



NATIONAL BANK OF SERBIA

INSURANCE SUPERVISION DEPARTMENT
PENSION FUNDS SUPERVISION DIVISION

VOLUNTARY PENSION FUNDS IN SERBIA

Third Quarter Report 2013

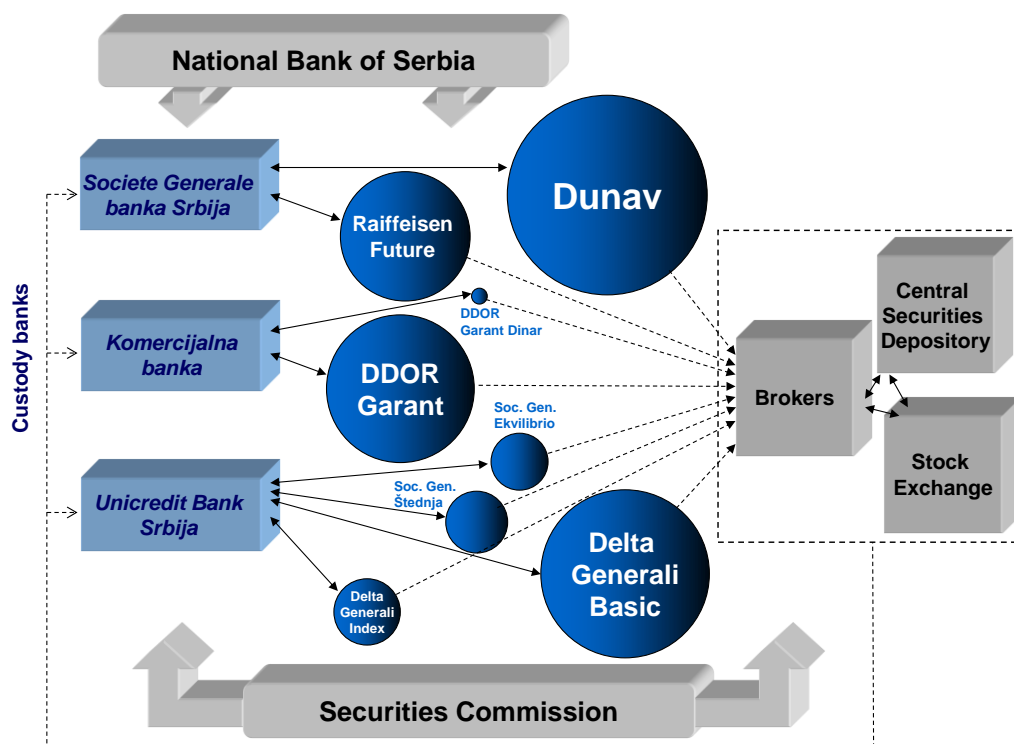
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1. Market participants

At end-Q3, the market of voluntary pension funds (VPFs) comprised five companies managing eight VPFs, three custody banks and four agent banks¹.

Market participants



At end-Q3, total employment in VPF management companies was 141, down by eight from end-Q2.

Management companies hire natural persons to disseminate information about VPF operation. For the time being, there are 465 persons engaged in these activities who were licensed by the NBS after passing professional examination and meeting other eligibility requirements.

¹ NLB banka a.d. Belgrade, Raiffeisen banka a.d. Belgrade, Sberbank a.d. Belgrade and Société Générale Banka Srbija a.d. Belgrade.

2. VPF net assets

At end-Q3 2013, net assets came close to RSD 19 billion, up by 4.4% quarter-on-quarter or 26% year-on-year. Net assets increased on account of net contributions² exceeding the amount of benefits and the return on investment. Furthermore, RSD 674.5 million were paid into individual accounts. Withdrawals amounted to RSD 217.3 million. Total return on investment in Q3 was RSD 342.5 mln.

Net assets reached close to RSD 19 billion (growth close to RSD 800 mln).

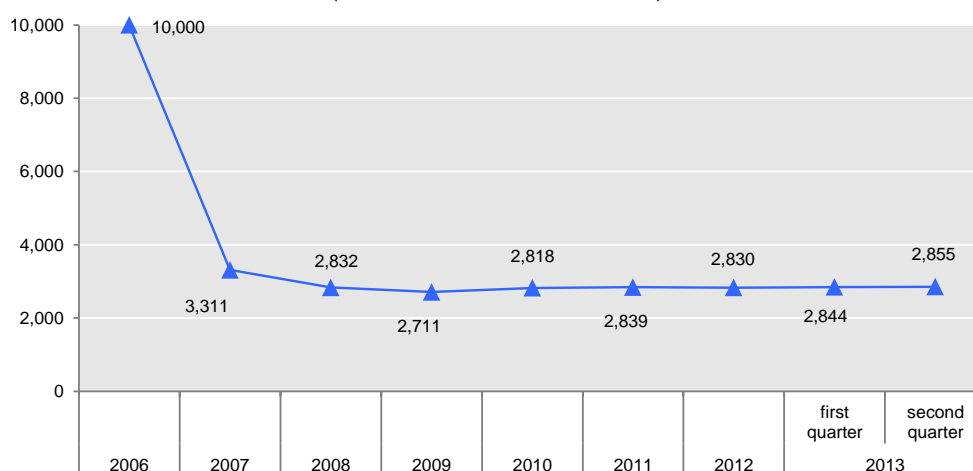
Net contributions exceeded benefits by RSD 457.2 million. Return on investment amounted to RSD 342.5 mln.

End-of-period net assets of the VPF sector
(in RSD billion)

| 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | | |
|------|------|------|------|------|------|------|------|------|
| | | | | | | Q1 | Q2 | Q3 |
| 3.1 | 4.6 | 7.2 | 9.9 | 12.5 | 16.0 | 17.0 | 18.0 | 18.8 |

Source: National Bank of Serbia.

End-of-period sector concentration
(Herfindahl–Hirschman Index)



Source: National Bank of Serbia.

Measured by HHI, market concentration in the sector³ remained high – 2,856 points at end-Q3. What also attests to high market concentration are two funds classified as ‘large’ and two as ‘medium’, making up over 96% of the market, while the largest fund accounted for c. 42% of total net assets.

² Net contributions are total contributions minus the front-load fee.

³ In terms of the share in total net assets.

| Number of funds by groups divided by market share (in units) | | | | | | | | | |
|---|------|------|------|------|------|------|------|----|----|
| Share in net assets (%) | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | | |
| | | | | | | | Q1 | Q2 | Q3 |
| Large (20 and above) | 3 | 2 | 2 | 3 | 2 | 2 | 2 | 2 | 2 |
| Medium (5 – 19.99) | - | 2 | 3 | 1 | 2 | 2 | 2 | 2 | 2 |
| Small (0 – 4.99) | 4 | 6 | 5 | 4 | 5 | 5 | 5 | 4 | 4 |

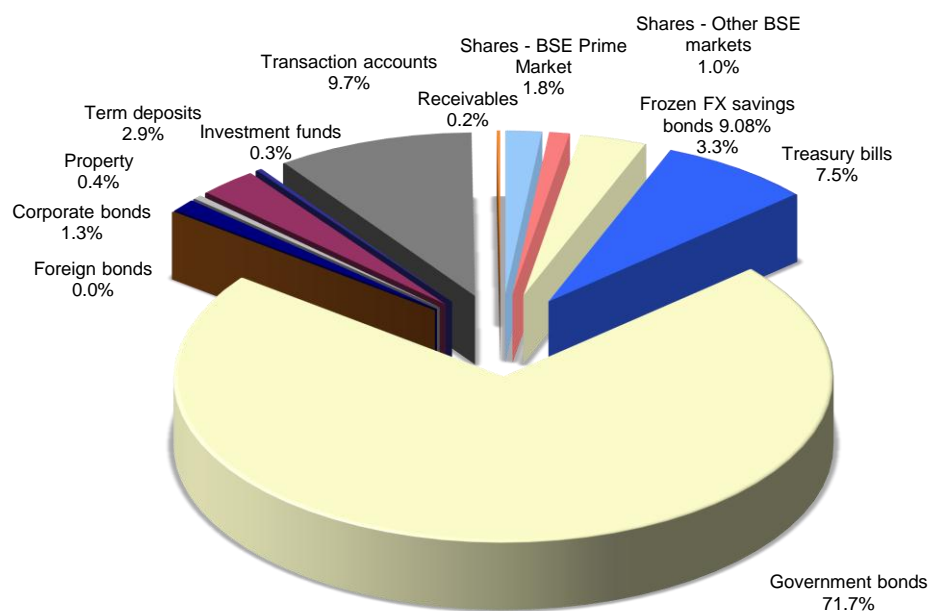
Source: National Bank of Serbia.

3. Structure of VPF net assets

In Q3, government debt securities accounted for the major portion of VPF assets – 82.5%, of which government bonds made up 71.7%, T-bills – 7.5%, and frozen FX savings bonds – 3.3%.

Most funds were invested in government instruments – 82.5%, while 19.1% of assets were in foreign currency.

Structure of VPF assets
(end-of-quarter)



Source: National Bank of Serbia.

Foreign currency denominated assets accounted for c. RSD 3.6 billion or 19.1% (16.5% in euros and 2.6% in US dollars), while dinar assets made up RSD 15.3 billion or 80.9% of total assets.

4. Return on investment

At end-Q3 2013, FONDex⁴ reached 1,815.31 points⁵. The return of FONDex, which represents the weighted average return of all funds, came at 1.9%, while the return for the last year measured 14.4%. Since the start of VPF operation⁶, the return of FONDex equals 9.1%.

Given the structure of VPF investment, the return is under the strongest impact of a change in the yield curve on government debt instruments⁷ (changes in interest rates of some maturities), changes in prices of shares, the level of the key policy rate and banks' interest rates, and changes of the dinar exchange rate against the euro.

A decrease was recorded in the volume of issues in the primary market of government debt instruments (T-bills and government bonds), while discount rates went up relative to the previous quarter.

The total market value of dinar-denominated issues came at c. RSD 50.5 billion vs. RSD 65 billion in the previous quarter. Most issued were 1-year (17.9 billion), 2-year (15.8 billion) and 3-month (9.8 billion) bills. Also issued were 6-month, 3-year, 5-year and 7-year bonds (total RSD 7.1 billion).

| Accepted rates of issued dinar government debt instruments, by maturity (%) | | | | | |
|---|---------|---------|---------|---------|---------|
| Maturity | Q3 2012 | Q4 2012 | Q1 2013 | Q2 2013 | Q3 2013 |
| 3m | 13.0% | 11.3% | 9.5% | 9.2% | 9.2% |
| 6m | 13.5% | 12.9% | 9.5% | 9.1% | 9.4% |
| 12m | 14.6% | 11.9% | 10.0% | 9.1% | 10.8% |
| 18m | 15.0% | 12.9% | | | |
| 24m | 14.5% | 13.0% | 10.8% | 9.9% | 11.5% |
| 36m | 16.0% | 14.0% | 11.4% | 10.5% | 12.0% |
| 60m | | 14.7% | 12.9% | 10.5% | 10.7% |
| 84m | | | 12.7% | 12.3% | 13.0% |

Source: Ministry of Finance.

⁴ FONDex shows movements in investment units of all VPFs in the market.

⁵ The initial FONDex value of 1000 points was recorded on 15 November 2006 when the first VPF began to operate.

⁶ Annual rate.

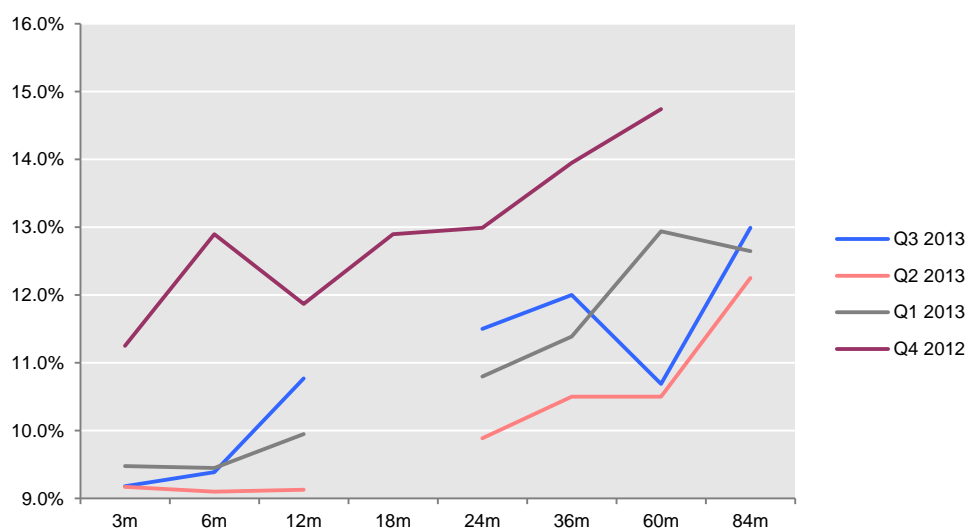
⁷ The interest rate declines in response to an increase in prices of debt instruments and vice versa. Prices of instruments of longer maturity are more sensitive to interest rate changes.

Market value of issued dinar government debt instruments, by maturity
 (RSD billion)

| Maturity | Q3 2012 | Q4 2012 | Q1 2013 | Q2 2013 | Q3 2013 |
|----------|---------|---------|---------|---------|---------|
| 3m | 10.7 | 6.7 | 9.0 | 2.9 | 9.8 |
| 6m | 12.1 | 8.3 | 5.7 | 5.6 | 2.9 |
| 12m | 16.2 | 19.2 | 27.1 | 20.4 | 17.9 |
| 18m | 11.7 | 16.1 | | | |
| 24m | 6.7 | 3.3 | 23.7 | 20.0 | 15.8 |
| 36m | 23.7 | 9.9 | 18.3 | 11.8 | 3.3 |
| 60m | - | 4.2 | 4.5 | 1.2 | 0.4 |
| 84m | | | 2.6 | 3.1 | 0.6 |
| Total | 81.0 | 67.6 | 90.9 | 65.0 | 50.5 |

Source: Ministry of Finance.

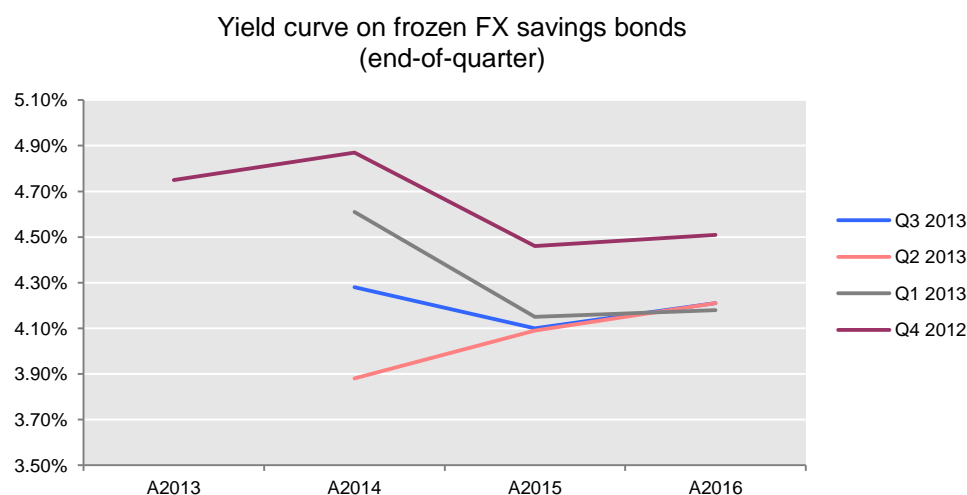
In the quarter under review, returns to maturity for dinar instruments increased from the previous quarter – by around 85 basis points on average.

Accepted rate on government dinar debt instruments
 (end-of-quarter)


Source: Ministry of Finance.

The period reviewed also saw the issue of euro-denominated government debt instruments worth c. RSD 12.9 billion – 2-year (RSD 5.7 billion) at a 4.48% rate, 3-year (RSD 4.3 billion) at a 5% rate, and 5-year (RSD 2.95 billion) at a 5.25% rate. Interest rates increased relative to the previous quarter.

At end-Q3 2013, yields on frozen FX savings bonds ranged from 4.10% to 4.28%⁸. The yield curve increased for the A2014 series, by 40 basis points. Year-on-year, yields on A2015 and A2015 series remained unchanged.



Source: Belgrade Stock Exchange.

Prices of Belgrade Stock Exchange (BSE) shares, measured by BELEX15⁹, rose by 9.3% in Q3 (the index value was 524.84 by end-September). The index rose by 21.8% over the last year. Measured by the number of transactions, BSE activity touched its ten-quarter low with 71,849 transactions, and turning volumes reached close to RSD 5.5 billion.

The key policy rate equalled 11%. It stayed flat on the previous quarter, but gained 50 basis points from end-September last year. Mirroring the increase in the key policy rate, the interest earned on dinar balances held in custody accounts increases, and vice versa.

Rates on term deposits were on average lower compared to the previous quarter.

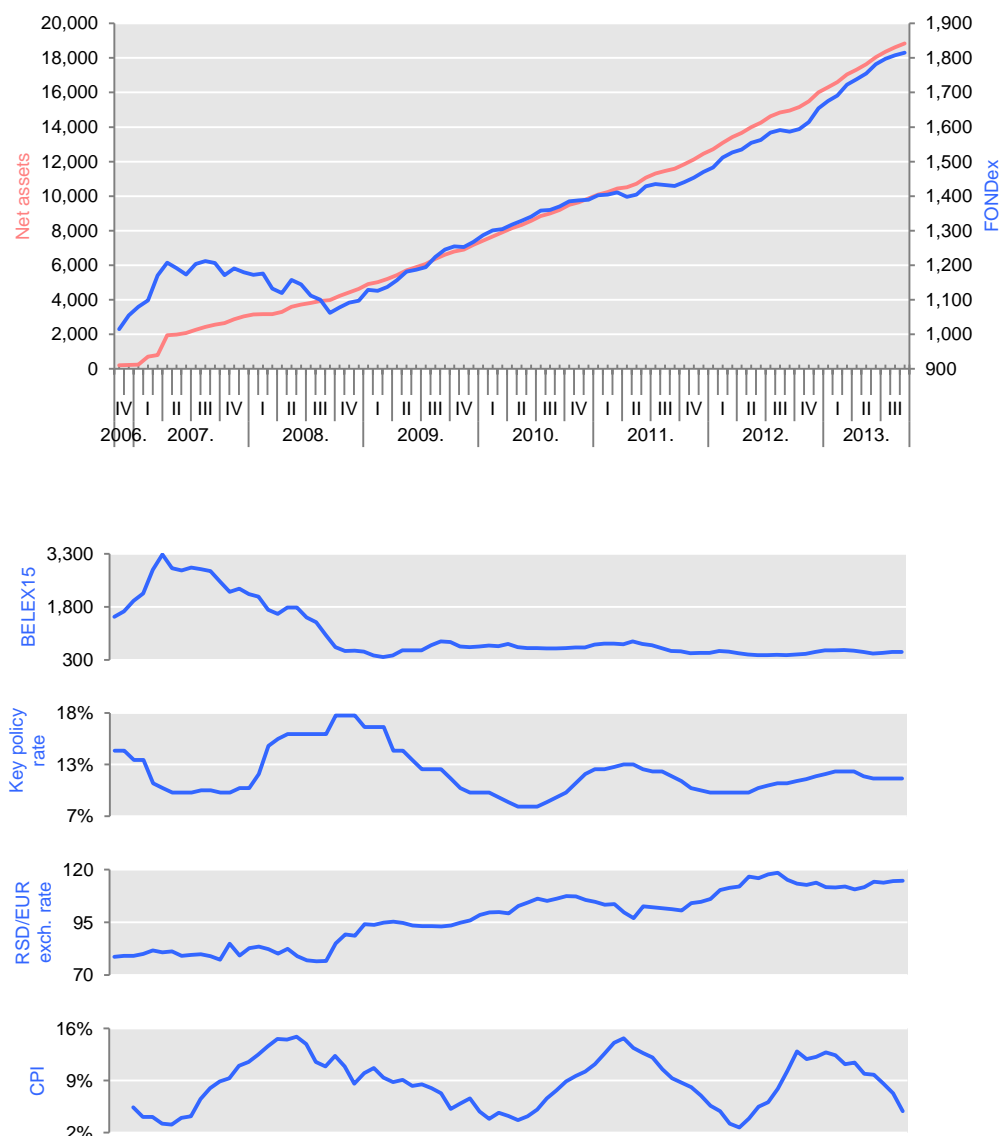
The exchange rate of the dinar was stable relative to the euro. At end-Q3, the dinar lost 0.38% from the previous quarter. In the same period, the dinar gained 2.9% vis-à-vis the US dollar.

Q3 saw a slowdown in inflation. Monthly growth rates came at -0.90%, 0.40% and 0% in July, August and September respectively. CPI went up by 4.9% in September 2013 y-o-y.

⁸ A2013 series bonds fell due on 31/05/2013.

⁹ Of total investment in shares, over 90% were shares covered by BELEX15, which means that BELEX15 is a relevant benchmark for shares in the funds' portfolio.

Movements in net assets, FONDEX and key indicators since the start of VPF operation
(in RSD mln, units, %)



Source: National Bank of Serbia, Belgrade Stock Exchange, Statistical Office

5. Fees charged by management companies

The Law on Voluntary Pension Funds and Pension Schemes sets out maximum fees that may be charged to fund members. Contribution and management fees may not exceed 3% and 2% respectively, while the account transfer fee may be charged only at the level of real transfer costs.

Management fees will be limited to 1.25% once net assets of all funds reach 0.75% of GDP.

The new Law, adopted in early May 2011, envisages different fees charged by management companies – these fees will be applied once net assets of all funds reach 0.75% of GDP. The maximum management fee is set at 1.25%, while the contribution fee is not capped. VPF net assets currently account for c. 0.53%¹⁰ of GDP.

Fees are one of the parameters that members should bear in mind when choosing a fund, but should not be observed as an isolated factor. The fee level is contingent on the fund investment strategy and its performance. As a rule, funds actively investing in more complex and riskier instruments are intended for younger persons who pay contributions over a longer horizon. Such funds charge higher fees, but are also expected to post higher return in the long run. On the other hand, a fund investing passively in safe financial instruments should charge lower fees. Investment policy (scheduled investment by fund members), fees charged by companies, the expected fund return and the risk taken by the fund (and the member) should be taken into account when choosing a fund.

Since the start of operation, companies charged a 2% management fee, while the contribution fee was cut to 2.19% on average by end-Q3 2013. The relative proportion of the two fees reversed – at the start of VPF operation, contribution fees were dominant by contrast to the current 86% of management fees. This was a result of rising net asset value and an enlarged base to which management fees are applied.

Though visible in the first instance, the contribution fee is not the largest cost incurred by a member. It is paid only once, as a front-load fee. The management fee is charged every day on the value of VPF net assets and is contained directly in the investment unit value, meaning that the calculated and published value is deduced by the amount of the management fee. In Q3 2013, the management fee equalled RSD 92.9 million. Over the past year, the fee equalled RSD 338.8 million and the yield reached RSD 2,190.3 million. A further rise in net assets and boosted fund competition may result in gradual lowering of the management fee.

¹⁰ Source: GDP – database of the Serbian Statistical Office, quarterly GDP at current prices, seasonally non-adjusted data.

| Fees charged by management companies (in RSD million) | | | | | | | | | |
|---|------|------|-------|-------|------|-------|------|------|------|
| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | | |
| | | | | | | | Q1 | Q2 | Q3 |
| Contribution fee | 43.5 | 56.9 | 54.9 | 59.3 | 57.9 | 60.1 | 13.5 | 14.7 | 15.1 |
| Management fee | 33.4 | 72.2 | 117.2 | 170.6 | 220 | 284.1 | 81.2 | 87.3 | 92.9 |

Source: National Bank of Serbia.

6. Trading in securities

VPF trading volumes equalled RSD 1.6 billion in Q3 2013.

On the purchase side, the major part related to auctions of government debt instruments. The share of VPFs in BSE trading was around 0.61%.

| VPF securities trading (in RSD billion) | | | | | | | | | |
|---|------|------|------|------|------|--|------|------|------|
| | | | | | | | 2013 | | |
| | 2008 | 2009 | 2010 | 2011 | 2012 | | Q1 | Q2 | Q3 |
| Securities trading | 1.5 | 12.6 | 14.9 | 19.3 | 13.3 | | 5.2 | 2.4 | 1.6 |
| Purchases | 1.1 | 8.1 | 8.1 | 10.6 | 7.1 | | 3.5 | 1.9 | 1.0 |
| Belgrade Stock Exchange | 0.8 | 0.4 | 1.3 | 0.7 | 0.3 | | 0.4 | 0.0 | 0.3 |
| Unregulated market | 0.3 | 0.4 | 0.3 | 1.3 | 0.1 | | 0.2 | 0.2 | 0.3 |
| Auctions of government securities | 0.0 | 7.3 | 6.5 | 8.6 | 6.7 | | 3.0 | 1.7 | 0.7 |
| Sales | 0.4 | 0.4 | 0.8 | 3.8 | 4.2 | | 0.9 | 0.3 | 0.0 |
| Belgrade Stock Exchange | 0.1 | 0.1 | 0.6 | 0.4 | 0.3 | | 0.5 | 0.0 | 0.0 |
| Unregulated market | 0.3 | 0.3 | 0.2 | 3.4 | 3.9 | | 0.5 | 0.3 | - |
| Maturity | 0.1 | 4.1 | 6.1 | 4.9 | 2.0 | | 0.7 | 0.2 | 0.5 |
| Purchase to sale and maturity ratio | 2.4 | 1.8 | 1.5 | 1.2 | 1.1 | | 2.1 | 3.6 | 1.9 |
| Share in total BSE trading (in %) | 1.2% | 1.1% | 7.6% | 3.8% | 2.6% | | 5.3% | 1.6% | 0.6% |

Source: National Bank of Serbia, Belgrade Stock Exchange.

7. Transaction costs

Transaction costs incurred in the purchase, sale and transfer of securities (Central Securities Depository fees, stock exchange fees, tax charges) and costs of the current maintenance of property that fund assets are invested in are charged against fund assets. Other costs are incurred by the management company.

Brokerage and custody bank fees account for the largest share of transaction costs. In Q3 2013, costs incurred by management companies accounted for 80% and those incurred by funds 20% of the total.

| Amount of transaction costs (in RSD million) | | | | | | | | | |
|--|------|------|------|------|------|------|------|-----|-----|
| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | | |
| | | | | | | | Q1 | Q2 | Q3 |
| Total | 10.0 | 5.3 | 7.4 | 9.7 | 7.0 | 4.7 | 3.1 | 1.0 | 0.7 |
| Brokerage fees | 4.5 | 2.2 | 3.8 | 4.5 | 2.9 | 2.0 | 1.4 | 0.4 | 0.3 |
| Custody bank fees | 1.8 | 1.5 | 2.0 | 2.4 | 2.2 | 1.5 | 0.9 | 0.3 | 0.3 |
| Stock exchange fees | 1.6 | 0.8 | 0.4 | 1.1 | 0.8 | 0.3 | 0.5 | 0.0 | 0.0 |
| Central Securities Depository fees | 1.0 | 0.6 | 1.2 | 1.5 | 1.1 | 0.9 | 0.3 | 0.2 | 0.1 |
| Other costs | 1.1 | 0.2 | - | - | - | - | - | 0.0 | 0.0 |

Source: National Bank of Serbia.

In response to relatively high trading volumes at the start of operation, particularly trading on the BSE, transaction costs were the highest at the time. The economic crisis induced contraction in the activity of management companies that directed their investment to safer instruments. In 2009, the costs rose again in response to reduced balances in transaction accounts, a shift to government T-bills and a gradual increase in shares trading. Q3 saw a significant drop in transaction costs, by contrast to Q2 when funds' investment activity was more intensive.

8. Number and structure of VPF users

At end-Q3 2013, 183,547¹¹ of users were in the accumulation phase¹². Total membership contracts¹³ stood at 244,306. At the same time, 167 users holding 194 membership contracts, who are currently in the withdrawal phase, are receiving scheduled payments. All information from this point onwards, unless specified otherwise, refers to users in the accumulation phase.

Total number of users was 183,547 in late Q3.

In the 2008–2011 period, the strongest growth in the number of new users was recorded in 2009 and 2011 (close to 9,000 and 8,000), while 2010 saw a marginal increase. Relative to Q2, the quarter under review saw an increase of 2,878 users.

¹¹ The number of users is the number of members of one or more VPFs. The number is smaller than the number of membership contracts as a significant number of users have more than one membership contract in one or several funds.

¹² VPF membership has two phases – the accumulation phase (when contributions are made) and the withdrawal phase (when the accumulated funds are withdrawn).

¹³ The number of membership contracts is the sum total of individual membership contracts and the number of members of all pension schemes.

| Number of contracts and users (in thousand) | | | | | | | | | |
|---|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | | |
| | | | | | | | Q1 | Q2 | Q3 |
| No. of contracts | 158.5 | 201.6 | 215.7 | 220.4 | 234.4 | 240.4 | 241.9 | 241.5 | 244.3 |
| No. of users | - | 156 | 165.2 | 166.8 | 174.9 | 179.8 | 180.9 | 180.7 | 183.5 |
| Percentage of active users (in %) | - | 41.1% | 34.9% | 33.6% | 35.1% | 30.5% | 31.2% | 31.0% | 30.4% |

Source: National Bank of Serbia.

VPF users account for c. 2.5% of the total population. Each tenth employee is a VPF member.

| Structure of users by payment dynamics (in units and %) | | | |
|---|----------------------------------|--------------|-----------|
| | Period | No. of users | Share (%) |
| Active users | 1 month | 55.764 | 30.4% |
| | 3 months | 63.191 | 34.4% |
| | 6 months | 66.116 | 36.0% |
| | 12 months | 72.009 | 39.2% |
| | From the start of membership (1) | 154.957 | 84.4% |
| No holdings | (2) | 28.590 | 15,6% |
| Total | (1+2) | 183.547 | |

Source: National Bank of Serbia.

Average accumulated funds per user depend on the amount of contributions, the funds' return, level of fees, and the length of the accumulation phase. With an increase in the level of contributions and the period of accumulation, alongside the returns, the amount of average funds in members' individual accounts increases. The average amount of accumulated funds of members who have made at least one contribution is somewhat above RSD 121,494 and is constantly rising.

At end-Q3 2013, the number of members of two or more VPFs amounted to 34,796 or c. 19% of the total.

| Average accumulated funds at period-end (in RSD thousand) | | | | | | | | |
|---|------|------|------|------|-------|-------|-------|-------|
| 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | | |
| | | | | | | Q1 | Q2 | Q3 |
| - | 34.6 | 52.2 | 70.5 | 84.5 | 105.3 | 111.9 | 118.6 | 121.5 |

Source: National Bank of Serbia.

Number of users by number of funds in which they are members
(in units)

| No. of funds | No. of users |
|--------------|--------------|
| 1 | 148,751 |
| 2 | 24,791 |
| 3 | 9,918 |
| 4 | 72 |
| 5 | 15 |

Source: National Bank of Serbia.

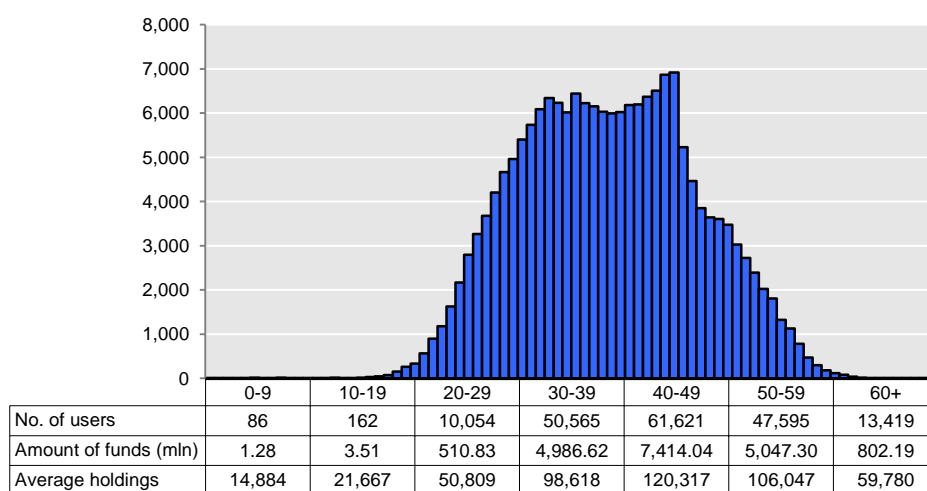
Number of users by membership contract
(in units)

| No. of contracts | No. of users |
|------------------|--------------|
| 1 | 137,057 |
| 2 | 34,026 |
| 3 | 11,132 |
| 4 | 967 |
| 5 | 288 |
| 6 | 46 |
| 7 | 31 |

Source: National Bank of Serbia.

In terms of gender composition, no significant changes were recorded relative to previous years. Men remained dominant with c. 59%.

Distribution of users and accumulated funds by age
(in units, RSD)



Source: National Bank of Serbia.

At end-Q3 2013, the average age of VPF users was close to 44 years, while users aged 30–50 accounted for c. 61%. Such structure has not changed since the start of VPF operation. Further, the percentage of users above the age of 53 is similar to previous years, accounting for c. 22% of the total.

9. Contribution payments, withdrawals and transfers

Apart from 2007 when most VPFs were set up and when contributions were the lowest, total contributions were stable throughout the years, ranging between RSD 2.2 and 2.5 billion a year.

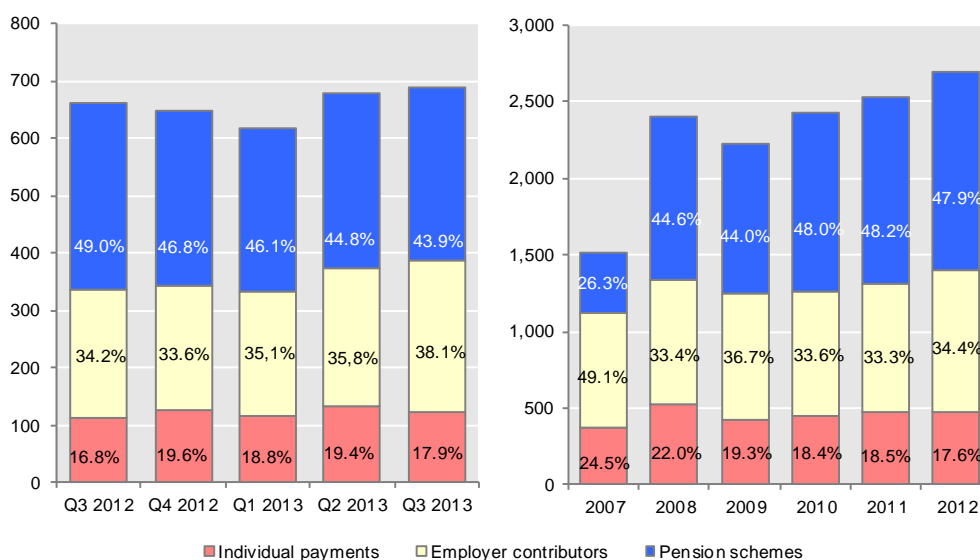
Contribution payments came at around RSD 689.6 million in Q3 2013.

| Total contributions (in RSD billion) | | | | | | | | |
|---|------|------|------|------|------|------|------|------|
| 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | | |
| | | | | | | Q1 | Q2 | Q3 |
| 1.52 | 2.41 | 2.22 | 2.43 | 2.53 | 2.69 | 0.62 | 0.68 | 0.69 |

Source: National Bank of Serbia.

In Q3 2013, of total contributions, individual contributions accounted for 17.9%, employer contributions 38.1% and pension schemes c. 43.9%. This ratio has been broadly unchanged since 2008.

Volume and structure of total contributions
(in RSD mln, %)



Source: National Bank of Serbia.

Though the Law envisages individual contributions, most are made through employers that thus show a high degree of responsibility towards their employees. Ample potential for further growth in the membership base are companies with high staffing levels. Contributions by individuals and employees up to a specified amount are exempt from payment of the household income tax and contributions for mandatory social insurance. The non-taxable contribution amount is set at RSD 5,214¹⁴ per employee per month. Payments in the same amount made by the employer through wage garnishment are also tax-exempt. This represents an additional incentive to employees and employers to direct a part of contributions to saving in VPFs. Withdrawals are generally made lump-sum as members entitled to withdrawal do not usually have long membership history and their accumulated sum is therefore relatively small. In the period ahead, we are likely to see an increase in scheduled and other types of withdrawals, in response to an increase in accumulation years and the accumulated sum, particularly after the start of application of the new Law setting the maximum lump-sum withdrawal at 30%.

Contribution payments came at around RSD 217.33 million in Q3 2013.

Total withdrawals
(in RSD million)

| 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | | |
|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| | | | | | | Q1 | Q2 | Q3 |
| 141.4 | 384.6 | 448.5 | 458.1 | 517.6 | 751.7 | 238.9 | 254.9 | 217.3 |

Source: National Bank of Serbia.

Withdrawals grow by the year as a result of system development – as contributions and net assets go up, and the years of VPF operation increase, absolute withdrawals will rise as well. In Q3 2013, net contributions exceeded withdrawals by c. RSD 457.2 million.

Transfers represent inter-fund transfers. A member may for any reason decide to transfer a part or all of his/her assets from one fund to another, and he/she has to cover only real transfer costs.

Inter-fund transfers amounted to RSD 20.9 million in Q3 2013.

Inter-fund transfers
(in RSD million)

| 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | | |
|------|-------|-------|-------|-------|------|------|------|------|
| | | | | | | Q1 | Q2 | Q3 |
| 19.5 | 235.1 | 141.5 | 216.1 | 165.9 | 72.3 | 55.0 | 26.2 | 20.9 |

Source: National Bank of Serbia.

¹⁴ Under the Government decree, this amount is adjusted with previous-year inflation once a year.