

VOLUNTARY PENSION FUNDS SECTOR IN SERBIA

Second Quarter Report 2008

July 2008

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1. INTRODUCTION

Serbia's VPF market consists of nine voluntary pension fund management companies which manage ten voluntary pension funds. In Q2 2008, the National Bank of Serbia issued two operating licenses and three licenses to organize and manage a fund.

By early Q2, all management companies complied with the legal obligation to invest less than 10% of the fund's assets in the shares not included in the A Listing of the Belgrade Stock Exchange. Although the cap on investment into shares included in the A Listing of the Belgrade Stock Exchange has been set at 40% of total fund assets,¹ management companies did not make full use of this investment option. In addition, the implementation of management companies' investment policies is still largely hindered by the fact that Serbia's equity market is underdeveloped and very shallow, offering only a limited range of securities in which companies can invest. Participation of large public enterprises in the stock exchange market, development of debt securities, and, especially, the announced issues of long-term government securities are expected to boost development of the country's equity market.

A realistic cap would be 30%, as, subject to the diversification principle, pension funds may invest no more than 10% of their assets in the shares of a single issuer and the A Listing of the Belgrade Stock Exchange includes shares of three issuers: Energoprojekt holding, Tigar and Sojaprotein.

From 31 March until 30 June 2008, Belex 15, the blue-chip index of the Belgrade Stock Exchange, gained 3.75%, while the general Belexline index rose only marginally, by 0.8%. By contrast to BSE indices, end-Q2 regional shock exchange indices lost 6% to 9%² of their value relative to end-Q1.

In the course of the second quarter, the dinar appreciated by around 4% against the euro, while the National Bank of Serbia raised its key policy rate by 50 basis points.

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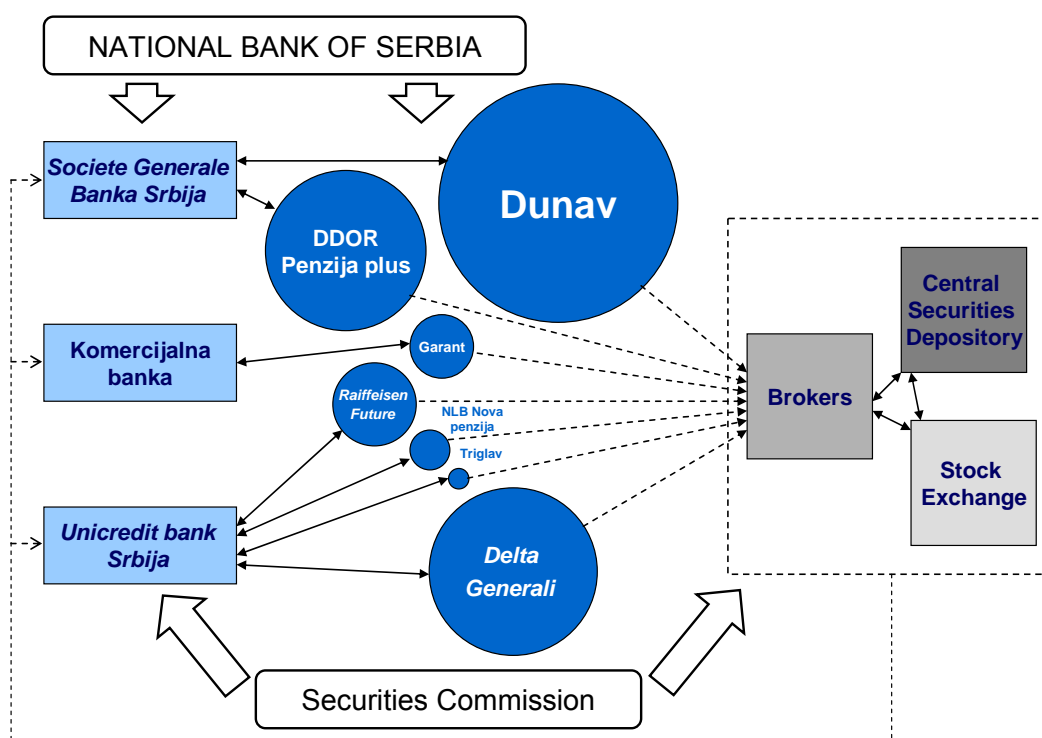
² The Croatian CROBEX and the Romanian BET fell by just over 6%, while the Bulgarian SOFIX and the Slovenian SBI20 declined by just over 8% and 9%, respectively. At the same time, the German DAX, the French CAC40 and the British FTSE250 declined by 1.79%, 5.78% and 8.66%, respectively.

2. MANAGEMENT COMPANIES

Market participants

In Q2, the NBS issued an operating license to the VPF management company *SOCIETE GENERALE PENZIJE* a.d. Beograd and to the VPF management company *HYPO* a.d. Beograd. VPF management company *SOCIETE GENERALE PENZIJE* a.d. Beograd is the first such company to set up two voluntary pension funds – *Societe Generale Štednja* and *Societe Generale Ekvilibrio*.³ VPF management company *HYPO* a.d. Beograd will set up the voluntary pension fund *HYPO*.

Chart 1: Participants in the market of voluntary pension funds⁴



As VPF management company *HYPO* a.d. Beograd entered into custody agreement with the custody bank *Erste Bank Srbija* a.d. Novi Sad, fund accounts will from now on be maintained by four custody banks. Given the controlling role of custody banks, strengthening of competition in the custody

³ As their investment policies reveal, the two funds will not be equally conservative in terms of investment. *Societe Generale Štednja* will be oriented towards more conservative and *Societe Generale Ekvilibrio* to moderately conservative investors.

⁴ The new funds and custody bank did not start operating in Q2.

banks' market is likely to result in the provision of higher-quality services and in increased security of investment in voluntary pension funds.

Fund management companies cooperate with 12 broker companies through which they buy and sell securities.

Ownership structure of management companies

The qualifying owners of all management companies are insurance companies and banks. Table 1 below gives a detailed overview of the ownership structure of management companies, classified by the activity of the founder.

Table 1: Ownership structure by founder's activity

Management company	Qualifying owner	
	Name	Core activity
Delta Generali, Beograd	Delta Generali Osiguranje, Beograd	Insurance
Raiffeisen Future	Raiffeisen Bank, Beograd	Bank
Garant penzijsko društvo	Skupina prva, Ljubljana	Insurance
DDOR Penzija plus	DDOR, Novi Sad	Insurance
Dunav	Dunav osiguranje, Beograd	Insurance
NLB Nova penzija	Continental banka, Novi Sad	Bank
	NLB LHB banka, Beograd,	Bank
	Nova Ljubljanska banka, Ljubljana	Bank
	Skupna pokojinska družba, Ljubljana	Pension fund
Triglav penzija	Zavarovalnica Triglav, Ljubljana	Insurance
	Triglav, družba za upravljanje, Ljubljana	Pension fund
Societe Generale Penzije	Societe Generale Banka Srbija, Beograd	Bank
	SOGECAP, Societe anonyme d'assurance sur la vie et de capitalisation, Pariz	Insurance
HYPO	Hypo Alpe-Adria-Bank, Beograd	Bank

Organizational network of management companies

As the two management companies which obtained the operating license in late Q2 2008 did not start operating during the quarter under review, the network of management companies remained broadly unchanged from a quarter earlier and continued to include 26 business units, branches and branch offices, the majority of which belong to a single management company.

For the time being, most of the companies have head offices only. On the other hand, four management companies expanded their network indirectly, by

engaging banks as their intermediaries. At end-Q2 2008, four banks⁵ engaged by four management companies provided intermediation services. As founders of the two newly established companies, the banks Societe Generale and Hypo AlpeAdria can be expected to act as their intermediaries, which is likely to increase the significance of intermediation by banks. Moreover, in Q2 the National Bank of Serbia issued another 20 licenses to private individuals to engage in the provision of information on voluntary pension funds. Out of 162 persons holding the above license, 84 have been hired so far.

Total employment in management companies came to 200, with the majority of employees engaged in sales and marketing activities. Total assets of all funds per employee increased steadily to reach around RSD 18.5 billion at end-Q2 2008.

Table 2: Total assets per employee at end-quarter

<i>in RSD mln</i>			
Q3 2007	Q4 2007	Q1 2008	Q2 2008
10.6	15.6	15.9	18.5

Fees charged by companies

As market competition strengthened, fees charged on contribution payment declined. And though regulations set the maximum fee level at 3% of the payment value, the average fee charged by management companies in Q2 2008 was 2.53%.

The fund management fee may equal no more than 2% p.a. of the annual value of the fund's assets. This fee is calculated on a daily basis and deducted from the value of the fund's assets. For fund members, this is a hidden cost, but it directly affects the investment unit value. No company has lowered this fee as yet.

Total fees charged by companies in Q2 equalled RSD 31.2 million. As in the quarter earlier, total management fees exceeded total fees on contribution payment. Namely, fees on contribution payment equalled RSD 14.3 million, or 45.7% of total fees charged, while the remaining 54.3%, or RSD 16.9 million, referred to management fees.

Fees paid by fund members include:

- *fee on contribution payment (up to 3% of the payment)*
- *fund management fee (up to 2% of the fund's assets value, per annum)*
- *account transfer fee (based on the actual costs of transfer).*

The level of fees charged by a management company must be published in the prospectus and on the management company's website.

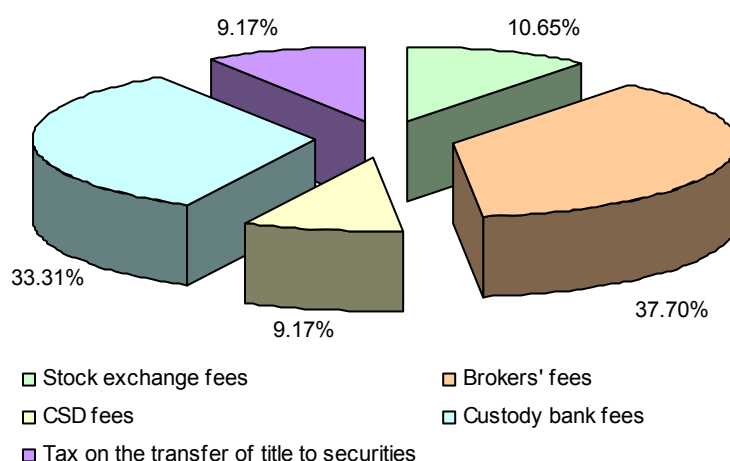
⁵ *NLB LHB banka Beograd a.d. Beograd, NLB Continental banka a.d. Novi Sad, Raiffeisen banka a.d. Beograd and Volksbank a.d. Beograd*

Transaction costs

In Q2 2008, transaction costs came to around RSD 0.7 million and were dominated by brokers' fees and custody bank fees. As the number of transactions plummeted, so did total transaction costs – by around 60% on a quarter earlier. The share of brokers' fees in total transaction costs declined by 4 percentage points, while the share of custody bank fees went up by 6.3 percentage points, continuing the trend from a quarter earlier.

Transaction costs are borne by companies. In Q2, they made up 2.36% of total fees charged for management company services or around 4 percentage points less than in Q1.

Chart 2: Composition of transactions costs in Q2 2008



3. VOLUNTARY PENSION FUNDS

Net assets of voluntary pension funds

Table 3: End-quarter net assets of the sector

in RSD million

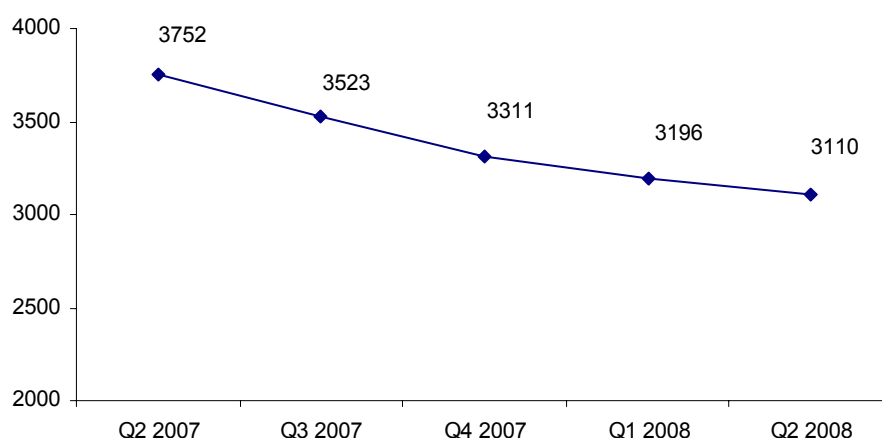
Q2 2007	Q3 2007	Q4 2007	Q1 2008	Q2 2008
2,069.85	2,563.26	3,045.63	3,177.11	3,719.00

In Q2 2008, net assets recorded a notable increase of 17% on a quarter earlier. For the sake of comparison, in Q1 2008 net assets rose by 4.32% and in Q4 2007 by 18.82%.

Fund members' payments were the main driver behind growth in net assets in Q2 relative to Q1. In addition to rising contribution payments, another major input to growth came from much lower withdrawals of moneys. Namely, whereas in Q1 one-off withdrawals of moneys came to RSD 202 million, in Q2 they equalled RSD 60 million or 70% less. In addition, the FONDex went up by around 1% in Q2.

At end-2006, the index of market concentration in the voluntary pension funds sector equalled a maximum of 10,000, as only one company operated at the time. Although the trend of decline in concentration continued in Q2, the HHI remains very high, with the total market share of funds⁶ which began collecting moneys during 2007 at slightly over 10%.

Chart 3: End-quarter concentration⁷ in the sector



According to their share of total net assets, funds have been classified into three groups. And whereas no funds had previously been classified as middle-sized, in Q2 one fund recorded a share of over 5% and crossed from the group of small-sized funds into the group of middle-sized funds.

⁶ Funds which did not inherit moneys from pension insurance.

⁷ Herfindahl-Hirschman (HHI) index has been used as a measure of market concentration since 1982. It is calculated by squaring the share of a specific variable (i.e. balance sheet total, deposits, credits...) of all market participants in a given sector and then summing up the resulting numbers. An index below 1000 indicates no market concentration. An index between 1000 and 1800 indicates moderate concentration, while an index above 1800 indicates high concentration.

Table 4: Market share by size

Share of net assets (%)	Number of voluntary pension funds
Large (over 20)	3
Medium (5 – 19.99)	1
Small (0 – 4.99)	3

Composition of assets of voluntary pension funds

The composition of assets changed during Q2 as the share of bonds fell and that of transaction accounts increased. The maturing of A2008 series bonds, which made up around 5% of total fund assets, was the main reason behind the decline in the share of bonds. This, at the same time, induced an increase in the share of foreign currency transaction accounts. In addition, one company for the first time invested a portion of fund's assets into real estate. The value of the real estate made up 1.84% of total funds' assets. Subject to NBS decision, the real estate is appraised by a certified appraiser each month.

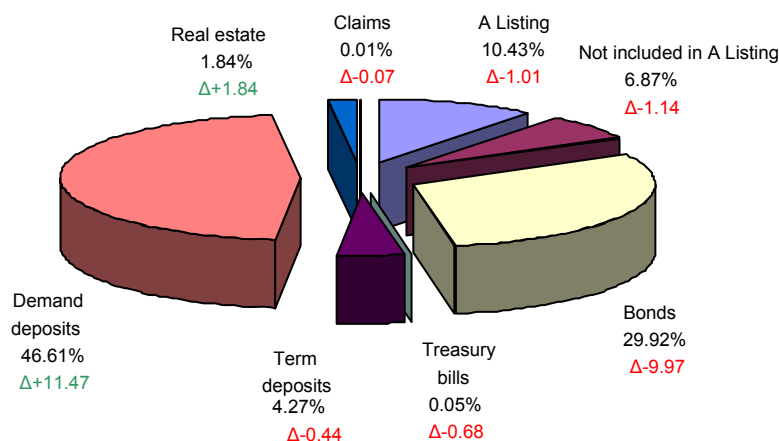
Investment in real estate includes investment in land, buildings and special parts of buildings which must be entered in the land register and insured against all risks. Up to 5% of the fund's assets can be invested in a single real estate, while total investment in real estate may not exceed 15%.

During Q1, funds could invest up to 15% of total assets in shares not included in the A Listing of the Belgrade Stock Exchange but meeting all the requirements prescribed by the Decision on Maximum Investment, while as of 1 April 2008, this limit was lowered to 10%. All funds timely complied with the above limits.

At end-Q2 2008, of total assets, RSD 1.3 billion or 36% was in a foreign currency (only euros, for the time being) and RSD 2.4 billion or 64% was in the domestic currency. Assets in euros referred primarily to bonds issued against frozen foreign currency savings. This ratio remained broadly constant over the past year.

Transaction accounts had the highest share of total fund assets, with 46.61%. Next were debt securities with 29.97%, shares with 17.30% and term deposits with 4.27%.

Chart 4: Composition of total fund assets at end-Q2⁸



Stock exchange trading by pension funds

The volume of VPF trading declined notably in Q2 relative to Q1. As the overall volume of trading in the Belgrade Stock Exchange increased during the same period, the ratio of VPF trading to total stock exchange trading was below 1%.

Relative to the preceding quarter, the value of trade in shares in the BSE increased by 68.9%, while the number of transactions declined by 9.3%. The value of trade in frozen foreign currency savings bonds and the number of transactions rose by around 96.5% and 17.3%, respectively.

As 89% of trading by VPF referred to purchase of securities, in Q2 2008 funds continued to be active on the demand side.

Table 5: VPF share of BSE trading

	<i>in RSD million</i>				
	Q2 2007	Q3 2007	Q4 2007	Q1 2008	Q2 2008
Volume of VPF trading	625.63	622.93	610.00	495.83	159.96
Share of BSE trading	1.17%	1.94%	1.72%	2.85%	0.54%
Volume of securities purchases by VPF	434.64	506.65	473.87	353.53	141.67
Share of BSE trading	0.81%	1.58%	1.33%	2.03%	0.48%

⁸ Shows changes relative to end-Q1 2008, in percentage points.

Number and structure users of VPF services

Whereas earlier reports provided information about the number of contracts only, this and all future reports will also contain data on the number of users of VPF services. A user is an individual, with a unique personal identification number or passport number (for foreign persons), who may hold one or more individual accounts in one or more pension funds. The provision of information on users will enable a better understanding of the VPF sector.

Total number of users at end-Q2 came to 147,677 and total number of contracts to 194,955. Slightly over 25,000 users or roughly 17% of the total hold accounts in several funds. The average amount of moneys per user is RSD 25,183.33.

Table 6: Number of users by number of funds of which they are members

No. of funds	No. of users
1	122,505
2	15,426
3	9,662
4	83
5	1

Table 7: Number of users by number of concluded membership contracts

No. of contracts	No. of users
1	113,800
2	23,104
3	8,665
4	1,632
5	425
6	49
7	2

The number of users which made at least one contribution payment (active users) in Q2 2008 came to 72,629 or 49.18% of the total. In the final month of the quarter, active users numbered 59,534 or 40.31% of the total.

Table 8: Breakdown of users by frequency of payment

	Period	No. of users	Share (%)
Active users	1 month	59,534	40.31%
	3 months	72,629	49.18%
	6 months	95,842	64.90%
	12 months	100,098	67.78%
	Since start of membership (1)	128,763	87.19%
No moneys in the account (2)		18,914	12.81%
Total (1+2)		147,677	100.00%

Table 9: Share in number of users, by size

Share in number of users (%)	No. of voluntary pension funds
Large (over 20)	2
Medium (5 – 19.99)	3
Small (0 – 4.99)	2

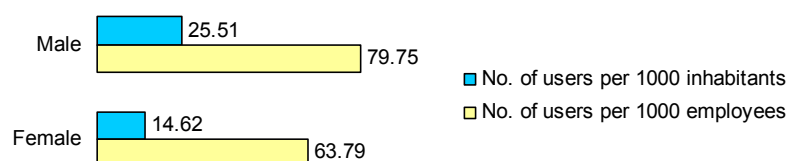
At end-Q2, the majority of users of VPF services were men, accounting for as much as 62.3% of all users. At the same time, the share of men in total fund assets was 59.8%, as women tend to deposit higher amounts to their individual accounts.

Table 10: Breakdown of users by gender

Gender	No. of users (± 0.04%)	Amount of moneys (in RSD mln)	Average moneys (in RSD)
Male	91,932	2,220.64	24,155.30
Female	55,680	1,495.59	26,860.47

The ratio of users to number of inhabitants and number of employees of a given gender (according to RSO data for 2006) also reveals that men account for a higher percentage of users of VPF services.

Chart 5: Ratio of number of users to number of inhabitants/employees, by gender



Average user age at end-Q2 was 43.6, while the majority of users were 48 years old. One in five users met the condition for withdrawal of moneys (53 years of age).

Chart 6: Distribution of users by age, end of Q2

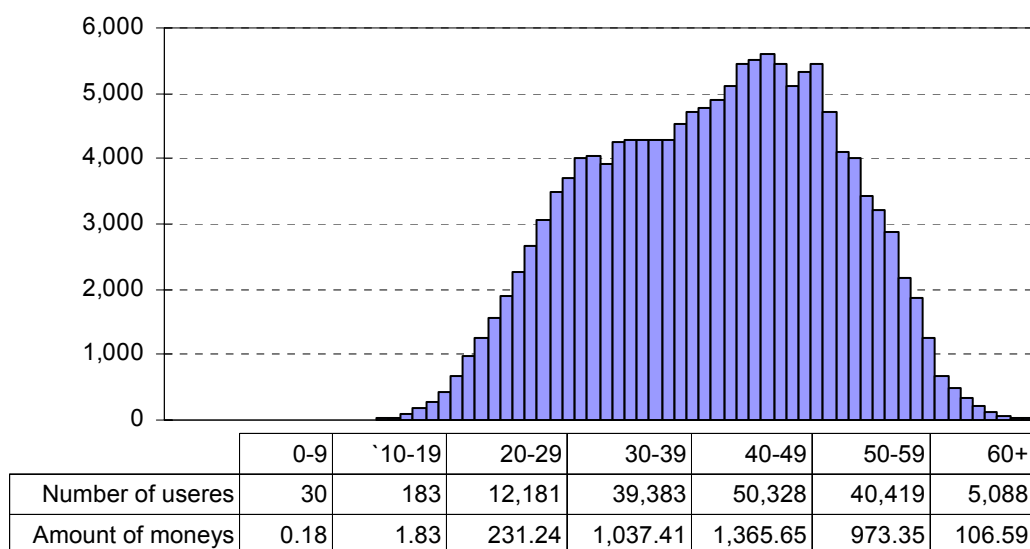


Table 11: Age structure of users

Age	Number of users	Share (%)	Amount of moneys (in RSD mln)	Share (%)	Average moneys (in RSD)
0-19	213	0.14%	2.01	0.05%	9,427.20
20-29	12,181	8.25%	231.24	6.22%	18,983.47
30-39	39,383	26.68%	1,037.41	27.92%	26,341.51
40-49	50,328	34.09%	1,365.65	36.75%	27,134.90
50+	45,507	30.83%	1,079.94	29.06%	23,731.24
50	5,108	3.46%	141.30	3.80%	27,663.42
51	5,322	3.61%	143.88	3.87%	27,034.96
52	5,455	3.70%	152.97	4.12%	28,041.52
53+	29,622	20.07%	641.79	17.27%	21,665.86
Total	147,612	100.00%	3,716.24	100.00%	

Breakdown by administrative region of the Republic of Serbia reveals that the majority of users come from the territory of the City of Belgrade. This comes as no surprise, given the leading position of this region in terms of population and employment numbers, as well as average salary levels. In terms

of number of users relative to the number of inhabitants, however, the City of Belgrade occupies only the fifth position.

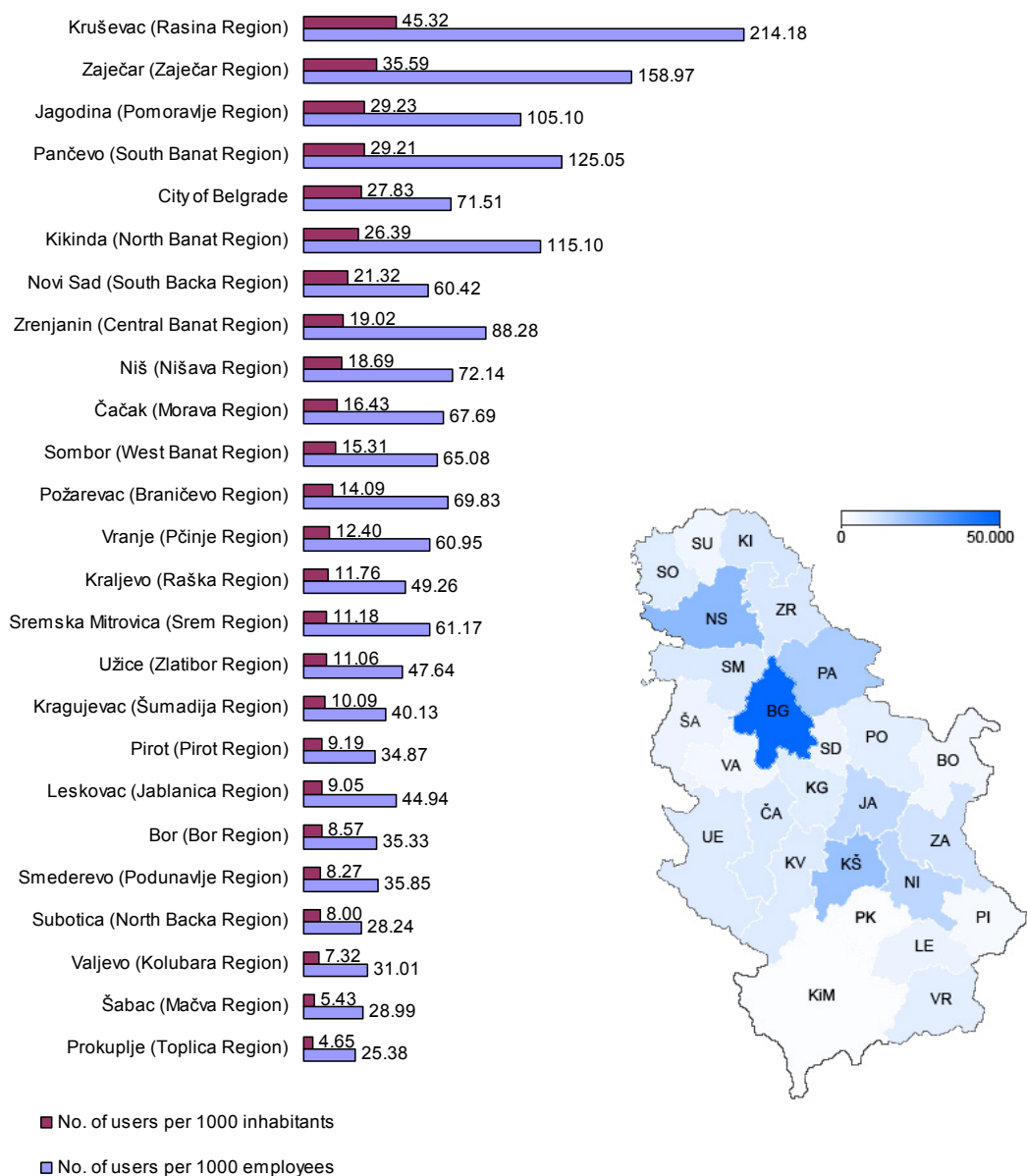
Table 12: Regional distribution of users and moneys at sector level

Region ⁹	Number of users	Share (%)	Amount of moneys (in RSD mln)	Share (%)	Average moneys (in RSD)	Ratio of average moneys to gross wages
City of Belgrade	44,604	31.51%	1,220.58	33.57%	27,365	0.57
Novi Sad (South Backa Region)	12,797	9.04%	513.60	14.13%	40,135	0.95
Kruševac (Rasina Region)	11,392	8.05%	74.50	2.05%	6,540	0.22
Pančevo (South Banat Region)	9,017	6.37%	324.26	8.92%	35,961	0.89
Niš (Nišava Region)	7,066	4.99%	289.10	7.95%	40,914	1.27
Jagodina (Pomoravlje Region)	6,480	4.58%	62.10	1.71%	9,584	0.29
Zaječar (Zaječar Region)	4,624	3.27%	40.57	1.12%	8,774	0.31
Kikinda (North Banat Region)	4,195	2.96%	87.40	2.40%	20,835	0.58
Zrenjanin (Central Banat Region)	3,803	2.69%	154.80	4.26%	40,705	1.13
Sremska Mitrovica (Srem Region)	3,745	2.65%	89.93	2.47%	24,013	0.65
Čačak (Morava Region)	3,617	2.56%	84.23	2.32%	23,288	0.78
Kraljevo (Raška Region)	3,490	2.47%	64.60	1.78%	18,509	0.61
Užice (Zlatibor Region)	3,373	2.38%	76.12	2.09%	22,566	0.67
Sombor (West Banat Region)	3,122	2.21%	71.61	1.97%	22,938	0.63
Kragujevac (Šumadija Region)	2,966	2.10%	49.95	1.37%	16,841	0.53
Vranje (Pčinje Region)	2,848	2.01%	67.67	1.86%	23,762	0.83
Požarevac (Braničevo Region)	2,755	1.95%	56.91	1.57%	20,656	0.51
Leskovac (Jablanica Region)	2,117	1.50%	64.13	1.76%	30,295	1.16
Šabac (Mačva Region)	1,738	1.23%	50.88	1.40%	29,276	0.92
Smederevo (Podunavlje Region)	1,713	1.21%	36.78	1.01%	21,471	0.51
Subotica (North Backa Region)	1,566	1.11%	54.99	1.51%	35,112	0.98
Valjevo (Kolubara Region)	1,361	0.96%	26.90	0.74%	19,768	0.59
Bor (Bor Region)	1,186	0.84%	24.05	0.66%	20,282	0.55
Pirot (Pirot Region)	920	0.65%	21.16	0.58%	23,005	0.82
Kosovo and Metohija	583	0.41%	14.09	0.39%	24,165	---
Prokuplje (Toplica Region)	457	0.32%	14.76	0.41%	32,290	1.26
Total	141,535	100 %	3,635.70	100 %		

The remaining 6,142 users or 4.16% reside outside the Republic of Serbia, or cannot be classified in any of the above regions, based on the available data.

⁹ Regions are administrative regions in the Republic of Serbia, save for Kosovo and Metohija where aggregate figure was provided. Data in the table refer to entire regions and not just the specified towns.

Chart 7: Ranking of regions in terms of number of users relative to number of inhabitants and concentration of users by region

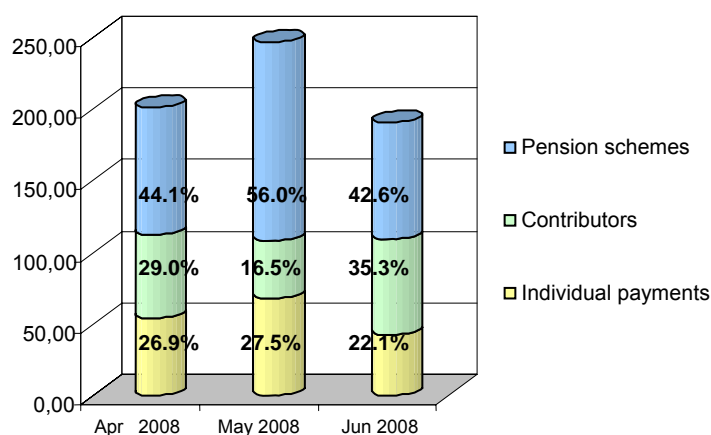


Contribution payments, disbursements and transfers among funds

Total contributions paid by fund members in Q2 2008 came to RSD 566.12 million. This is an increase of 25% relative to Q1 2008, when total contributions equalled RSD 452 million. The rise in contribution payments resulted from the start of implementation of two large contracts with public enterprises. Average contribution by members came to RSD 2,930 in Q2 and RSD 3,204 in June.

Of total contributions, 22% referred to individual payments, 35% referred to employer contributors, while the highest percentage of around 43% referred to pension schemes. The share of pension schemes increased on a quarter earlier as two public enterprises concluded pension scheme contracts during Q2.

Chart 8: Volume and composition of total payments



Withdrawals of moneys declined relative to Q1. The bulk of withdrawals referred to one-off payouts, while programmed payouts accounted for less than 1% of the total.

Transfers among funds increased by around 25% relative to Q1. The transfer fee is based on the actual costs of such transfer, i.e. payment system costs, and is deducted from the fund's assets. These costs are not high and do not represent an impediment for fund members to transfer their moneys to another fund.

Table 13: Transfers among funds and permanent withdrawal of moneys in the sector at end-Q2 2008

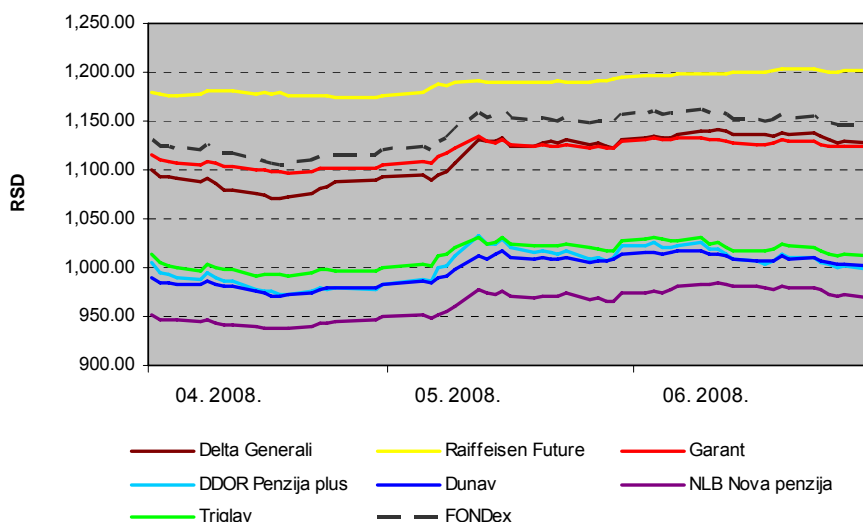
	<i>in RSD mln</i>	
	Transfers among funds	Withdrawal of moneys
Q2 2008	72.24	61.19

Values of investment units and returns of funds

The majority of voluntary pension funds recorded an increase in investment unit value in Q2, as their investment activity subsided and prices in the Belgrade Stock Exchange calmed down. In Q2, BSE's blue-chip index, Belex 15, gained 3.75%, while the dinar appreciated by around 4%. The exchange rate of the dinar against the euro decreased from RSD 82.31 at the start of period to RSD 78.98 at the end of period. By triggering a drop in the value of foreign currency bonds, such exchange rate movements negatively affected the investment unit value, but the strength of this impact was not too significant as the share of bonds in the composition of funds' assets declined. In addition, as the impact of the rise in the price of shares and interest on cash accounts proved to be stronger, the FONDex, as the average weighted value of investment units of all funds, went up by 1.04%.

Table 14: Values of investment units and FONDex in Q2

		Start of quarter	End of quarter	Maximum	Minimum
Investment unit value	Dunav	987	1001.78	1017.49	970,68
	Raiffeisen Future	1179.9	1200.93	1204.22	1173,71
	Delta Generali	1104.92	1127.34	1142.16	1069,99
	Garant	1116.49	1123.39	1132.82	1097,08
	DDOR	1009.36	997.65	1028.95	972,86
	NLB	952.58	969.21	983.70	937,14
	Triglav	1016.33	1011.60	1031.18	991,54
FONDex		1132,39	1141.14	1161.89	1105.92

Chart 9: Movements in values of investment units and FONDEX in Q2

At end-Q2 2008, six funds operating for over a year had the obligation to report their returns for the past year and returns earned since the start of their operations until 30 June 2008.

Table 15: FONDEX return

	Since the start of operations ¹⁰	In the past year		
		31 Dec 2007	31 Mar 2008	30 Jun 2008
<i>FONDEX</i>	4.28	11.65	-2.84	-2.12

Given the long-term character of investment in voluntary pension funds, fluctuations in investment unit values in the first year of a fund's operations, though they can have an adverse effect on the returns earned, should not act as a disincentive for either present or potential fund members.

The purpose of investing VPF's assets is to raise the value of invested funds, while at the same time minimizing risks. Although all companies aim to earn

It is important to make a difference between the returns of the fund and the returns on the individual account of a fund member. The returns on individual accounts of fund members are calculated for each individual account separately and depend on the overall success of the fund's operations, value of investment units at the time of contribution payment, length of the period during which payments are made and payment amounts. The returns of the fund depend on the value of investment units only, i.e. on the success of investment of the fund's assets

¹⁰ Returns since the start of operations are given at annual level.

maximum possible returns to the benefit of fund members, investment risk is never entirely eliminated and there is always a possibility that the returns on the investment of fund's assets will be negative. The returns earned by the fund are distributed to individual accounts of all members.

4. CONCLUSION

Voluntary pension funds have been operating in our country for just under two years, which is a relatively short time period given the long-term character of this financial institution. The VPF sector still has notable scope for development, as funds' net assets account for around 0.15% of GDP, which is well below the European average (15%) and the average for other countries of the region (5%). In addition, only 7.4% of all employed persons have concluded membership contracts with one of the existing funds. Pension funds market is still highly concentrated, but there is potential for the setting up of new and development of existing funds. To illustrate, in just over 1 year of operations, one of the funds managed to record a market share of over 5%. The founding of two new management companies and three voluntary pension funds also points to strong interest of both founders and users of VPF services.

The development of the organizational network of companies is an important factor of increase in the market share of funds, and it is banks that play an important role in achieving this objective. Namely, banks are the only financial institutions that can engage in intermediation, and, given the scope and accessibility of their organizational network to users, the use of this sales channel appears likely to give a comparative advantage.

As Serbia's equity market is still underdeveloped, with only a small number of financial instruments which meet the conditions for investment of VPF assets, possibilities for diversification of funds' portfolios are limited. In Q2, investment in securities declined and one company, for the first time, invested a portion of the fund's assets into real estate. The announced issue of dinar securities could help expand the range of investment options available to pension funds.