
Quick facts		
Number of old-age pensioners: 4.7 mil.	Administrators: 7	Administrators: 8
Number of insured: 5.9 mil.	Funds: 7	Funds: 10
Average old-age pension: €295,63	Custodians: 3	Custodians: 3
Average salary (gross): € 1060.70	Brokers: 14	Brokers: 21
Net replacement ratio (state pension): 27.87%	AuM: €12.96 bln	AuM: €0.52 bln
	Participants: 7.46 mil.	Participants: 0.50 mil.
Average pension replacement ratio: 51%		

Source: Own elaboration based on CNPP, ASF and INSSE data, 2020; Notes: Exchange rate RON/EUR = 4.783; data on average old-age pension and gross salary and data on the number of old-age pensioner are as of November and December 2019; data on number of participants and assets under management as of December 2019.

The overall coverage of Pillar II, measured as a ratio between the number of participants and the economically active population, was almost entire working population in 2019, while Pillar III covered only 6% of the economically active population. Thus, we can expect than future pension income stream will be influenced mostly by Pillar II pensions, while Pillar III will generate an insignificant part of individuals income during retirement.

Summary Return Table				
	Pillar II		Pillar III	
Holding Period	Nominal	Real	Nominal	Real
1 year	11.89%	7.84%	10.81%	6.76%
3 years	5.64%	2.44%	4.60%	1.40%
7 years	6.36%	4.76%	5.41%	3.80%
10 years	7.29%	4.63%	6.02%	3.35%
Entire history	8.04%	4.90%	6.58%	2.61%

Source: BETTER FINANCE own composition

Pillar I – State Pensions

The first pillar of the Romanian pension system is organized on the Pay-as-You-Go (PAYG) principle of redistribution, being funded on an ongoing basis and functioning on the defined-benefit rule.

The state (through the National House of Public Pensions, a public institution constituted for this purpose in particular[236]) collects the social pension contribution from the contributors[237] and immediately pays the pensions to the current retirees.[238] State pension in Romania is also based on the principle of solidarity between generations and gives the right to pension entitlement upon retirement age, following a minimum contribution period (15 years), as provided by law.

This compulsory system is closely connected to the economic activity and income of citizens. In 2017, it was 88%[239] financed from social security contributions made by both employers and by employees, while generally consuming the biggest part (or entirety) of the social security budget.

Social security contributions are paid to the State's social security budget at a rate of 4% of payroll for employers and 25% of income (gross earnings) for employees, of which 3.75% is distributed to mandatory pension funds (pillar II); there are sectors where there are reduced contribution rates (21.25% instead of 25%).[240]

The pensions are calculated using a formula to an algorithm based on the mean salary score (which is calculated by comparing an individual's own salary to the average monthly salary), the correction coefficient, the full vesting period (35 years), and on pension points, which are expressed as a nominal value.

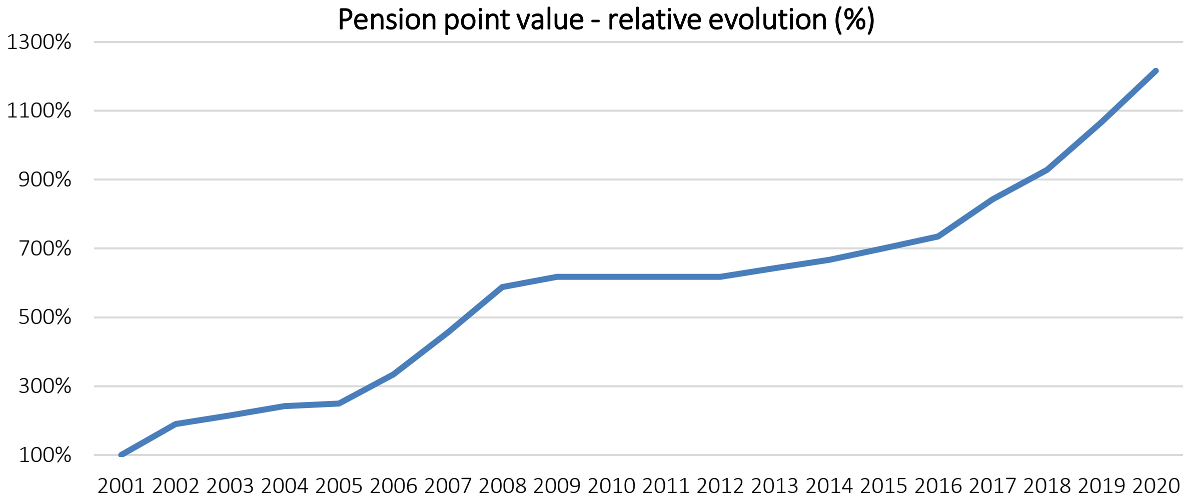
Therefore, the pension entitlement is calculated when the employee claims it and uses the values determined for that date (once), using the following formula:

[236] In Romanian, „Casa Naţională de Pensii Publice", hereinafter CNPP, as per Article 4.2 read in conjunction with Article 52 (Chapter IV, Section I) of Law no. 263/2010: http://legislatie.just.ro/Public/DetaliiDocument/124530.
[237] According to the principle of contributivity, as per Article 2.c) of Law no. 263/2010.
[238] According to the principle of redistribution provided in Article 2.e) of Law no. 263/2010.
[239] In 2017, 75% of the budget was constituted from social security contributions and 25% from the consolidated state budget – see Annex no. 1/03 to Law no.7/2017 concerning the social security budget for 2017; in 2018, 88% of the budget was financed from contributions and 12% from the consolidated state budget – see Annex no. 1/03 of Law no. 3/2018 concerning the social security budget for 2018.
[240] According to the Romanian Ministry of Finance website, https://www.mfinante.gov.ro/detalii.html?method=searchAnaf&pagina=taxe&den=CONTRIBUTII%20DE%20ASIGURARI%20SOCIALE.

Pension allowance =

Mean Salary Score x Correction Coefficient x Value of the Pension Point.

The most important variable is given by the value of the pension point, which continues to grow for the 19th year in a row.



Source: *BETTER FINANCE own composition based on CNPP data*

However, in 2019, the legislation on calculating Pillar I old-age pensions came into force. Since September 2021, all old-age pensions will be recalculated. The new law increased the pension point value from 1,100 RON (€230 Eur) to 1,265 RON (264 Eur), which will be increased again in September 2020 to 1,440 RON (€297.93) although it was announced that it will grow to 1,775 RON (€397.73).

According to Romania's legislation, starting on 1 January 2011, the standard retirement age is 63 years for women and 65 years for men. These levels will be gradually reached as follow:

- between January 2011 and January 2015, the standard age for the pensioning of women will grow from 59 years to 60 years and for men from 62 years to 65 years;
- at the end of 2015 period retirement age will gradually increase only for women from 60 years to 63 years until 2030.

Early retirement - According to Law no. 263/2010 regarding the public pension schemes (in force since 1 January 2011) claiming early pension is possible as of a maximum 5 years before the standard retirement age, provided the worker has at least eight or more contribution years. The deduction made on early pension payment is fixed at 0.75% for each month (9% per year), which might bring a maximum deduction of 45% from the standard pension. The deduction is applied until the standard age limit is reached.

Pillar II – Funded pensions

Romania's mandatory private pensions system (Pillar II) is based on the World Bank's multi-pillar model. It is a fully funded scheme, with mandatory participation and distinct and private management of funds based on personal accounts and on the defined contribution (DC) philosophy with minimum return guarantees. The minimum return guarantee means that participants will receive at least the sum of contributions, net of fees, at retirement. Each fund has to comply, during the accumulation phase, with a minimum return mechanism that is set quarterly by national regulation and based on average market performance of all funds. Pillar II represents the privately managed mandatory pensions funds or schemes.

The beginning of Pillar II in Romania is connected with three important dates:

- January – July 2007 (Authorizing the administrators),
- 17 September 2007 – 17 January 2008 (Choosing pension fund by participants),
- 20 May 2008 (Collecting the first contributions to Pillar II).

Pillar II has been mandatory since its inception for all employees paying social security contributions under the age of 35 and voluntary (optional) for employees aged 35 to 45.[241]

Contribution collection is centralized by CNPP (The National House of Public Pensions), which collects and directs the contributions towards the mandatory pension funds.

A participant contributes during his active life and will get a pension when reaching the retirement age of 65 for men and 63 for women. The starting level of contribution was at 2% of the participant's total gross salary and it should go up by 0.5 percentage points a year, to reach 6% of total gross revenues in 2017. However, these values were never reached and the value for 2019 was 3.75%. The contribution level is fixed, with no possibility to contribute less or more based on individual preferences.

The contributions to a pension fund are recorded in individual personal pension account. The savings are invested by the pension fund administrator, according to the rules and quantitative limits generally set by the law regulating Pillar II vehicles.[242] Participants can choose only one pension fund.[243]

Mandatory pension funds are managed by their administrators - Pension Management Companies (PMCs). Each PMC can manage only one mandatory pension fund. Mandatory pension funds operations are similar to the investment funds. PMC must obtain several licenses from Romania's pension market regulatory and supervisory body, which is the Financial Supervisory Authority (in Romanian, *Autoritatea de Supraveghere Financiară*, '**ASF**').

The ASF is in charge of control, regulation, supervision and information about private pensions as an independent administrative authority and legal entity under the control of the Romanian Parliament.

Withdrawal from the system is only allowed at the standard retirement age of participants in the private pension system.

Pillar III – Voluntary private pension

[241] Article 30 of Law no. 411/2004 regarding the privately managed pension funds.
[242] Article 23 defines the guiding principles and rules of conduct the fund administrator must follow, Article 25 defines the quantitative limits on asset allocations and Article 28(1) lists the ineligible investments (Law no. 411/2004).
[243] Article 31 of Law no. 411/2004.

Romania's voluntary private pensions system Pillar III is also based on the World Bank's multi-pillar model. It is also a fully funded system, based on personal accounts and on the defined contribution (DC) philosophy. Pillar III represents privately managed supplementary, voluntary pensions.

The beginning of Pillar III in Romania is connected with two important dates:

- October 2006 – May 2007 (Authorizing the administrators),
- May 2007 (Collecting the first contributions to third Pillar).

Participation is open to everybody earning an income, either employees or the self-employed. Contributions are generally made through the employers in case of employees. In case of self-employed, the contributions are sent directly on the accounts managed by pension management companies. The contributions are made by the employee, with the possibility for employers to contribute a share.

Voluntary pension funds as a special purpose vehicle are managed by their administrators - Pension Management Companies (PMCs), Life Insurance Companies (LICs) or Asset Management Companies (AMCs). Each administrator is obliged to establish and operate at least one voluntary pension fund. However, in contrast to Pillar II, administrators can manage as many funds as they wish. A voluntary pension fund operates on a similar basis as investment fund. Pension fund administrators must get several licenses from Romania's Financial Supervisory Authority.

Participants to such a fund contribute during their active life and will get a pension at the age of 60 (both woman and men) if he had accumulated at least 90 contributions. The contribution is limited up to 15% of the participant's total gross income. The contribution level is flexible - it can be decided upon, changed, and even interrupted and resumed.

Pension Vehicles

Pillar II – Funded pensions

As indicated above, each PMC specifically authorized to provide Pillar II savings products in Romania is allowed to manage only one mandatory pension fund. At the introduction of the Pillar II, the total number of authorized administrators (funds) was 18. Consolidation started as early as 2009 and 2010. Currently (end of 2019), there are 7 administrators offering (management companies) offering pension funds in the second pillar. The two biggest mandatory pension funds (NN and AZT) serve almost 50% of participants and have a market share (as % of AuM) of 57%.

Each PMC is authorized and supervised by ASF. One of the most important conditions imposed on PMC is to attract at least 50,000 participants. ASF withdraws the fund's authorization if the number of participants drops below 50,000 for a quarter.

The structure of savers, assets under management and market share of respective mandatory pension fund (PMC) is presented in a table below.

Table RO2. Pension Management Companies market share in Romania (Pillar II)				
Mandatory Pension Fund (PMC)	Assets under management *(in €)*	Market share based on AuM	Number of participants	Market share based on participants
ARIPI	1,124,383,876	8.68%	765.597	10.26%
METROPOLITAN LIFE*	1,835,412,419	14.16%	1,042,361	13.97%
AZT VIITORUL TAU	2,798,078,749	21.59%	1,589,057	21.29%
BCR	869,382,533	6.71%	667.635	8.95%
BRD	490,054,860	3.78%	450.164	6.03%
NN	4,565,266,989	35.22%	2,015,665	27.01%
VITAL	1,278,529,794	9.86%	931,880	12.49%
TOTAL	**12,961,109,220**	**100.00%**	**7,462,359**	**100.00%**

Source: Own calculation based on ASFRO data

Mandatory pension funds' investment strategy is very strictly regulated. The law imposes percentage limits for different asset classes.

Mandatory pension funds can invest:

- up to 20% in money market instruments;
- up to 70% in State bonds of Romania, the EU or EEA;
- up to 30% in bonds and other transferable securities issued by the local public administrations in Romania, the EU or EEA, traded on a regulated market in RO, EU or EEA;
- up to 50% in securities traded on a regulated market in Romania. the EU or EEA;
- up to 15% in bonds issued by third-party states, traded on a regulated market in Romania, the EU or EEA;
- up to 10% in bonds and other transferable securities issued by the local public administration in third-party states, traded on a regulated market in Romania. the EU or EEA;
- up to 15% in bonds issued by the World Bank. the European Bank for Reconstruction and Development and the European Investment Bank, traded on a regulated market in Romania, the EU or EEA;
- up to 5% in bonds issued by Non-governmental Foreign Bodies, traded on a regulated market in Romania, the EU or EEA;
- up to 5% in units issued by Undertakings for Collective Investment in Transferable Securities – UCITS, including ETF in Romania, the EU or EEA;
- up to 3% in ETC`s and equity securities issued by non UCITS set up as closed investment funds, traded on a regulated market in Romania, the EU or EEA;
- up to 10% in private equity - only for voluntary pension funds.

There is no explicitly defined general quantitative limit on equity investments.

Aside from the quantitative restrictions by asset class, fund managers have quantitative limits by type of issuer:

- 10% of the total number of shares issued by one issuer;
- 10% of the preferential shares issued by one issuer;

- 25% of the equity securities issued by an UCITS, ETF, non UCITS closed investment fund or ETC;
- 10% of an issuer's bonds, with the exception of the state bonds.

Mandatory pension funds can invest all their assets abroad. There are no explicit restrictions regarding investments made abroad.

Pension funds can have one of three possible risk profiles, which are calculated on a daily basis according to a formula established by ASF regulations:

- low risk (risk level up to and including 10%),
- medium risk (risk level between 10%, exclusively, and 25%, inclusively),
- high risk (risk level between 25%, exclusively, and 50%, inclusively).

Pillar III – Voluntary private pensions

The Romanian Pillar III allows each administrator (PMC, LIC or AMC) to manage as many voluntary pension funds as they prefer. At its inception, there were only four providers and six voluntary pension funds. Currently (at the end of 2018), there was 8 providers offering 10 voluntary pension funds. Only two administrators (NN and AZT) are currently offering more than one voluntary pension fund.

Each administrator in Pillar III (PMC, LIC or AMC) is authorized by ASF and must get several licenses from ASF. ASF withdraws the fund's authorization if the number of participants drops below 100 for a quarter.

Voluntary pension funds are also constituted by civil contract and authorized by ASF. Accounting of the voluntary pension fund is separated from the administrator.

Investment rules in the voluntary private pension pillar are the same as in the mandatory pillar (see quantitative and restriction limits for different asset classes in the text above), with less strict limits on private equity (5%) and commodities (5%).

The structure of savers, assets under management and market share of respective voluntary pension fund is presented in a table below.

Table RO3. Pension Management Companies market share in Romania (Pillar III)					
Risk profile	Mandatory Pension Fund (PMC)	Assets under management *(in €)*	Market share based on AuM	Number of participants	Market share based on participants
High	AZT VIVACE	21,916,716	4.18%	20.266	4.04%
	NN ACTIV	60,11,071	11.47%	52.085	10.39%
Medium	AZT MODERATO	57,528,728	10.97%	39.053	7.79%
	BCR PLUS	93,845,454	17.90%	137.594	27.46%
	BRD MEDIO	28,142,364	5.37%	30.307	6.05%
	NN OPTIM	219,538,599	41.88%	188.862	37.69%
	PENSIA MEA	16,065,190	3.06%	9,547	1.91%
	RAIFFEISEN ACUMULARE	20,216,647	3.86%	14.174	2.83%
	STABIL	5,062,446	0.97%	5.403	1.08%
	AEGON ESENTIAL	1,808,726	0.35%	3.832	0.76%
	TOTAL	**524,234,941**	**100.00%**	**501.123**	**100.00%**

Source: Own calculation based on ASFRO data

Charges

Pillar II – Funded pensions

According to the Mandatory Pensions Law, the fund manager's income resulted from the administration of privately administrated pension funds are composed of:

- management fees and commissions;
- transfer penalties (covered from personal assets, in case of moving to another fund/PFC earlier than in 2 years – between 3.5% and 5%);
- tariffs for additional information services, in particular:
    - Depositary commission (depository fee);
    - Transaction costs (trading fees);
    - Bank commissions (banking fees);
    - Fund auditing taxes (pension fund auditing fees).

Since 2019, the administration fee is established by:

a) deducting an amount from the contributions paid, but not higher than 1.0%, before the conversion of contributions into fund units (Management commission), of which 0.5% is transferred to the National House of Public Pensions (Casa Nationala de Pensii Publice; the organization that administers the social insurance program);

b) Management fee - 0.02% to 0.07% of net assets under management, depending on the fund's rate of return relative to the inflation rate. Before 2019, the maximum monthly management fee was 0.05 percent.

The transfer penalty represents the amount paid by the participant in the event of a transfer to another administrator, occurring within two years of the subscription date to the private pension fund, with the maximum ceiling of this penalty being established by ASF and set at maximum 5% of assets (Norm CSSPP 12/2009 for Pillar II and Norm 14/2006 for Pillar III).

The fund also pays for the annual auditing fee (Fund auditing taxes) and the rest of the fund's expenses (custody, depositary, transaction/trading expenses) must be supported by the pension company (the administrator).

The next table compares effective charges of mandatory pension funds in Pillar II over time (calculated via total and net NAV).

Table RO4. Effective annual charges in mandatory pension funds (Pillar II) in %

Mandatory pension fund	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
ARIPI	1.23%	0.86%	0.75%	0.68%	0.63%	0.62%	0.62%	0.63%	0.61%	0.58%	0.63%	0.49
METROPOLITAN LIFE	0.54%	0.70%	0.65%	0.61%	0.62%	0.60%	0.59%	0.60%	0.58%	0.56%	0.61%	0.59
AZT VIITORUL TAU	0.56%	0.69%	0.66%	0.60%	0.61%	0.61%	0.60%	0.60%	0.58%	0.56%	0.61%	0.48
BCR	1.69%	0.93%	0.75%	0.64%	0.63%	0.62%	0.63%	0.61%	0.58%	0.56%	0.62%	0.48
BRD	2.04%	1.11%	0.87%	0.75%	0.70%	0.62%	0.62%	0.64%	0.60%	0.56%	0.61%	0.47
NN	0.55%	0.62%	0.61%	0.58%	0.62%	0.60%	0.60%	0.60%	0.58%	0.56%	0.61%	0.48
VITAL	0.00%	0.58%	0.79%	0.70%	0.65%	0.64%	0.61%	0.61%	0.58%	0.56%	0.61%	0.60
EUREKO	*0.32%*	*0.16%*	*0.80%*	*0.65%*	*0.64%*	*0.65%*	-	-	-	-	-	
PENSIA VIVA	*0.09%*	*0.61%*	*0.60%*	*0.58%*	*0.59%*	-	-	-	-	-	-	
BANCPOST	*8.01%*	-	-	-	-	-	-	-	-	-	-	
KD	*5.90%*	*0.58%*	-	-	-	-	-	-	-	-	-	
OMNIFORTE	*2.00%*	-	-	-	-	-	-	-	-	-	-	
OTP	*14.6%*	*6.01%*	-	-	-	-	-	-	-	-	-	
PRIMA PENSIE	*8.86%*	*6.72%*	-	-	-	-	-	-	-	-	-	
TOTAL	0.77%	0.70%	0.66%	0.61%	0.62%	0.61%	0.60%	0.60%	0.58%	0.56%	0.61%	0.51

Source: Own calculation based on CNPP data

Pillar III – Voluntary private pensions

According to the Voluntary Pensions Law,[244] the administrator shall charge a fee from participants and beneficiaries for the management of a pension fund.

- The levels of fees shall be established in the pension scheme prospectus and shall be the same for all participants and beneficiaries;
- Participants shall be notified of any change to the fees at least 6 months before it is applied.

The administrator's revenue will come from:

[244] Law number 204/2006 concerning voluntary pensions

- management commission (up to 5% from the contributions) and management fee (up to 0.2% monthly from total gross assets in pension fund);
- transfer penalties (covered from personal assets, in case of moving to another fund/PFC earlier than in 2 years – 5%);
- fees for services requested by participants:
    - Depositary commission (depository fee);
    - Transaction costs (trading fees);
    - Bank commissions (banking fees);
    - Fund auditing taxes (pension fund auditing fees).

Management fees are made up of:

a) deduction of a percentage from contributions paid by participants; this percentage cannot be higher than 5% and must be made before contributions are converted into fund units (Management commission);

b) deduction of a negotiated percentage from the net assets of the voluntary pension fund; this percentage cannot be higher than 0.2% per month and shall be mentioned in the pension scheme prospectus (Management fee).

A transfer penalty is applicable (paid by the participant) in the event of a transfer to another fund within two years of having joined the previous fund; its upper limit is established by Commission norms. The next table compares effective charges of voluntary pension funds in pillar III over time (calculated via total and net NAV).

Table RO5. Effective annual charges of voluntary pension funds (Pillar III) in %

Voluntary pension fund	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
AZT VIVACE	1.05%	1.47%	2.83%	2.83%	2.52%	2.06%	2.00%	1.91%	1.84%	1.74%	1.67%	1.79%	2.14%
NN ACTIV	0.04%	1.64%	1.85%	2.38%	2.19%	2.34%	2.14%	2.09%	2.17%	2.1%	1.95%	2.11%	2.04%
AZT MODERATO	0.99%	1.83%	2.16%	1.86%	1.66%	1.41%	1.33%	1.28%	1.24%	1.18%	1.13%	1.21%	1.56%
BCR PLUS	5.61%	2.38%	2.28%	2.77%	2.44%	2.4%	2.23%	2.27%	2.16%	2.03%	1.97%	2.16%	2.11%
BRD MEDIO	-	-	0.85%	1.9%	1.56%	2.86%	2.18%	2.14%	2.2%	2.11%	1.91%	2.18%	2.05%
*CONCORDIA MODERAT**	-	-	*1.47%*	*1.47%*	*1.43%*	*1.46%*	0.00%	0.00%	*0.00%*	*0.00%*	*0.00%*	*0.00%*	*0.00%*
*EUREKO CONFORT**	-	-	*0.05%*	*0.00%*	*0.18%*	*0.06%*	*0.14%*	*0.07%*	*0.00%*	*0.00%*	*0.00%*	*0.00%*	*0.00%*
NN OPTIM	0.09%	1.58%	1.68%	2.09%	1.97%	2.05%	1.99%	1.97%	2.00%	1.94%	1.85%	2.00%	1.96%
PENSIA MEA	3.22%	3.17%	2.85%	2.66%	2.66%	2.7%	2.66%	2.66%	2.64%	2.43%	2.37%	2.56%	2.51%
RAIFFEISEN ACUMULARE	-	0.15%	2.93%	2.4%	2.23%	2.15%	2.43%	2.26%	2.47%	2.16%	2.06%	2.19%	2.02%
STABIL	-	-	2.26%	1.61%	1.5%	1.65%	1.63%	3.16%	3.71%	3.37%	2.8%	2.99%	2.81%
AEGON ESENTIAL	-	-	-	-	-	-	-	-	1.87%	3.15%	2.99%	3.12%	2.86%
*BRD PRIMO**	-	-	*0.83%*	*1.57%*	-	-	-	-	-	-	-	-	-
*OTP STRATEG**	*708.75%*	*19.1%*	*3.8%*	*2.91%*	-	-	-	-	-	-	-	-	-
TOTAL	4.72%	1.91%	2.12%	2.3%	2.09%	2.1%	1.99%	1.99%	2.01%	1.92%	1.83%	1.99%	1.99%

Source: Own calculations based on ASFRO data

The year 2019 brought further increase in effective annual charges, and the Pillar III confirmed that the Pillar III pension funds remain expensive pension vehicles.

Taxation

Pillar II – Funded pensions

Romania applies an EET system for the taxation of future mandatory accounts. Employee contributions are tax-deductible and investment income on the level of the pension fund is tax-exempt. Pension benefits paid out during retirement will be subject to a personal income tax (10% tax rate) above a certain level.

Pillar III – Voluntary private pensions

The amount of contributions to voluntary pension funds is fiscally deductible from each subscriber's gross monthly wage or any other assimilated revenue if the total amount is not greater than the equivalent in RON of €400 in a fiscal year. The same rule applies to the employer, meaning that the employer can deduct the amount paid to the employee's voluntary pension account up to €400 annually.

The investment returns achieved by the third pillar fund are tax exempt until the moment of payments toward subscribers' start. The pension benefits paid from Pillar III are subject to personal income tax, thus representing an 'EET' regime.

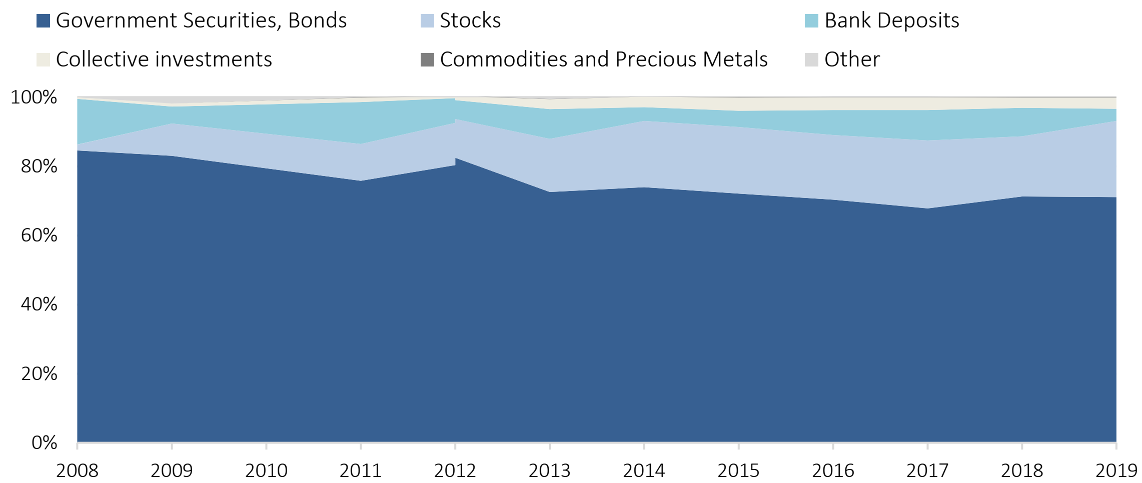
Pension Returns

Pillar II – Funded pensions

Seven asset managers offer seven mandatory pension funds in Romania. Performance analysis reveals similarities in their investment strategy, implying similarity in the pension funds' portfolio structure.

For the purpose of this study, we simplified the portfolio structure to only six main asset classes.

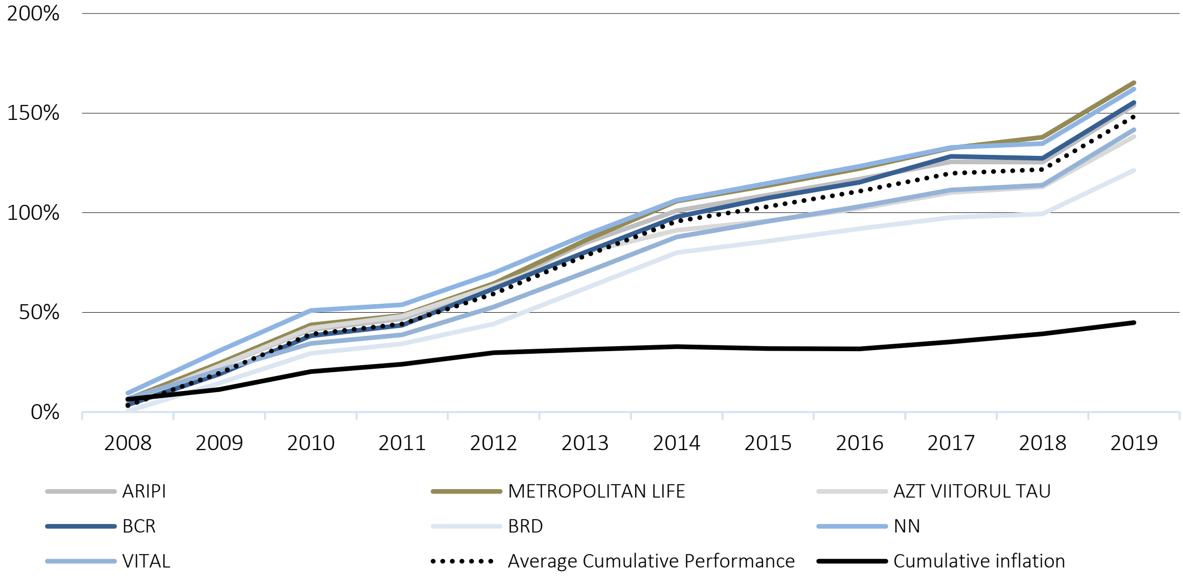
Graph RO6. Portfolio structure of Pillar II mandatory pension funds



<u>Source</u>: Own composition based on ASFRO data

Romanian mandatory pension funds invest mostly in government securities and bonds asset classes. The second most important asset class (from the portfolio structure point of view) are equities and the third most important are bank deposits. Three other classes have minimal impact on pension fund's performance. The portfolio structure of the Romanian Pillar II is presented below. According to the data available, currently almost 71% of all investments in Pillar II pension funds are bond investments and 21% is invested in equities. Mandatory Pension Funds' performance compared to the inflation index is presented below.

Graph RO7. Mandatory Pension Funds – Cumulative Nominal Performance



Nominal as well as real returns of Pillar II pension funds in Romania, weighted by AuM, are presented in a table below.

Table RO8. Nominal and Real Returns of II. Pillar in Romania						
2008		6.40%			0.02%	
2009		17.57%			12.88%	
2010		15.04%			7.09%	
2011		3.22%			0.05%	
2012		10.55%			5.98%	
2013	Nominal return after charges, before inflation and taxes	11.48%	8.04%	Real return after charges and inflation and before taxes	10.16%	4.90%
2014		8.92%			7.88%	
2015		3.69%			4.73%	
2016		3.76%			3.85%	
2017		4.26%			1.67%	
2018		1.06%			-1.96%	
2019		11.89%			7.84%	

<u>Source</u>: Own calculations based on ASFRO data

To indicate the evolution of annualized performance (nominal as well as real) of Pillar II pension funds in Romania based on different holding periods, see the summary table below.

Table RO9. Nominal and Real Returns of II. Pillar in Romania		
Holding Period	Net Nominal Annualized Performance	Real Net Annualized Performance
1-year	11.89%	7.84%
3-years	5.64%	2.44%
5-years	4.87%	3.10%
7-year	6.36%	4.76%
10-years	7.29%	4.63%
Since inception	8.04%	4.90%

Source: Table RO8

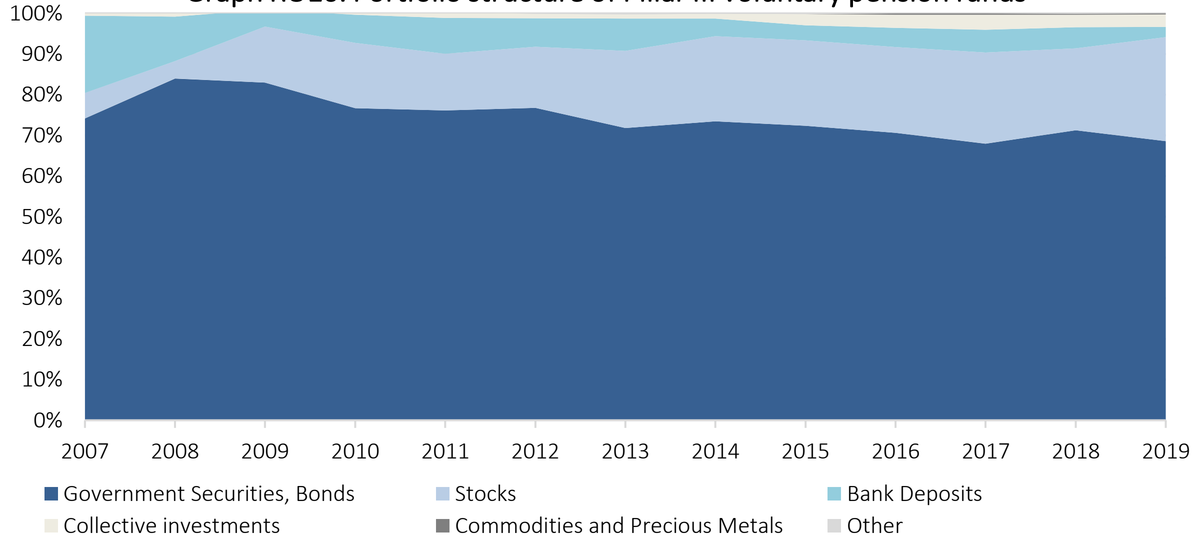
Pillar III – Voluntary private pensions

The eight asset managers offer 10 voluntary pension funds in Romania. AZT and NN are the only providers which offer two voluntary pension funds. The performance of all pension funds shows the same finding as with Pillar II mandatory pension funds - there is similarity in voluntary pension funds' investment strategy. Performance results also imply a similarity in pension funds' portfolio structure.

Analyzing the portfolio structure of voluntary pension funds based on CSSPP data, we can conclude that most of the performance is tied to the Government Securities and Bonds asset classes. The second most important asset class (from the portfolio structure point of view) is equities and the third most important is bank deposits. The three other classes have minimal impact on pension fund's performance results.

Portfolio structure of Romanian Pillar III voluntary pension funds is presented below. According to the data for 2019, around 69% of all investments in Pillar III pension funds are bond investments and about 26%, of which 3.25% is invested in stocks with rising portion of collective investment vehicles (UCITS funds). Overall, Pillar III portfolio structure is very similar to that of Pillar II over the whole analysed period. The difference in the performance could therefore be devoted to the negative impact of fees, which are significantly higher in Pillar III.

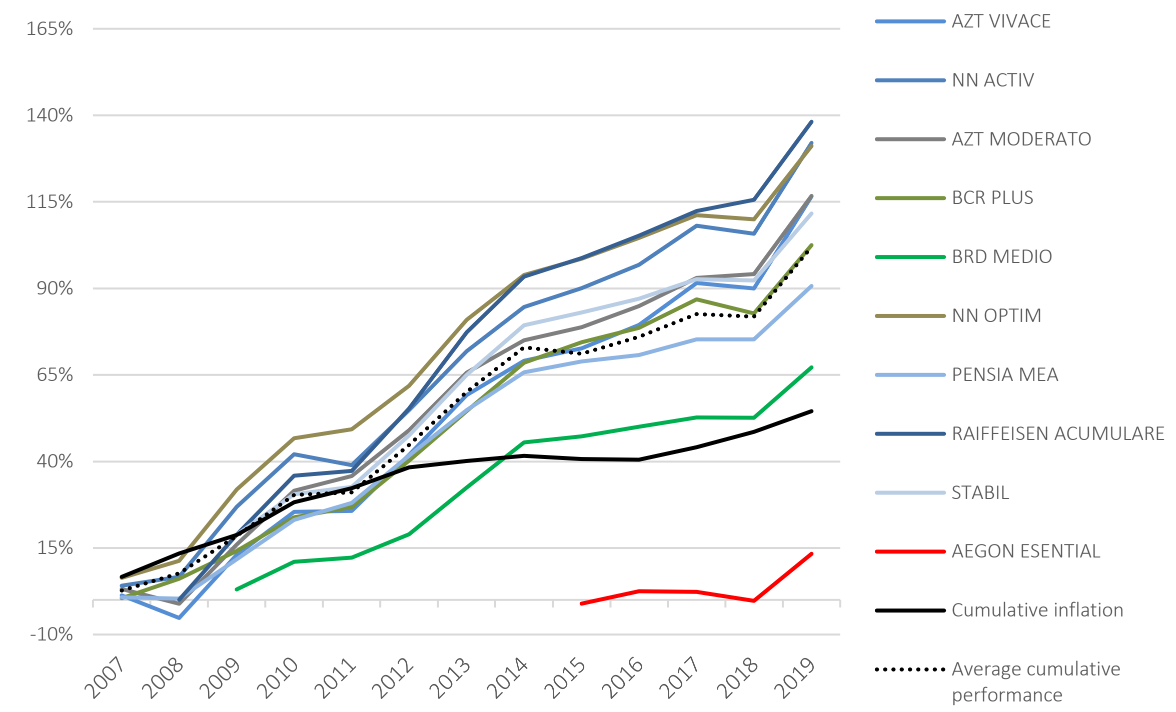
Graph RO10. Portfolio structure of Pillar III voluntary pension funds



Source: Own composition based on ASFRo data

All voluntary pension funds' performance on a cumulative basis compared to the inflation index is presented in the graph below.

Graph RO11. Voluntary Pension Funds – Cumulative Nominal Performance



Source: Own composition based on ASFRo data

Nominal as well as real returns of voluntary pension funds in Romania, weighted by AuM, are presented in a summary table below.

Table RO12. Nominal and Real Returns of III. Pillar in Romania

2007		1.86%			-4.80%	
2008		1.72%			-4.66%	
2009		15.51%			10.82%	
2010		11.14%			3.19%	
2011		1.59%			-1.59%	
2012		9.96%			5.40%	
2013	Nominal return after charges, before inflation and taxes	11.36%	6.06%	Real return after charges and inflation and before taxes	10.05%	2.61%
2014		7.48%			6.44%	
2015		2.55%			3.22%	
2016		2.91%			3.00%	
2017		3.96%			1.38%	
2018		-0.66%			-3.68%	
2019		10.81%			6.76%	

Source: Own calculations based on ASFRo data

To indicate the evolution of annualized performance (nominal as well as real) of Pillar III voluntary pension funds in Romania based on different holding periods, see the summary table below.

Table RO13. Nominal and Real Returns of Pillar III (Voluntary Pension Funds) in Romania		
Holding Period	Net Nominal Annualized Performance	Real Net Annualized Performance
1-year	10.81%	6.76%
3-years	4.60%	1.40%
5-years	3.85%	2.08%
7-year	5.41%	3.80%
10-years	6.02%	3.35%
Since inception	6.58%	2.61%

Source: Table RO12

Conclusions

Romania's population is rapidly decreasing and aging, which – unless they adopt the necessary reforms - will lead to the explosion of the demographic bomb in a few decades. That is why Romania introduced the private pensions system in 2007, which is based on the model tested and recommended by the World Bank. The multi-pillar private pensions system includes Pillar II (mandatory schemes) and Pillar III (voluntary schemes).

In the public PAYG pensions system, the state collects contributions from employees and redistributes the money among existing pensioners. Demographics show that this redistribution logic is no longer viable, as contributors' numbers will fall, and the number of pensioners is already going up. The departure from this dilemma takes the form of the private pensions system, allowing each active person to save for their own future retirement.

Romanian pillar II is a fully funded system based on personal accounts and on the defined contribution (DC) philosophy. Pillar II is mandatory for all employees aged under 35 years and voluntary (optional) for employees aged 35 to 45. The starting level of contribution was set at 2% of the participant's total gross income and increases by 0.5 percentage points annually until it reaches 6 of total gross income in 2017. However, this level has not been reached, and the contribution system has inversed.

Mandatory pension funds are managed by their administrators - Pension Management Companies (PMCs). Each PMC is obliged by respective law to administrate and manage just one mandatory pension fund. Currently, there are seven PMCs managing seven mandatory funds on the Romanian Pillar II market. The market is dominated by two PMCs (AZT and NN).

Romanian pillar III is also a fully funded system based on personal accounts and on the defined contribution (DC) philosophy. Pillar III represents privately managed supplementary pensions. This system is opened to all income cohorts. The tax advantage contribution is limited to 15 of participant's total gross income.

Voluntary pension funds in Pillar III are managed by their administrators - Pension Management Companies (PMCs), Life Insurance Companies (LICs) or Asset Management Companies (AMCs). Each administrator is obliged to establish and operate at least one voluntary pension fund. Currently, there are eight providers offering 10 voluntary pension funds. Pillar III market is fairly concentrated, where three dominant players cover almost 90 of the market.

Mandatory as well as voluntary pension funds' investment strategy is strictly regulated. The law imposes percentage limits and restrictions for different asset classes. It must be noted that investment rules in mandatory and voluntary system are very similar. This fact logically causes implications on portfolio structure, thus also on performance of mandatory and voluntary pension funds in Romania. Currently about 70 of all investments in Pillar II as well as Pillar III pension funds are bond investments (Romanian Government Money market instruments and Bonds) and only about 19 is invested in equities.

Overall, the real return of pension funds in Pillar II as well as Pillar III are positive and well above the inflation. However, considering the fee structure, Pillar II savers are better positioned as the charges are almost 5-times lower than the fees applied in Pillar III.

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