

VOLUNTARY PENSION FUNDS
SECTOR IN SERBIA

Fourth Quarter Report 2010

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1. INTRODUCTION

Voluntary pensions funds (VPFs) have operated in the Serbian market for more than four years. At end-2010, VPF net assets reached RSD 9.9 bln.

In Q4 2010, the VPF management company and fund DDOR Penzija plus merged with the Hypo-Garant company and fund, and now operate as DDOR-Garant. Founders of these two companies decided to merge and thus strengthen their market position. NLB Nova penzija management company suspended its operation in Serbia and its fund was acquired by Delta Generali. At end-2010, the market comprised two companies managing several VPFs. The merging of market participants reduces operating costs and creates conditions for cutting fees charged by management companies.

In 2010, management companies weathered the economic crisis by investing assets into the least risky financial instruments in the Serbian capital market.

At end-2010, FONDex, the index of investment units of all VPFs in the Serbian market, reached 1,390 points. The initial FONDex value of 1000 points was recorded on 15 November 2006 when the first VPF began to operate. The return on T-bills and interest earnings gave the strongest boost to FONDex.

In Q4 2010, the return on FONDex amounted to 1.44%¹, or 9.65% over the last year.

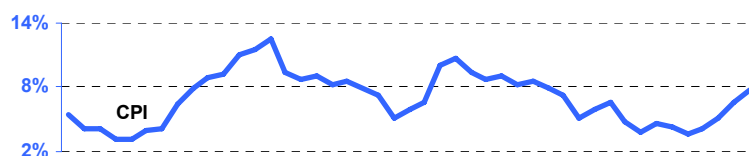
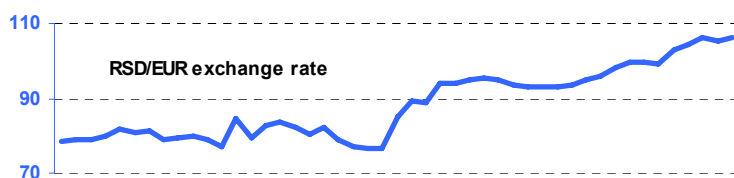
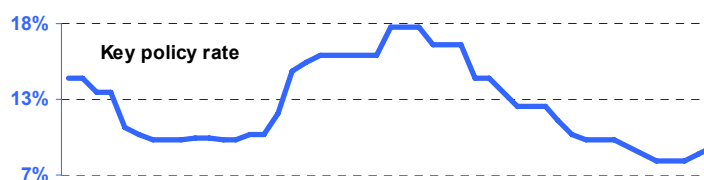
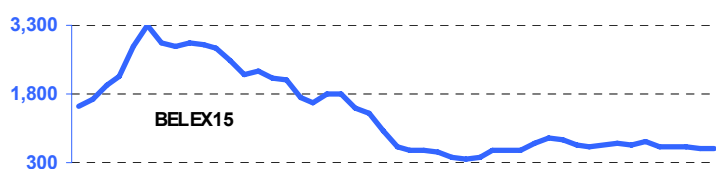
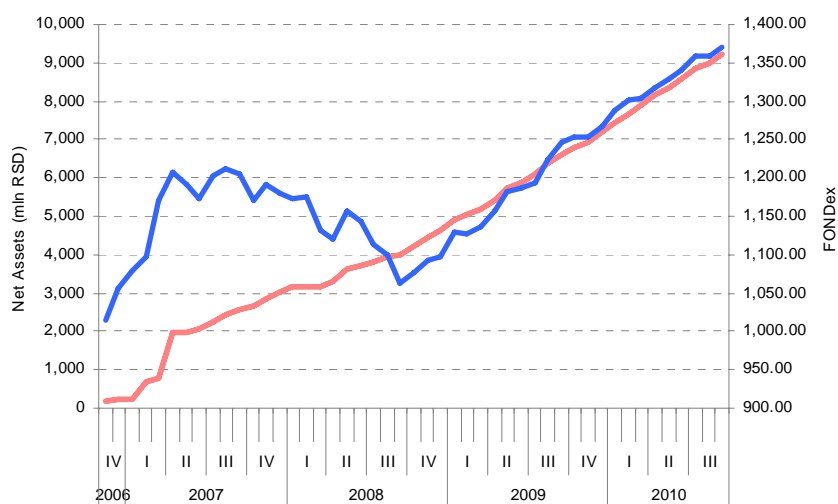
Table 1: Return and market value of issued T-bills by maturity

T-bill maturity (in months)	2010 – Q3		2010 – Q4	
	Estimated return* (%)	Market value of issued bills (RSD bln)	Estimated return* (%)	Market value of issued bills (RSD bln)
3	11.13%	15.6	13.60%	20.9
6	12.55%	18.6	15.00%	33.1
12	12.90%	10.3	14.70%	5.0
18	13.17%	2.6	14.74%	1.1
24	13.42%	2.8	14.82%	1.2

* end-of-quarter estimated return (linear interpolation)

¹ 5.9% p.a.

Chart 1: Movements in FONDex, net assets and key indicators since the start of VPF operation



Growth in return on varying maturity T-bills, set in train by mid-Q3 2010, continued until the year-end. VPFs invested most in 6- and 12-month T-bills, steering clear of long-term risk of return volatility. By end-2010, euro-indexed 6-month T-bills were issued for the first time at 5.25%, attracting 5.87% of total fund assets. Euro-indexed T-bills were sold in record amounts (RSD 21 bln nominally) as professional investors perceived Serbia's currency risk as substantial. Sold T-bills reached around RSD 86.5 bln nominally, up by RSD 33.2 bln from Q3. The amount of T-bills falling due in Q4 was RSD 46.3 bln.

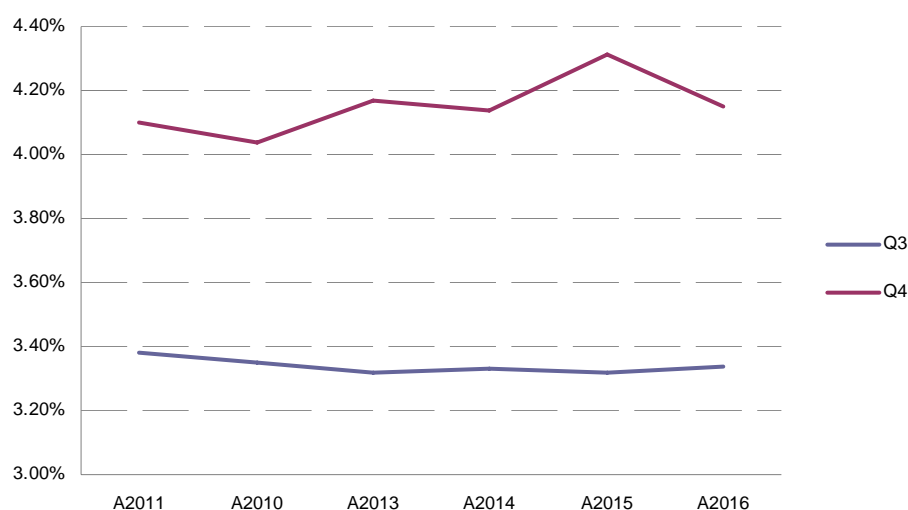
In early 2011, the return on T-bills hit a downward path. The dinar's appreciation and a reduction in investors' perceived currency risk prompted a hike in demand for dinar T-bills of over one-year maturity.

In Q4 2010, trading on the Belgrade Stock Exchange (BSE) amounted to c. RSD 9.25 bln and outstripped the trading levels recorded over previous quarters (RSD 4.9 bln, 4.7 bln and 4.2 bln respectively). Trading in shares came at RSD 7.6 bln, close to Q4 2008-levels. Most traded were AIK shares – RSD 2.1 bln and NIS shares – RSD 1.45 bln. The number of transactions continued up, chiefly due to trading in NIS shares making up 97% of the total. A part of VPF assets invested in shares rose from 6.2% to 11.38%, in response to the purchase of NIS shares considered safe and fixed-return investment over the last two quarters. At end-2010, VPFs invested 6.29% of total assets in NIS shares, thereby acquiring 0.8% of the total NIS issue. In 2010, VPFs accounted for 34.4% of total trading in NIS shares. Further, VPFs sold the majority of NIS shares to Gazprom Neft at RSD 506.48 per piece.

In Q4, BELEX15 picked up, lessening its total annual decline. The index changed 5% in Q4 and -1.8% over the whole year. It rose further in 2011.

More than a third of assets (39.7%) were euro-denominated, most of which invested in frozen FX savings bonds (18.1%), while 11.87% of assets were placed in banks' FX transaction accounts. In November 2010, the exchange rate stabilised at 107 dinar per one euro, and began to slide thereafter (the lowest value recorded in Q4 was 104.34 RSD/EUR). One dinar was worth 95.9 and 105.5 euros in early and late 2010 respectively.

Management companies responded to plummeting return on frozen FX savings bonds over the first nine months of 2010 by cutting their investment. Set on an upward path in Q4, the return on frozen FX savings bonds gained 1 percentage point (relative to 30 September 2010) within less than two months and amounted at end-November to 4.25% for A2012-series and 4.54% for A2014 and A2015-series bonds. Trading in frozen FX savings bonds came to RSD 1.65 bln in Q4 vs. RSD 0.28 bln in December 2010. Rising return (continuing into 2011) and plummeting trade in frozen FX savings bonds indicate investors' inclination to shares and T-bills rather than frozen FX savings bonds. The share of these bonds in total fund assets declined from 19.6% to 18.1% in Q4.

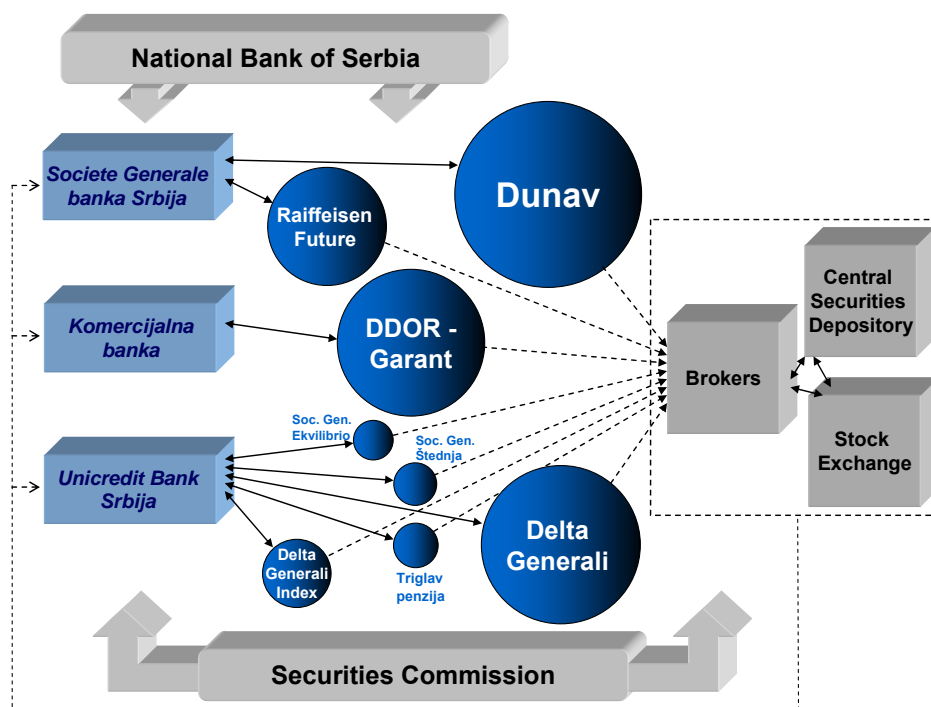
Chart 2: Yield curve for frozen FX savings bonds (end of quarter)

The interest earned by VPFs on dinar funds deposited with custody banks generally fluctuates in response to changes in the NBS key policy rate. Until May 2010, the NBS was cutting its key rate (11 May – 8%) only to start raising it from early August. In Q4, the NBS raised its rate on three occasions – twice by 1 percentage point. On 31 December 2010, the NBS key policy rate stood at 11.5%. At the overall industry level, VPFs held in custody bank dinar accounts 13.5% of total assets on average in 2010, or 6.84% at the year-end. In 2010, negative correlation was identified between the percentage of dinar funds in transaction accounts and the percentage of assets invested in T-bills. In making their investment decisions, companies were guided by the level of the NBS key policy rate and the rate of return on T-bills.

Given the VPFs' conservative investment policy, low-risk instruments such as RS securities and NIS shares accounted for 71% of total investment at end-2010, while 22% of assets were held in bank accounts.

According to estimates of the Serbian Statistical Office, economic activity measured by GDP rose by 1.8% in 2010 relative to the year before. Industrial output picked up 3.0%, while construction declined most by 13.6%. Consumer prices were rising throughout Q4 2010, resulting in 10.3% inflation at the year-end. Based on the October Labour Force Survey, the Statistical Office issued a 19.2% unemployment figure for 2010. Economic recovery and improved standard of living are paramount in attracting more VPF members.

2. MARKET PARTICIPANTS



The VPF market comprises six companies managing eight VPFs, three custody banks, 59 natural persons engaged in dissemination of information about VPF membership (of 229 of them licensed by the NBS to perform such activities) and four agent banks².

VPF management companies cooperate with 10 brokerage houses in securities trading.

At end-Q3 2010, total employment in VPF management companies was 129, down by 46 and 89 relative to end-2009 and end-2008 respectively. The largest cuts were made in the sales and marketing sectors, as a result of a declining number of companies.

3. VPF OPERATIONS

Net VPF assets

In Q4 2010, net assets rose 7.1% q-o-q or 37.2% y-o-y. In 2010, RSD 2,428.36 mln were paid to members' individual accounts, which impacted most, together with the returns, on net asset growth. In 2010, total contributions, net

² NLB banka a.d. Belgrade, Raiffeisen banka a.d. Belgrade, Volksbank a.d. Belgrade and Société Générale Banka Srbija a.d. Belgrade.

of contribution fees, came to RSD 2,369 mln, whereas withdrawals amounted to RSD 458.14 mln. Total fees charged by companies were RSD 229.88 mln.

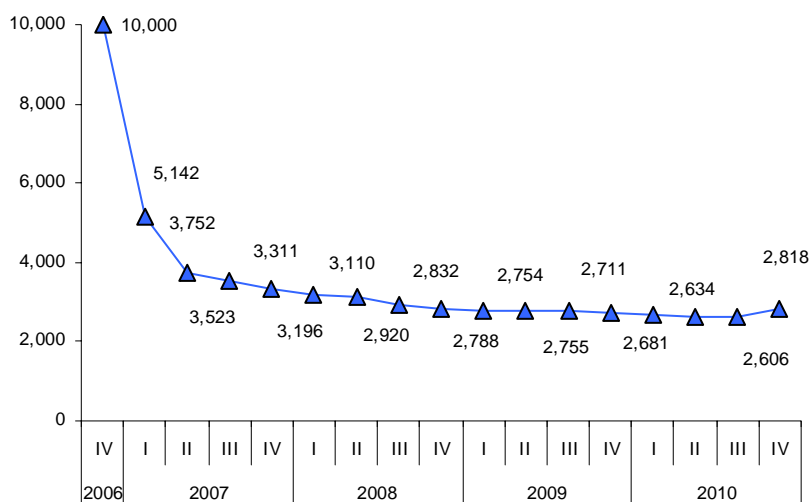
Table 2: End-quarter net assets of the VPF sector

in RSD bln

2007 Q4	2008 Q4	2009 Q4	2010			
			Q1	Q2	Q3	Q4
3.05	4.64	7.19	7.90	8.57	9.21	9.86

Growth in net assets in Q4 was generated by members' net contributions³ (RSD 521.5 mln). Members' total contributions, net of the contribution fee, amounted to RSD 645.8 mln, standing above the quarterly average for 2010, while withdrawals came at RSD 124.3 mln.

³ Total contributions net of the contribution fee and withdrawals.

Chart 3: End-quarter concentration in the sector

Strengthened due to merging of HYPO-Garant and DDOR Penzija plus, market concentration measured by HHI equalled 2,818 points at end-Q3.

VPFs are classified in three groups by their share in total net assets: large, medium and small. The structure, however, changed relative to the prior period – at end-2010, only one fund was classified as ‘medium’. High concentration was also reflected in 88.1% of total net assets managed by three companies (RSD 8.69 bln).

Table 3: Number of funds by groups divided by market share

Share in net assets (%)	2007 Q4	2008 Q4	2009 Q4	2010			
				Q1	Q2	Q3	Q4
Large (20 and above)	3	2	2	2	2	2	3
Medium (5 – 19.99)	-	2	3	3	3	3	1
Small (0 – 4.99)	4	6	5	4	4	4	4

Composition of VPF assets

The exposure of fund assets to specific types of market risk remained broadly unchanged from Q3.⁴ Due to an increase in the proportion of shares, the percentage of assets exposed to price risk rose to 31.7%. The exposure to property risk was not significant due to a small share of property. The portion of assets exposed to currency risk was 39.7%, which is an increase relative to Q3, while 87.7% of assets were exposed to interest rate risk.

⁴ Breakdown of assets by the type of market risk they are directly exposed to.

Chart 4: End-quarter composition of VPF assets⁵

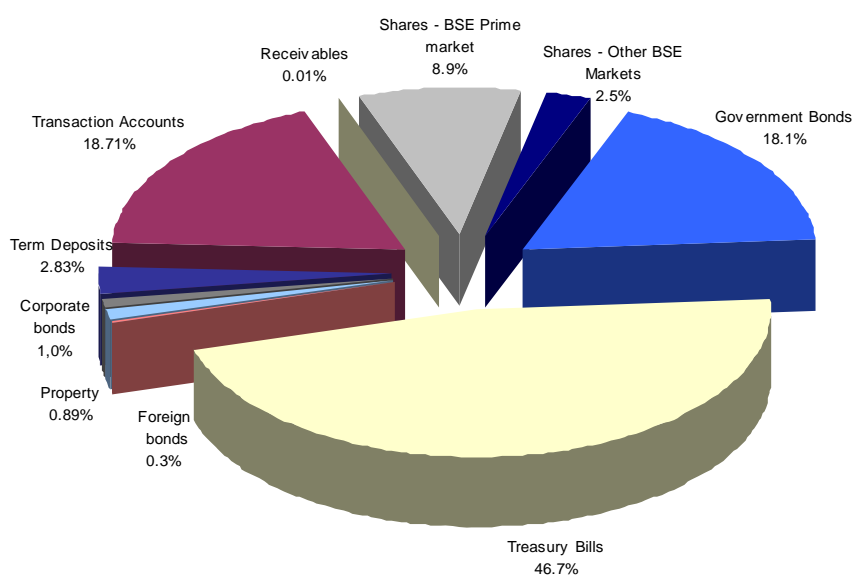


Table 4: Exposure of VPF assets to market risk

	Price risk	Currency risk	Interest risk	2007	2008	2009	2010			
							Q1	Q2	Q3	Q4
Shares	✓			22.4%	6.3%	7.2%	6.5%	5.5%	6.2%	11.4%
Frozen FX savings bonds	✓	✓	✓	37.8%	33.7%	25.2%	26.3%	21.2%	19.6%	18.1%
T-bills		✓*	✓	0.8%	0.0%	46.6%	42.1%	42.3%	41.6%	46.7%
Foreign government securities	✓	✓	✓		-	-	-	-	0,3%	0,3%
Corporate bonds	✓	✓	✓		-	-	-	-	1,1%	1,0%
Property	✓	✓		-	1.7%	1.1%	1.0%	1.0%	1.0%	0.9%
Funds in dinar accounts			✓	37.7%	57.4%	15.9%	18.6%	18.9%	16.0%	8.0%
Funds in FX accounts		✓	✓	1%	0.9%	4.0%	5.5%	10.7%	14.1%	13.5%

* relates to a portion of euro-denominated T-bills

VPF securities trading

VPF performance in Q4 was up 52% on Q3 and reached RSD 5,352 mln. T-bills retained their major share in securities purchases (over 81%), resulting in the maturity to sale ratio of 96% : 4%.

BSE trading of 8.06% was above the 2010 average owing chiefly to the purchase of shares of the Serbian Oil Company (NIS).

⁵ Changes are shown in percentage points on end-Q3.

Table 5: VPF securities trading

in RSD bln

	2008	2009	2010	2010			
				Q1	Q2	Q3	Q4
Securities trading	1.51	12.59	14.92	3.11	2.94	3.53	5.35
Purchases	1.07	8.12	8.12	1.57	1.42	1.87	3.26
BSE	0.78	0.40	1.3	0.14	0.12	0.41	0.63
Unregulated market	0.25	0.38	0.31	0.15	0.03	0.13	-
Auctions of government securities	0.03	7.34	6.53	1.29	1.28	1.33	2.63
Sales	0.39	0.39	0.76	0.14	0.10	0.39	0.13
BSE	0.09	0.05	0.56	0.004	0.034	0.39	0.13
Unregulated market	0.30	0.34	0.19	0.13	0.064	-	-
Maturity	0.05	4.08	6.04	1.40	1.42	1.26	1.96
Purchase to sale and maturity ratio	2.42	1.82	1.47	1.0	0.93	1.13	1.6
Share in total BSE trading	1.2%	1.1%	7.6%	2.9%	2.1%	19.1%	7.0%

Fees charged by management companies

The Law on Voluntary Pension Funds and Pension Schemes sets 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.

Since the start of operation, companies charged a 2% management fee, while the contribution fee declined, currently standing at 2.47% on average. The relative shares of these two types of fees in the total have also changed – at the start of VPF operation, contribution fees were dominant by contrast to the current 74% of management fees. This was prompted by rising net asset value and an enlarged base to which management fees are applied.

A further rise in net assets and boosted fund competition may result in gradual lowering of the management fee. The management fee level should be contingent on the fund investment strategy and its performance. A fund actively investing most of its assets in more complex and riskier instruments, may charge higher fees. Such funds are expected to post higher return in the long run. On the other hand, a fund investing passively in safe financial instruments should charge lower management fees. The fee charged by a company should be correlated with the investment structure and performance.

One company has envisaged in its schedule of charges a variable amount of fee depending on its performance in the sector and the sum of accumulated funds in individual accounts.

Table 6: Fees from 2007 to 2010

in RSD mln

	2007	2008	2009	2010	2010			
					Q1	Q2	Q3	Q4
Contribution fee	43.5	56.9	54.9	59.3	14.7	14.4	13.9	16.4
Management fee	33.4	72.2	117.2	170.6	37.1	40.9	44.7	47.8

Transaction costs

Transaction costs are incurred by management companies in securities trading.

Brokerage, custody bank and stock exchange fees account for the largest share of transaction costs. Transaction costs are directly related to the volume of management company trading and types of instruments being traded. Most costs are incurred in securities trading on the BSE and lowest costs in T-bills trading.

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 a contraction in the activity of management companies that directed their investment to safer instruments implying lower cost. In 2009, the costs rose again in response to high T-bill trading volumes and a gradual increase in share trading. At the same time, a rise in net assets pushed up the value of fund transactions in absolute amount.

Table 7: Transaction costs from 2007 to 2010

in RSD mln

	2007	2008	2009	2010	2010			
					Q1	Q2	Q3	Q4
Transaction costs	10.00	5.34	7.37	9.74	1.53	1.11	3.10	3.72
Brokerage fees	4.52	2.22	3.80	4.46	0.74	0.45	1.70	1.57
Custody bank fees	1.83	1.47	1.98	2.41	0.39	0.35	0.86	0.81
Stock exchange fees	1.56	0.84	0.38	1.14	0.13	0.10	0.24	0.67
Central Securities Depository fees	0.99	0.56	1.20	1.45	0.26	0.20	0.30	0.68
Transfer tax relating to the acquisition of securities	1.10	0.24	-	-	-	-	-	-

In all years but the first year of companies' operation, transaction costs made up on average 4% of total fees charged. The level of transaction costs varies depending on companies' investment activity.

VPFs generally invest in long-term debt securities, while the portion of shares is relatively low. Such structure impacts on low transaction costs – c. 0.1% relative to net assets.

Number and structure of VPF beneficiaries

At end-2010, 166,780⁶ of beneficiaries were in the accumulation phase⁷. Total membership contracts⁸ stood at 220,451. At the same time, 10 beneficiaries holding 14 membership contracts, who are currently in the withdrawal phase, are receiving scheduled payments. All information from this point onwards, unless specified otherwise, refers to beneficiaries in the accumulation phase.

Table 8: Number of contracts and beneficiaries from 2007 to 2010

	2007	2008	2009	2010	2010			
					Q1	Q2	Q3	Q4
No. of contracts	158,461	201,610	215,704	220,451	217,026	219,517	221,493	220,451
No. of beneficiaries ⁹	- 9	155,954	165,244	166,780	166,625	166,862	168,066	166,780
Percentage of active beneficiaries – 10 ¹⁰	- 9	41.14%	34.85%	33.62%	33.59%	33.71%	32.88%	36.31%

In the 2008–2010 period, the strongest growth in the number of new beneficiaries was recorded in 2009 (close to 10,000), while 2010 saw an insignificant increase.

Average accumulated funds per beneficiary depend on the amount of contributions, the funds' return and the length of the accumulation phase. All three factors impact on the growth in average funds in members' individual accounts. Average accumulated funds of members who have made at least one contribution is slightly above RSD 70,000 and is constantly rising.

VPF beneficiaries in Serbia may be domestic and foreign persons. The number of domestic persons holding fund membership contracts is double that held by foreign nationals who, however, hold on average eight times more funds in their accounts.

⁶ The number of beneficiaries 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 beneficiaries have more than one membership contract in one or several funds.

⁷ VPF membership has two phases – the accumulation phase (when contributions are made) and the withdrawal phase (when funds accumulated are withdrawn).

⁸ The number of membership contracts is the sum total of individual membership contracts and the number of members of all pension plans.

⁹ Data on the number of beneficiaries and the average amount of accumulated funds are available as of June 2008.

¹⁰ The average percentage of active beneficiaries by month in the period it relates to.

Table 9: Average funds from 2007 to 2010

in RSD

	2007	2008	2009	2010			
				Q1	Q2	Q3	Q4
Average accumulated funds	-	34,594	52,234	57,145	61,930	66,401	70,481

At end-2010, the number of members of two or more VPFs amounted to 28,627 or 17% of the total.

Table 10: Number of beneficiaries by number of funds in which they are members

No. of funds	No. of beneficiaries
1	138,153
2	17,449
3	11,136
4	36
5	6

Table 1: Number of beneficiaries by number of membership contracts

No. of contracts	No. of beneficiaries
1	127,409
2	26,750
3	11,338
4	930
5	316
6	33
7	3
9	1

Table 2: Structure of beneficiaries by payment dynamics

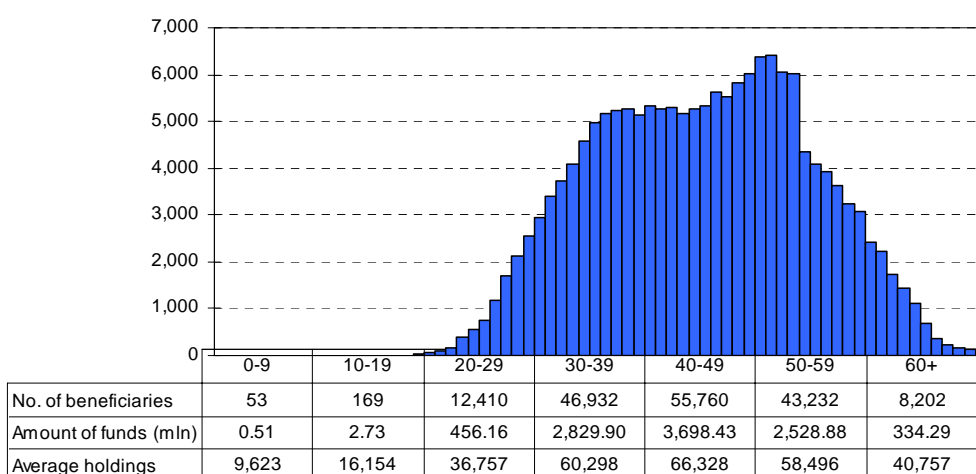
Active beneficiaries	1 month	No. of beneficiaries	Share (%)
	3 months	73,290	43.94%
	6 months	78,395	47.01%
	12 months	80,770	48.43%
	From the start of membership (1)	85,163	51.06%
	1 month	139,934	83.90%
No funds on accounts (2)		26.846	16.10%
Total (1+2)		166.780	100%

In terms of gender composition, no significant changes were recorded relative to previous years. Men remained dominant (c. 60.2%), but on average, continued to hold less funds in their individual accounts. As a result, their share in net assets in 2010 was 58.3%. The gender ratio is slowly changing – of new members, there were 52.8% men and 47.2% women.

At end-2010, the average age of VPF beneficiaries was close to 44 years, while beneficiaries aged 30–50 accounted for over 60%. Such beneficiary structure has not changed since the start of VPF operation. Further, the

percentage of beneficiaries meeting the age requirement for the withdrawal of funds (53 years) was largely similar to earlier years and accounted for approximately 20% of the total.

Chart 5: Distribution of VPF beneficiaries by age



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 2.4 bln p.a. In 2010, contributions exceeded by over RSD 200 mln the 2009 levels.

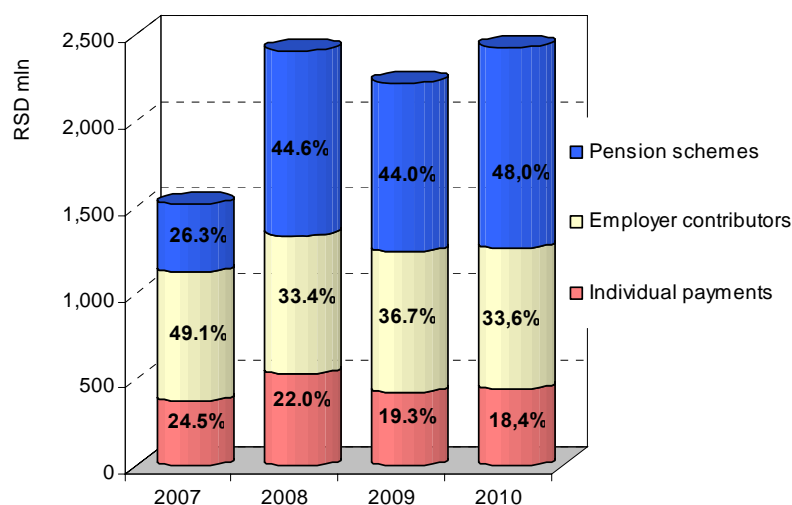
Table 13: Contributions

in RSD bln

	2007	2008	2009	2010	2010			
					Q1	Q2	Q3	Q4
Total contributions	1.52	2.25	2.22	2.43	0.62	0.59	0.56	0.66

Most contributions are made in the last quarter, particularly last month of a year. In Q4 2010, contributions hit their record high of around RSD 662 mln, up by RSD 100 mln on Q3.

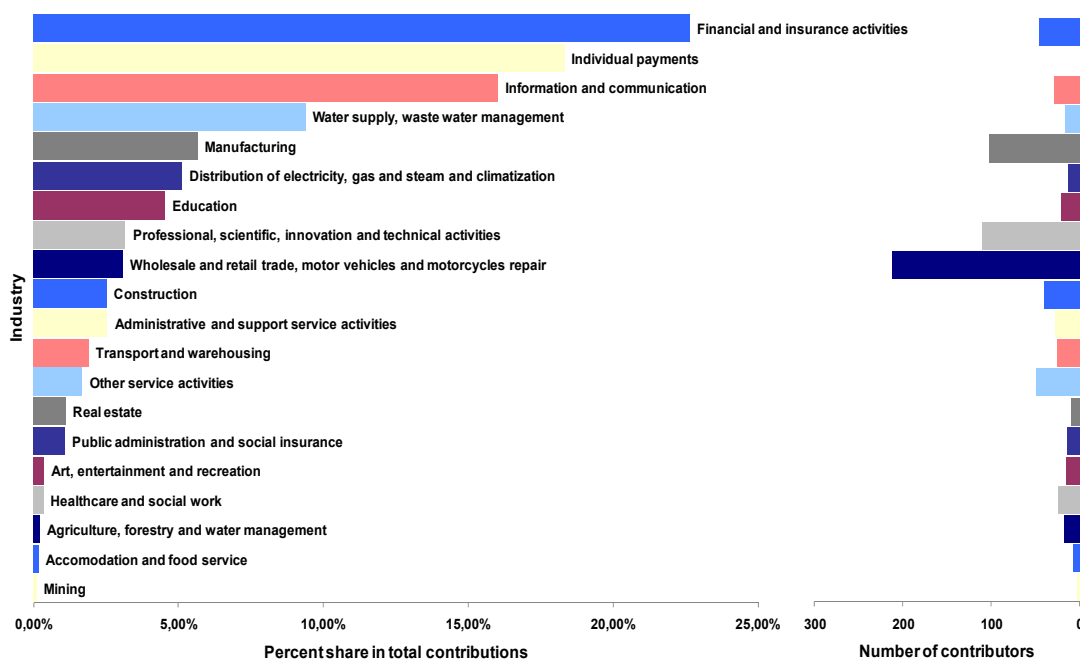
Chart 6: Volume and composition of total contributions by year



Most contributions are made through pension plans that imply the highest saving for the employer in terms of exemption from tax and contribution payment for the paid-in amount, up to the legally stipulated threshold. Furthermore, pension plan sponsors can negotiate the level of contribution fees for their members, which is another reason for the above contribution method.

In 2010, of total contributions, individual payments accounted for c. 18%, employer contributions 34% and pension plans 48%. This ratio has remained broadly unchanged since 2008.

Chart 7: Payment of contributions and number of contributors by activity



A high level of concentration is recorded among contributors. Though not numerous, large contributors (big companies and public enterprises) accounted for almost 40% of total payments. Five contributors paid over RSD 100 mln each (c. RSD 1 bln together) or 38% of the total. The remaining 1,000 of companies paid less than RSD 100 mln each, or somewhat above RSD 1 bln together. The remaining contributions were made by individuals.

Though the Law envisages individual payments, most contributions were made through contributors and pension plans. Employers may contribute on behalf of their employees and thus make saving in the form of tax relief. Ample potential for further growth in the membership base are companies with high staffing levels.

Withdrawals are generally lump-sum, which is logical as members entitled to withdrawal are not long-standing fund members and their accumulated sum is therefore relatively small. Future period is likely to see an increase in scheduled and other types of withdrawals, in response to growth in accumulation years and the accumulated sum, particularly after the adoption of the new Law prescribing the maximum lump-sum amount to be drawn.

Table 3: Withdrawals

in RSD mln

	2007	2008	2009	2010	2010			
					Q1	Q1	Q1	Q1
Total withdrawals	141	384	448	458	106	127	101	124

Withdrawals grow by the year as a result of system development – as contributions and net assets increase and the Pillar III matures, absolute withdrawals will rise as well. However, what is atypical for the nature of VPFs is that withdrawals are made as soon as beneficiaries turn 53 (the minimum retirement age); such beneficiaries, however, do not meet the requirements for state pension. The new Law forbids lump-sum withdrawals – a beneficiary can draw up to 30% one-off and the rest over the period he/she defines, but not within less than 2 years. The ‘saving for old age’ maxim is thus fully upheld – beneficiaries will be receiving retirement income apart from their state pension.

Transfers practically refer to inter-fund transfers. A member may transfer a part or all of his assets from one fund to another, thereby covering only the real transfer costs. The largest transfers were recorded in 2008.

Table 15: Inter-fund transfers

in RSD mln

	2007	2008	2009	2010	2010			
					Q1	Q2	Q3	Q4
Total withdrawals	19	235	141	216	46	49	46	76

Return/risk ratio

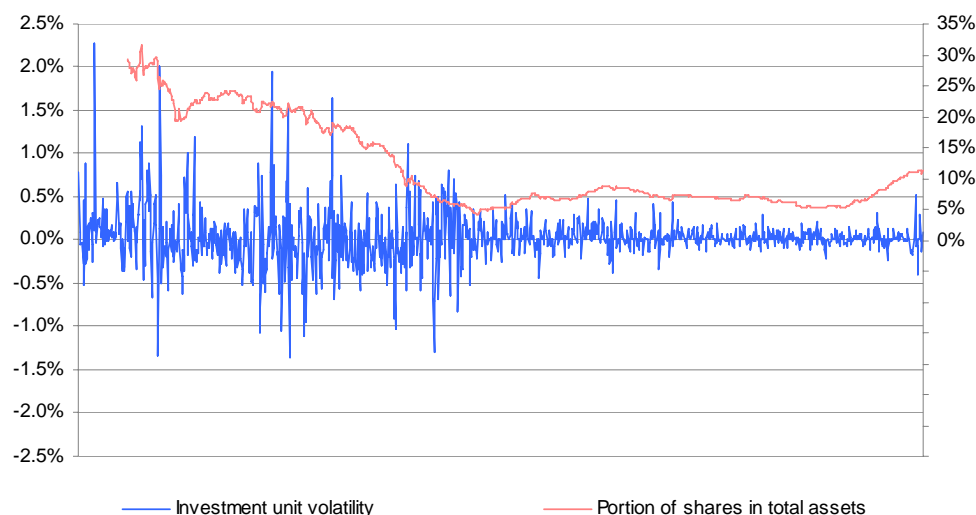
Given a short period of VPF operations, market turbulences (the crisis, plummeting stock, etc) and varying times of the start of VPF operation, the return from the outset of operations is not an adequate basis for comparing fund performances. Furthermore, when comparing returns, the portfolio risk should also be taken into account.

Fund return is the percentage change in the investment unit value over a particular period. It represents the ratio of the investment unit value at the start and end of the period. The VPF return since the start of operation may be classified into three phases. The first phase of decreasing return lasted until September 2008 in response to plummeting BSE stock making up over 20% of the overall portfolio. Responding to market changes, funds rechannel their investment to safer instruments, which results in modified investment structure and lowering of the portion of shares to below 10%. At one moment, over 50% of assets were held in custody bank transaction accounts. Funds directed their assets in T-bills when they were first issued, while at the same time maintaining the portion of frozen FX savings at around 25-30%. Such investment policy enabled VPFs to maintain their assets, while FONDex never fell below 1000 points. The shift in the investment structure ushered in the second phase marked by vigorous growth in return. That was the time of key policy rate hikes that exerted a positive impact on T-bills and deposits, the EUR/RSD exchange rate and consequently euro-indexed instruments. The third phase featured stagnation in return (c. 10% in 2010). Such trends indicate that short-term return volatility is possible, particularly in case of funds investing a major part of their assets in riskier securities. Besides, such funds expect higher return in the long run.

Fund risk implies the investment unit volatility directly linked to the risk of instruments from the fund portfolio and their mutual correlation. It is measured by the standard annualised deviation of daily investment unit return. The higher volatility and divergence from the mean value, the higher the standard deviation as a risk measure. Following the initially higher risk levels over 5% p.a, stemming from greater positions taken in shares, the risk entered a steady downward path reflected in modified investment structure, only to measure 1–2% a year.

Investment unit volatility was more pronounced in 2007 and 2008 when funds began to operate. The riskiest were investments in equity instruments and BSE shares. As their portion in assets declined, volatility subsided.

Chart 8: Daily changes in investment unit value and movements in the portion of shares



Riskier funds are those leaving more room for riskier investments (into shares, etc) with a view to posting higher return in the long run. They are intended for younger members with over a 10-year investment horizon. As such funds can suffer even short-term losses they are not tailored to older members intending to draw their funds within a short term. Members should therefore opt for a fund with no or small percentage of risky instruments with low volatility.

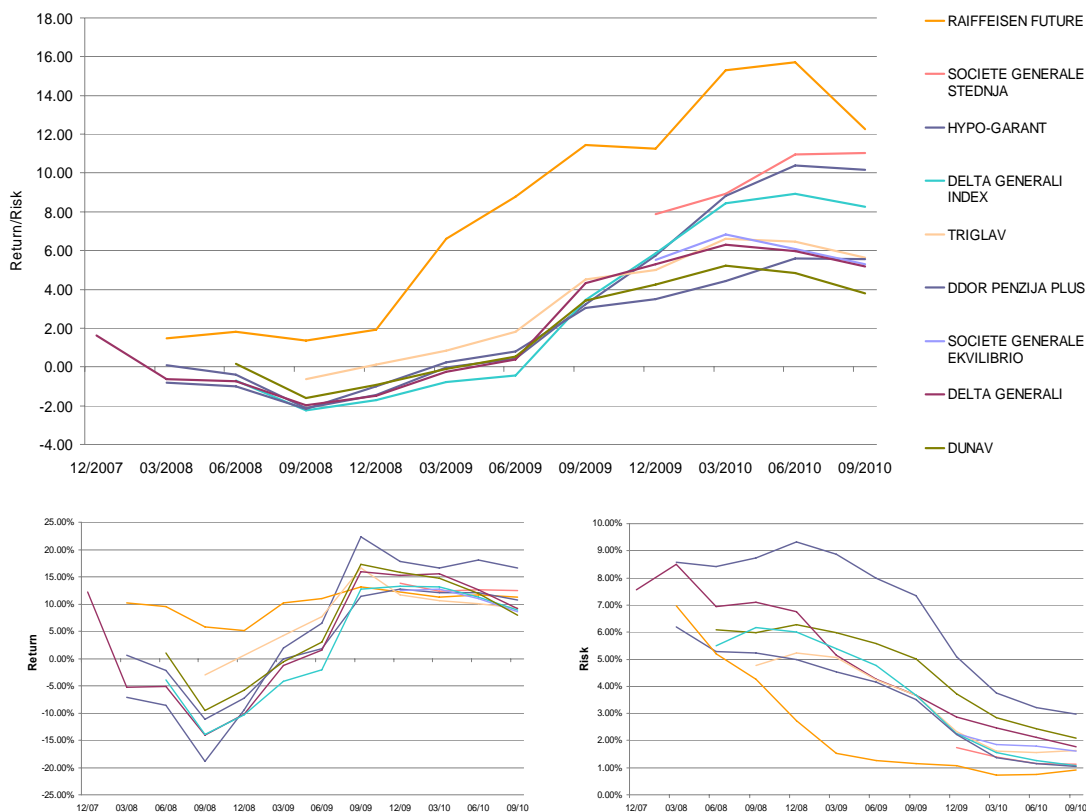
Table 16: Return and risks of VPFs and FONDex

Name of VPF; start of business / return from the start of business (p.a.)	For the past year			
	Investment risk			
	2007	2008	2009	2010
Delta Generali 15/11/2006 / 7.33%	12.08% 7.56%	-9.75% 6.76%	15.20% 2.88%	9.25% 1.45%
Raiffeisen Future 03/01/2007 / 11.26%		4.90% 2.72%	12.14% 1.08%	8.81% 1.69%
DDOR-Garant 10/01/2007 / 7.42%		-7.07% 4.99%	12.66% 2.21%	9.40% 1.26%
Dunav 02/04/2007 / 5.08%		-5.83% 6.27%	15.84% 3.72%	9.40% 1.77%
Delta Generali INDEX (ex Nova penzija) 16/04/2007 / 2.41%		-10.18% 5.99%	13.19% 2.26%	8.55% 0.97%
Triglav penzija 11.09.2007/6,66%		0.46% 5.24%	11.67% 2.34%	9.16% 1.67%
Societe Generale Štednja 06/11/2008 / 12.07%			13.76% 1.75%	9.84% 1.33%
Societe Generale Ekvilibrio 06/11/2008 / 11.16%			12.38% 2.24%	9.12% 1.31%
FONDex 15/11/2006 / 8.30%		-6.88% 6.29%	15.04% 3.21%	9.57% 1.57%

The return/risk ratio¹¹ moved in line with changes in its individual components. Since the start of VPF operation, the ratio moved in three phases. The first phase was marked by a moderate decline, triggered by falling return, though the decline was mitigated by diminished fund riskiness. It is noteworthy that funds taking less risk at the time posted higher return. Such ratio is however expected in light of negative trends in the financial market. Still, once the market enters calmer waters, the ratio may change as its current levels are unsustainable from a long-term perspective (VPFs being long-term investment vehicles). The second phase was that of vigorous growth in the value and rising return, together with a further decline in risk. The third phase saw stagnation, prompted by the stabilisation of risk and return in 2010.

¹¹ The return/risk ratio is calculated by dividing the return for a particular period by the value of risk for the same period.

Chart 9: Return/risk ratio in VPF market, chronologically



The return/risk ratio measures the performance of investment and risk management systems. A fund with a higher ratio posts better results. Individual components of the ratio are equally important as two funds may have different component values and the same ratio (higher return and higher risk). The choice between such two funds depends on member's risk tolerance. Assuming the same ratio value, choosing a fund with higher return implies higher risk, i.e. worse performance in times of market turbulences. Management companies prescribe in their investment policies investment limitations and possible fund riskiness.

The return/risk ratio has its limitations. First, the period it covers is short and data series are insufficient. Furthermore, given the circumstances of fund operation (the crisis, volatile environment, plummeting stock exchange shares), the results achieved are not adequate for establishing future values. The most conservative funds, i.e. those taking the lowest risk, posted the highest return. Besides, due to poor BSE liquidity and undeveloped secondary T-bill trading, the investment unit volatility may be underestimated.

International practice (Good practice of the VPF risk management system – the governing board's role and investment policy)

To entrench international practice of pension fund supervision, the IOPS¹² adopted in 2010 a number of documents including “Good Practices for Pension Funds’ Risk Management Systems”. In its recommendations, the IOPS underlines the role of company’s governing board in risk management, placing a special focus on controlling investment and operational risks and mechanisms for monitoring the company and fund operational risk.

Companies need to establish an advanced risk management system comprised of strategies, processes and reporting procedures necessary to identify, measure, monitor, assess, control and report, on a continuous basis, all material risks, at an individual and an aggregated level, to which a fund is or could be exposed.

The risk management system needs to be well integrated into the organisational structure and decision making processes. It should also be commensurate with the nature, scale and complexity of the pension fund.

The governing board should determine and regularly review its overall risk management strategy. This process involves understanding the risks that the company and the fund are exposed to; setting acceptable levels of risk; and outlining how these risks will be measured, monitored and controlled. The governing board should check whether the system is working effectively on an on-going basis and that there is a process in place for modifying or adapting the strategy as required. The risk management strategy needs to be documented, communicated to all relevant staff members and followed. There should be a clear division of responsibilities within the company. Decision making, execution and checking functions should be assigned to different persons. For smaller companies with limited numbers of staff, it may be difficult to assign clear division of responsibilities and powers. However, there is still a need for transparent mechanisms for handling conflicts of interest, particularly as smaller companies tend to outsource their functions.

Investment risk is a major challenge for any pension fund and should therefore be a key element of their risk management systems. An investment policy is a key mechanism for identifying and managing investment risk. A company should adopt investment policy that would normally contain the following elements: investment objectives, the acceptable level of investment risk, types and portions of assets in the portfolio, foreign exchange exposure, valuation methodology, performance measurement and benchmarking, description of the investment decision making process, method and frequency of amending the investment policy.

¹² International Organisation of Pension Supervisors: www.iopsweb.org.

4. CONCLUSION

The first four years of VPF operation were marked by the global economic crisis. At the very onset, VPFs faced the crisis in the securities market and a decline in households' standard of living. Though over RSD 8 bln were invested in private pensions, contributions did not rise as expected. Adjusted by retail price growth, tax facilities increase by the year. On the other hand, the securities market featured an inadequate number of financial instruments and a contraction in prices and liquidity of BSE shares.

Despite adverse trends, VPFs were apt to respond to the volatile market. They significantly lowered the portion of risky investments (shares) in favour of non-risk government securities (frozen FX savings bonds and T-bills). Risk was minimised and assets protected from major losses. All this led to preservation of fund members' net assets and their growth. FONDex did not fall under RSD 1000 and posted much better results than other forms of collective investment vehicles.

In 2010 and early 2011, new instruments were issued, allowing for greater investment diversification. Long-term dinar and euro-indexed T-bills were issued, as well as 2026-maturity T-bills. The first corporate bond was admitted to the BSE unregulated market and fund investment was widened to include foreign markets. At the same time, shares of two large companies – NIS a.d. Novi Sad and Nikola Tesla Airport were listed on the BSE Prime Market.

There is ample room for further development of Pillar III in Serbia. As the economy recovers and the standard of living improves, contributions into private pension funds will rise as well. Clear signals about the need to save for old age, sent to citizens by economic policy creators, are likely to bolster the sector development. Further, awareness raising and education about VPFs will certainly enhance citizens' interest in securing additional retirement income. Besides, more weight should be lent to private pensions in the dialogue between employers and employees, enabling employers to display greater social care for their staff.