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Promoting Paritarian Social Funds in Hungary, Poland, The Czech Republic and The Slovak Republic

The Role of the Financial Sector as a Silent Partner behind the Paritarian Social Funds

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"Freedom was idealised 10 years ago. But adapting to a world of individual freedom has proved very difficult."

Quote of TADEUZ MAZOWIECKI, First Post-Communist Prime Minister of Poland

It was not easy: the region as a whole had to recover from the output collapse that followed the demise of the ex-Soviet bloc. GDP in 1998 languished at 65% of its 1989 level according to the EBRD (European Bank for Reconstruction and Development).

In Russia and Ukraine it was much worse: 1998 output was 50% of 1989 GDP in Russia and only 35% in Ukraine.

"Even the economically advanced countries of Central Europe, such as Poland, Hungary and the Czech Republic, can not afford the Social Security safety net which protects western workers."

Financial Times, Wednesday November 10, 1999

The role of the Financial Sector as a Silent Partner

A second pension pillar – company and industry-wide/ sector pension funds – hardly exists in the New Member States of the European Union.

What exists mainly is what they call their second pillar i.e. funded individual DC type plans which are the funded part of the first/social security pillar. They exist in the Baltic States, in Poland, the Slovak Republic, Hungary, Romania and Bulgaria but not in the Czech Republic, Slovenia, Cyprus and Malta.

We call this – what they call the second pillar – a first-pillar bis (because it is part of the first social security pillar).

The role of the Financial Sector as a Silent Partner (cont'd)

The World Bank has played a major role in the setting up of this so-called second pillar/first pillar bis and continues to act in the monitoring of this pillar. The European Union was, unfortunately, highly absent in this process. Even in the accession negotiations with the new Member States pensions were not on the agenda... (from what we understand). This is remarkable given the big price tag related to pensions and an ageing population (which are a fact of life in Central and Eastern Europe).

The role of the Financial Sector as a Silent Partner (cont'd)

Funded pensions in aggregate are still very modest in Central and Eastern Europe. They are a new phenomenon.

According to a recent study of Allianz Global Investors total assets of this second pillar/first pillar-bis amounted to € 5.1 billion end 2006 (which equals about the 20th largest Dutch pension fund) versus nearly € 2,5 trillion in the EU15. Allianz projects an annual growth rate of 19% - which seems a lot to us – to € 21 billion in 8 years. This € 21 billion is about one fiftieth of the <u>current</u> asset size of Dutch pension funds...

The role of the Financial Sector as a Silent Partner (cont'd)

We wonder whether the current approach in most of Central and Eastern Europe/the New Member States is a good one:

a) It is all DC

b) All the risks, investment and other are taken by the individual.

The role of the Financial Sector as a Silent Partner (cont'd)

Ref a)

They miss the benefical effects of DB type plans/ of solidarity and of paritarian control which provide a buffer against financial shocks.

The role of the Financial Sector as a Silent Partner (cont'd)

Ref b)

The individual bears all the risks, particularly investment risk. The current market turmoil, once again, demonstrates that such investment risks are real and considerable. If such risks would persist over time, they may well cause the end of individual DC plans as is now clear already with some 401(K) plans in the United States.

The role of the Financial Sector as a Silent Partner (cont'd)

The financial sector is dominant. The same names of financial institutions always crop up in countries where the World Bank has inspired/ dominated the pension reform process, be it in Latin America, in Central and Eastern Asia and in Central and Eastern Europe. Are these good names? Is what they are doing good enough?

Silent Partner?

The financial sector is not a silent partner in Central and Eastern Eruopean pensions. It is, to the contrary, a very loud and outspoken partner. One example: in the survey we did for the European Commission 2 years ago ("The Pension issues in the New Member States") it appeared that many respondents were of the opinion that the role of the financial sector should even be re-inforced particularly related to transparency (!). In other words: the financial sector should control itself. The financial sector, in our view, is a provider/a seller, nothing more, nothing less.

Return, risk, costs, choice, education/transparency

Pension funds in the Netherlands and in Belgium which benefit from paritarian control obtained a net after costs return of around 10% annualised over long periods (15 to 20 years).
They benefit from risk mitigation.
They are supervised by the social partners and by the legal surpervisor. Whereas many people in Central and Eastern Europe believe that the financial sector should be an educator, this latter role is clearly separated in the EU15. Pension funds in the EU15 provide better transparency than second pillar/first pillar bis funds in Central and Eastern Europe.

Return, risk, costs, choice, education/tranparency (cont'd)

Costs in Central and Eastern Europa are high: up to 6 or 7% of premiums we understand i.e. much higher than in Western Europe. The vehicle used (investment funds/mutual funds) is expensive. Choice between funds for the individual is often limited (also by law, e.g. in Poland); this is, in our opinion, quite unnecessary.

Conclusion

It seems that return of Central and Eastern European pension funds is lower than in the EU15;

that the risks, wich the individual bears, are higher;

that education and transparancy are suboptimal;

that costs are excessive;

and that choice is insufficient.

Conclusion (cont'd)

It seems that te World Bank model is in need of repair and that the lack of action of the European Commission was/is regretful.