

VOLUNTARY PENSION FUNDS SECTOR IN SERBIA

First Quarter Report 2008

May 2008

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1. VOLUNTARY PENSION FUNDS SYSTEM IN SERBIA IN Q1 2008

The Law on Voluntary Pension Funds and Pension Schemes (hereinafter: Law) and 22 pieces of secondary legislation enacted pursuant thereto have been applied as of 1 April 2006. The Law regulates the operations of voluntary pension fund management companies (FMC), the setting up of voluntary pension funds (VPF) and the types of securities and real estate in which funds' assets may be invested. The secondary legislation enacted by the NBS sets out detailed criteria for investment in the country and abroad. Portfolio managers of the companies analyse investment options daily and, adhering to the prescribed legal framework and the company's investment policy, invest the assets of the fund managed by the company in order to earn returns for fund members.

To meet their legal obligation, in Q1 2008 fund management companies sent annual notifications to all members, with information on the value of the fund's assets, on balances in members' individual accounts, contributions paid and fees charged. This furthers the transparency of operations of voluntary pension funds and promotes availability of information significant for fund members, enabling each fund member to evaluate the justifiability of his/her decision to invest in a pension fund.

During Q1 2008, prices of shares and volumes of trading in the Belgrade Stock Exchange continued to decline. The Belex 15 index dropped by 25.86%, while the Belex Line index declined by 19.92%, which is the steepest quarterly decline in the stock exchange index since the start of operation of voluntary pension funds. Although such movements in share prices affected the values of net assets and investment units of voluntary pension funds, these values recorded a more moderate decline (FONDex went down by 3.97%), due to conservative regulatory restrictions on investment, but also to the 3.89% depreciation of the dinar against the euro in this period.

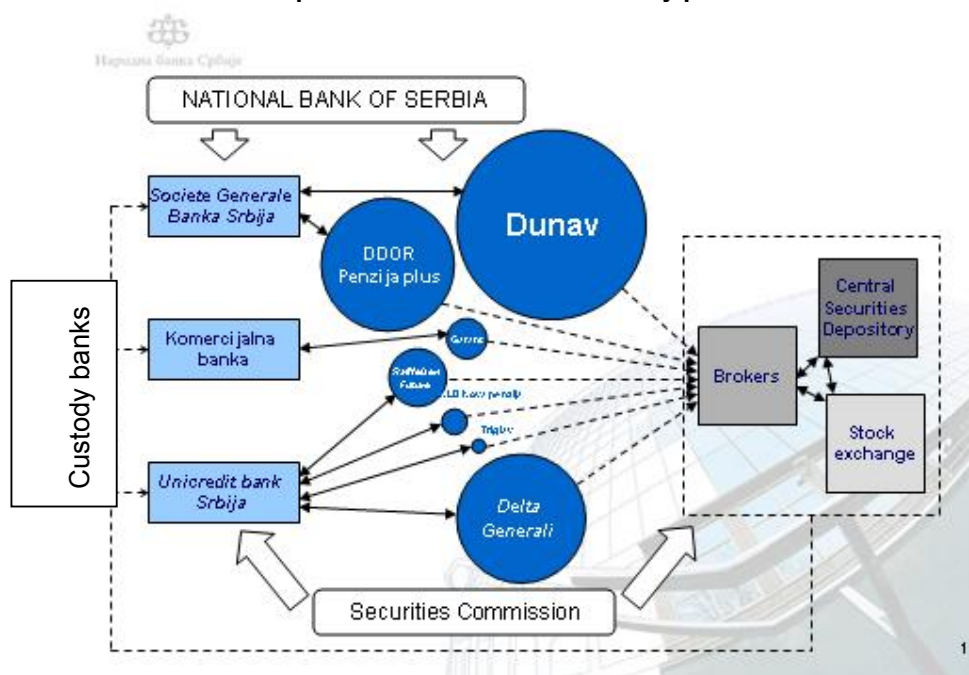
In Q1 2008, the key policy rate was raised on three occasions, from 10% at the start of the quarter to 14.5% at end-quarter. This led to an increase in deposit rates of commercial banks and a resultant rise in the return earned by funds on such investment. The average interest rate on dinar assets of funds thus increased from 8.16% at the start of the quarter to 12.59% at end-quarter.

2. MANAGEMENT COMPANIES

Market participants

In Q1 2008, the number of participants in the market of voluntary pension funds remained unchanged – the market comprised seven FMC, seven VPF and three custody banks maintaining fund accounts.

Scheme 1: Participants in the market of voluntary pension funds¹



Management companies cooperate with twelve broker companies through which they buy and sell securities.

¹ The size of voluntary pension funds as depicted in the scheme corresponds to the size of their respective net assets.

Ownership structure of management companies

Six management companies are foreign owned. At end-November, the Italian company Fondiaria-SAI acquired a majority stake in the equity capital of the insurance company DDOR Novi Sad and, after the completion of the sale procedure in early 2008, became the indirect owner of the FMC DDOR Penzija plus.

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

Table 1: Ownership structure by the activity of the founder

Management company	Qualifying owner ²	
	Name	Main 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	Nova Ljubljanska banka, Ljubljana,	Bank
	NLB LHB banka, Beograd,	Bank
	Continental banka, Novi Sad	Bank
	Skupna pokojinska družba, Ljubljana	Pension company
Triglav penzija	Zavarovalnica Triglav, Ljubljana	Insurance
	Triglav, družba za upravljanje, Ljubljana	Pension company

Organizational network of management companies

The organizational network of management companies is still only developing and includes a total of 26 business units, branches and branch offices, the majority of which belong to the network of a single company. For the time being, most companies have head offices only, which is to be expected since the costs of expanding the direct network are very high. However, management companies have not yet made full use of the possibility to include intermediaries in the sales network to work with new users on behalf of the companies.

The current regulations allow companies to provide information on VPF membership, take other actions to inform interested persons on VPF operations and distribute prospectuses, either directly or through intermediaries.

² A qualifying owner is a person holding a share of over 10% in the capital or voting rights of a management company.

Intermediaries for the provision of such services may be either banks or private individuals licensed for the provision of information by the National Bank of Serbia. Such private individuals, however, may not receive payments for the purchase of investment units. By end-Q1 2008, private individuals were issued a total of 147 licenses for the provision of information on VPF. Management companies are currently engaging 80 private individuals and 3 banks as intermediaries.

Seven management companies employ around 200 persons, the majority of whom are engaged in sales and marketing activities. At end-Q1 2008, total assets managed by management companies reached RSD 16 million per employee, having almost doubled relative to mid-2007.

Fees charged by companies

In accordance with the rules on the fees charged by management companies, fund members pay the fee for company services and the account transfer fee.

- The fee for company services consists of the fee on contribution payment and the fund management fee. The Law on Voluntary Pension Funds and Pension Schemes sets the maximum level of such fees, but the companies may offer more competitive terms and conditions in the market.
- The fee for the transfer of a fund member's account to a fund organized and managed by another management company is proportional to the actual costs of such transfer, which, for the time being, mean only the fee charged by custody banks depending on the amount being transferred.

All fees that a company charges from a member must be published in the prospectus and on the web site of the management company.

As market competition strengthened, the level of fees charged on contribution payment subsided. And though regulations set the maximum fee level at 3% of the payment value, in Q1 2008 the average fee charged by management companies was 2.39%.

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. It is a hidden cost for fund members, as it is charged through the calculation of the investment unit. No company has as yet lowered the level of this fee.

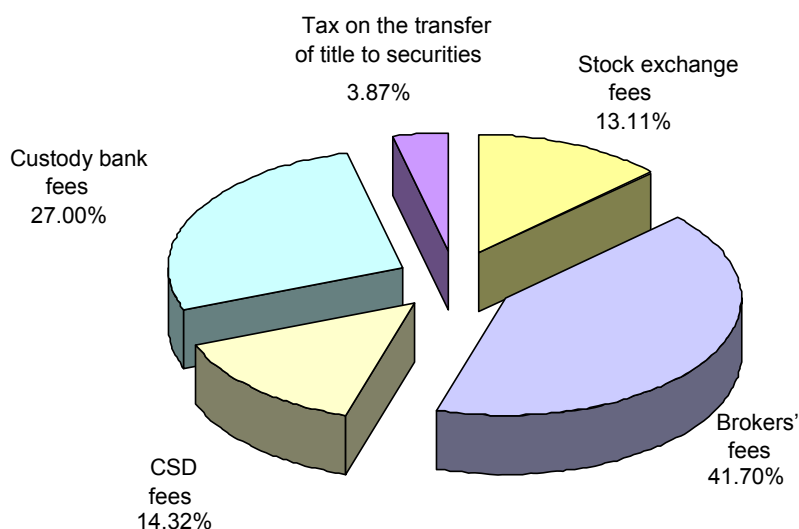
Total fees charged by companies in Q1 equalled RSD 27.8 million. As opposed to a quarter earlier, when the share of fees on contribution payment was dominant, in Q1 2008 fees on contribution payment equalled RSD 12.2 million, or 44% of total fees charged, while the remaining 56%, or RSD 15.6 million, referred to management fees. This was a result of a decline in total payments from a quarter earlier and a lowering of management fees.

Transaction costs

In Q1 2008, the composition of transaction costs remained broadly unchanged from Q4 2007. The share of brokers' fees in total transaction costs declined by 6 percentage points, due to a lower number of transactions, while the share of custody bank fees went up by 7 percentage points.

In Q1, total transaction costs made up 6.83% of fees for management company services.

Chart 1: Composition of transaction costs in Q1 2008



3. VOLUNTARY PENSION FUNDS

Net assets of voluntary pension funds

Table 2: End-quarter net assets of the sector³

in RSD mln				
Q1 2007	Q2 2007	Q3 2007	Q4 2007	Q1 2008
800.88	2,069.85	2,563.26	3,045.63	3,177.11

In the first quarter of 2008, net assets growth slackened and came to only 4.32% on a quarter earlier. For the sake of comparison, in Q4 2007 and Q3 2007, net assets increased by 18.82% and 23.84%, respectively. Such slowdown was due to a decline in the value of investment units and a drop in contribution payments, but also to substantial withdrawals of assets during February and March, through one-off payouts to members who have reached the prescribed age limit (53+). In these two months alone, the level of payouts exceeded the total amount of payouts for the entire year 2007.

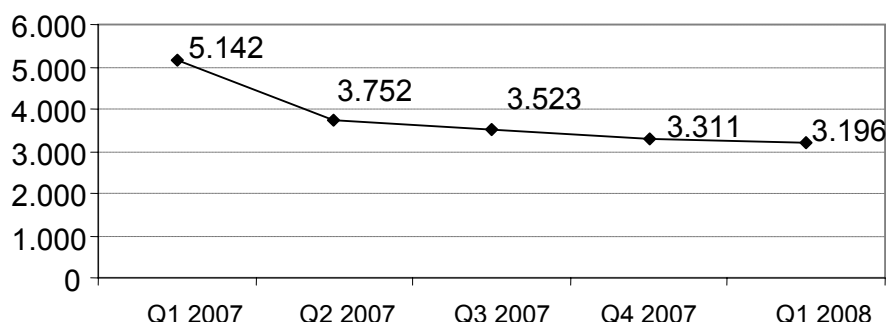
Table 3: Interfund transfers and withdrawal of assets at end-Q1 2008

in RSD mln		
	Interfund transfers	Withdrawal of assets
Q1 2008	58.32	202.12

At the time of transfer of an individual account of a fund member from one fund to another, only the actual costs of transfer and/or payment system charges are charged and deducted from the fund member's assets. As these costs are not significant, they do not discourage interfund account transfers.

³ Substantial growth in net assets in Q1 and Q2 2007 resulted from the transfer of assets collected in respect of voluntary pension insurance provided by some insurance companies prior to the enactment of the Law on Voluntary Pension Funds and Pension Schemes. Following the enactment of the Law, such insurance companies were required to transform into management companies and to transfer assets collected in respect of voluntary pension insurance. In this way, Delta Generali, DDOR Penzija plus and Dunav started their voluntary pension fund operations with assets of RSD 1,500 million. As the second portion of assets comprises mainly contributions to funds, the growth in assets can be said to have been generated mainly by member payments.

Chart 2: End-quarter concentration⁴ in the sector



At end-2006, the index of market concentration in the voluntary pension funds sector was at a maximum of 10,000, as only one company operated at the time. The level of assets managed by newly established “greenfield” funds is still much lower than that managed by funds which inherited assets from pension insurance operations. As a result, the market of voluntary pension funds is highly concentrated, with three funds accounting for over 90% of the market. Although the trend of declining concentration continued into Q1 2008, the HHI remains very high, with the overall market share of new funds still below 10%. However, one fund from the group of small funds is expected to increase its share of net assets to 5% in the next quarter and thereby cross over into the group of middle-sized funds.

Table 4: Market share by size

Fund size (share of net assets in %)	Number of voluntary pension funds
Large (over 20%)	3
Medium (5% -19.99%)	0
Small (0% - 4.99%)	4

⁴ 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.

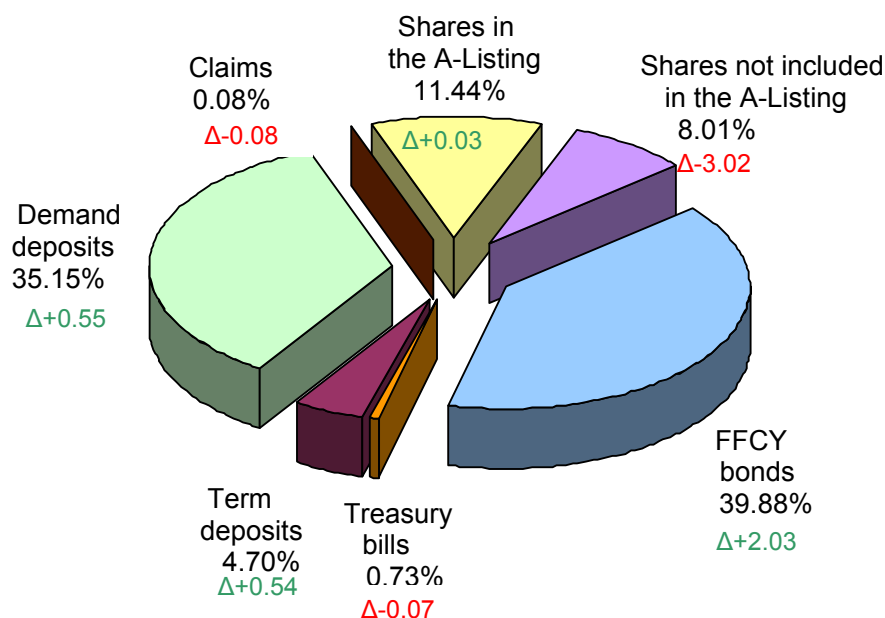
Composition of assets of voluntary pension funds

The composition of funds' assets remained broadly unchanged, with debt securities continuing to account for the major share of total assets in Q1 2008.

As regards investment in shares, in Q1 2008 the A Listing included shares of Energoprojekt Holding, Tigar and Sojaprotein, the same as in a quarter earlier. Subject to regulations, funds may invest up to 40% of their assets in A-listed shares and up to 10% of their assets in the securities of a single issuer.

The maximum amount to be invested in shares that are not included in the A Listing but meet all other requirements prescribed by the decision on maximum investment levels equalled 20% of total assets in Q4, but was lowered to 15% as of 1 January 2008. As of 1 April, this limit was lowered further down to 10% of the fund's assets. All funds timely complied with the new limit.

Chart 3: Composition of total assets of funds at end-Q1 2008⁵



Debt securities accounted for the largest share of total fund assets (40.61%), followed by transaction accounts (35.15%), shares (19.45%) and time deposits (4.70%).

⁵ Shows changes relative to end-2007.

At end-Q1 2008, of total assets, RSD 1,280.12 million or 40.11% was in a foreign currency (only euros, for the time being) and RSD 1,911.64 million or 59.89% was in the domestic currency. Assets in euros referred primarily to bonds issued against frozen foreign currency savings. This ratio remained broadly constant throughout the year.

Volume of stock exchange trading by pension funds

Negative movements in index values and trading volumes in the Belgrade Stock Exchange continued in Q1 2008, causing the volume of trading by pension funds to decline by 20% on a quarter earlier. Although the share of trading by funds in total trading in the BSE increased, this increase was due mainly to a sharp decline in overall stock exchange trading volumes. Such developments had a negative impact on the returns earned by voluntary pension funds.

Table 5: VPF share in Belgrade Stock Exchange trading⁶

	Q1 2007	Q2 2007	Q3 2007	Q4 2007	in RSD million Q1 2007
Volume of VPF trading	299.00	625.63	622.93	610.00	495.83
Share in Belgrade Stock Exchange trading	0.68%	1.17%	1.94%	1.72%	2.85%
Volume of securities purchases by VPF	252.87	434.64	506.65	473.87	353.53
Share in Belgrade Stock Exchange trading	0.58%	0.81%	1.58%	1.33%	2.03%

Voluntary pension funds are still mostly active on the side of demand for securities.

⁶ The data refer to the total volume of trading by VPF, as a significant indicator of funds' activity. It should also be noted that in Q1 2008 OTC trading accounted for as much as 39% of total trading.

Payment of contributions to voluntary pension funds

At end-Q1 2008, the number of contracts concluded with management companies came to 181,772, of which two funds accounted for around 70%. The number of individual accounts to which contributions have been paid since the start of operations of voluntary pension funds to date has been increasing to reach 161,173 at end-Q1. By end-March 2008, a total of 20,599 contracts were concluded subject to which no payment has yet been made, while funds which inherited assets from insurance operations hold 30,539 inherited contracts based on which no contributions have been paid.

Table 6: Share in the number of contracts by size

Fund size (share in number of contracts, in %)	Number of voluntary pension funds
Large (over 20%)	2
Medium (5% -19.99%)	1
Small (0% - 4.99%)	4

Total payment (total contribution of fund members) in Q1 2008 came to RSD 451.78 million, which is a decline by 22% relative to the final quarter of 2007 when total payments came to RSD 581.73 million. The first half of Q1 was marked by a notable decline in total payments to pension funds, as a number of public enterprises ceased to pay contributions for their employees. However, in late Q1 payments rallied on account of new pension schemes.

Table 7: Number of active members and total payments to funds

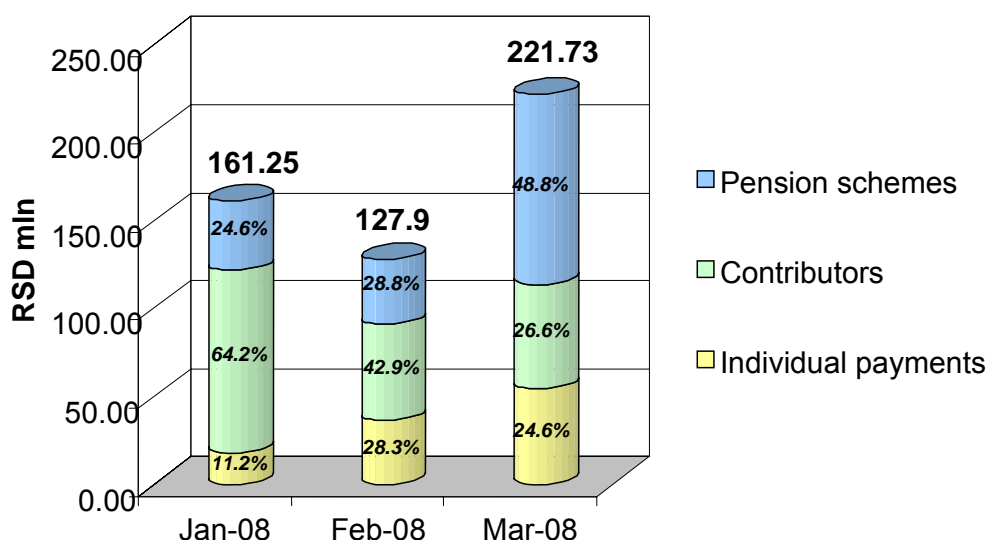
	Number of active members	Payments to funds (RSD mln)
Dec 2007	91,991	219.97
Jan 2008	87,924	159.28
Feb 2008	55,083	113.09
Mar 2008	85,740	179.41

Of total payments, individual payments accounted for RSD 108.84 million or 21.34%, pension schemes for RSD 184.56 million or 36.18%, while the largest portion, RSD 216.70 million or 42.48% referred to contribution payments by employers.

The composition of payments altered notably in Q1. Namely, although in January it remained broadly unchanged relative to prior periods, in February and March a completely new trend emerged, as the share of payments by contributors slumped, while the share of pension schemes went up as a result of

signing of large new contracts which in March reached almost one half of total payments.

Chart 4: Volume and composition of total payments



In January, average payment per individual account came to RSD 1,824.63, down by 28.4% on December 2007. This decline, however, proved to be only temporary, as in the remaining months of the quarter average payment rebounded to reach RSD 2,322.59 in February and RSD 2,585.10 in March.

Investment unit value

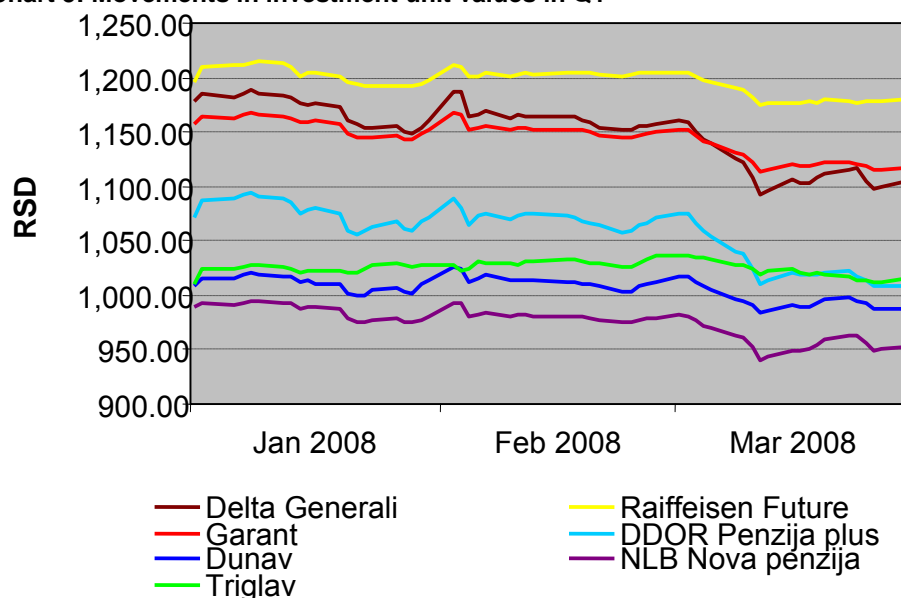
Investment unit values of most voluntary pension funds declined in Q1, reflecting subsiding prices of shares in the Belgrade Stock Exchange. As around 40% of assets of voluntary pension funds are invested in euro-denominated financial instruments, exchange rate movements also affected investment unit value.

Table 8: Investment unit values in Q1

Investment unit value	Dunav	Raiffeisen Future	Delta Generali	Garant	DDOR	NLB	Triglav
Start-of-quarter	1,009.02	1,196.02	1,178.50	1,157.70	1,071.62	989.32	1,010.24
End-of-quarter	986.99	1,179.90	1,104.93	1,116.49	1,009.36	952.58	1,016.33

Maximum value	1,026.01	1,214.74	1,187.93	1,167.91	1,093.95	994.80	1,036.57
Minimum value	984.05	1,175.34	1,098.45	1,113.39	1,008.13	941.06	1,010.24

Chart 5: Movements in investment unit values in Q1



Returns of voluntary pension funds

In accordance with the Law on Voluntary Pension Funds and Pension Schemes, the returns of voluntary pension funds are published four times a year, at the end of each quarter. The return on investment during the first year of operations is not published. The return is calculated for the 12-month period immediately preceding the day of publication or cumulatively for a 5-year period and since the start of operation.

At end-Q1 2008, data on returns earned by five funds operating for over a year (Delta Generali, Raiffeisen Future, DDOR Penzija plus, Dunav and Garant) were published. Annual returns for the period from 31 March 2007 until 31 March 2008 and returns earned since the start of operation of a fund by 31 March 2008 were published.

Although all companies try to earn the highest possible return to the benefit of their fund members, the investment risk is not completely eliminated and there is always a possibility that the return on investment of fund assets would be unsatisfying or even negative. The returns earned by the fund are distributed among individual accounts of all members, pro rata to the level of their individual account balances.

It should also be noted that there is a difference between the returns of the fund and the returns on an 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 successfulness of the fund's operations, the value of investment units at the time of making the contribution payment, the length of the period during which payments are made and the level of payments. The returns of a fund depend exclusively on the value of investment units, i.e. successful investment of a fund's assets.

4. REGULATORY ACTIVITIES IN Q1

In Q1 2008, the National Bank of Serbia enacted a Decision on Opening, Maintaining and Transferring Individual Accounts, published in the „RS Official Gazette“, No. 24/08 of 7 March 2008. This decision liberalized the form of annual notifications to fund members, prescribing at the same time an obligation for management companies to make sure that the information contained in such annual notifications is relevant, truthful, reliable and accurate.

In addition, amendments have been planned to the Decision regulating the types of financial institutions that can act as intermediaries of voluntary pension fund management companies and the requirements for issuing licenses to natural persons to engage in the activities of providing information on the fund. The new decision aims to improve the quality of the sales network.

5. CONCLUSION

In Q1 2008, there were 7 voluntary pension funds managed by 7 voluntary pension fund management companies operating in the market. More than 100,000 private individuals invested around RSD 3 billion in pension funds. Notwithstanding adverse circumstances in the stock exchanges, both in the country and abroad, both private individuals and employers recognized the importance of long-term savings. This was reflected in the fact that, though the average investment unit value mirrored movements in the stock exchange, both average return and funds' assets increased.

In late Q1 2008, net assets of all funds were just shy of RSD 3.2 billion or around 0.12% of GDP. As the regional average of this indicator equals 5.4%⁷, compared to around 17% in the EU countries, it can be concluded that this sector has great potential for development.

⁷ Average calculated based on data from Slovenia, Croatia, Hungary and Bulgaria.

In 2007, the voluntary pension funds sector recorded profits of RSD 94 million. It should, however, be noted that in the first year of their operations management companies recorded losses of RSD 254 million, which was to be expected given the costs involved in the start of company operations, as well as the development and market positioning of the company. However, as the assets of the management company are independent from the fund's assets, this loss cannot be compensated for by reducing the value of assets accumulated in individual accounts of fund members. Losses prompted 5 management companies to increase their capital levels late last and early this year. Dunav, Garant penzijsko drustvo, NLB Nova Penzija, Raiffeisen Future and Triglav Penzija also decided on capital increases to ensure that their capital should, at all times, be above the legally prescribed minimum.

Table 9: Capital increase of voluntary pension fund management companies

VPF management company	Capital increase
Triglav Penzija	RSD 25,000,000
NLB Nova Penzija	EUR 1,000,000
Garant	EUR 115,000
Dunav	RSD 84,000,000
Raiffeisen Future	EUR 200,000

Contributions paid by the employer and/or by direct debits from the salary are not subject to taxes. The tax breaks have contributed to the development of the pension funds system, encouraging employers to raise their employees' salaries through the payment of contributions to the pension fund. In 2007, contribution payments of up to RSD 3,000 were exempt from taxation, while as of February 2008 this amount was raised to RSD 3,303, following indexation to retail price growth.

Finally, it should also be noted that the main preconditions to the development of an efficient "third pillar" in Serbia are: improved standard of living, macroeconomic stability, widening and deepening of the capital market and financial education of Serbia's citizens.