

European Pension Funds Congress



DC Pensions in Croatia

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General information

- Croatia has 4,4 million inhabitants
- Pension system based on III pillars (since 2002)
 - I. Pillar State pension fund ; contributions paid 15% of gross salary (or 20%)
 - II. Pillar Compulsory; contributions paid 5% of gross salary (currently government considers to gradually raise contributions; but due to negative trends in the region and budget deficit it is likely to be postponed)
 - III. Pillar Voluntary; Two types of Voluntary Pension Funds:
 - For individuals (also called open-end pension funds)
 - Occupational pension funds (established by sponsors)
 - In a payout phase personal assets of the member are transferred to pension insurance company
- 1,55 million members of Compulsory Pension Funds
- 162.000 members of Voluntary Pension Funds. To make voluntary pension funds interesting for people tax allowances for employers and state subsidies for individuals exist
- Only DC Pension Funds

Macroeconomic data and forecasts

	2007	2008	2009	2010F	2011F
GDP (EUR bn)	42,8	47,4	45,4	45,6	47,1
Population (mn)	4,4	4,4	4,4	4,4	4,4
GDP per capita (EUR)	9.654	10.681	10.245	10.299	10.641
GDP (constant prices yoy %)	5,5	2,4	-5,8	-1,5	47,1
Private Consumption, real, yoy (%)	6,2	0,8	-8,5	-2,5	1,2
Fixed Investment, real, yoy (%)	6,5	8,2	-11,8	-6,6	3,5
Public Consumption, real, yoy (%)	3,4	1,9	0,2	-0,5	0,0
Exports, real, yoy (%)	4,3	1,7	-16,3	3,3	1,7
Imports, real, yoy (%)	6,5	3,6	-20,7	-1,3	1,4
CPI (average, yoy %)	2,9	2,1	2,4	1,0	2,5
Monthly wage, nominal (EUR)	961	1.044	1.050	1.058	1.072
Unemployment rate (%)	9,6	8,4	9,4	10,5	10,2
Budget balance (% of GDP)	-2,0	-1,4	-3,9	-6,5	-6,0
Current account balance (EUR bn)	-3,2	-4,3	-2,4	-1,7	-1,8
Current account balance (% of GDP)	-7,6	-9,2	-5,4	-3,7	-3,9
Net FDI (EUR bn)	3,5	3,2	1,0	1,4	1,8
FDI (% of GDP)	8,1	6,8	2,1	3,0	3,7
Gross foreign debt (EUR bn)	32,9	40,0	44,6	46,0	48,5
Gross foreign debt (% of GDP)	76,9	84,4	98,2	100,8	102,9
FX reserves (EUR bn)	9,3	9,1	10,0	10,7	11,5
(Cur.Acc-FDI)/GDP (%)	0,6	-2,3	-3,3	-0,7	-0,2
FX reserves/Gross foreign debt (%)	28,3	22,8	22,4	23,3	23,7
Source: Unicredit research, Erste Bank					

EMPLOYMENT	2009
Number of employees (Full Time job)	1.520.000
Number of pensioners	1.173.000
Ratio Employees/Pensioners	1,3
Social transfers from Budget as a percentage of GDP (%)	16,8
Transitional Cost (EUR mn)	627
Transitional Cost as a percentage of GDP (%)	1,38
Source: HZMO	

Current situation

- Pension Funds (II. Pillar) are treated as a part of social security system and as such many quantitative limits exist (but also for voluntary pension funds which are not a part of social security system)
- Within set limits prudent professional rule applies
- Strong home country bias not only because of the restrictions implemented by the law (max 20% in foreign securities, min 50% in Croatian government securities)
- Management company guarantees certain return of the pension fund. Guaranteed return is based on the average performance of pension funds; consequence → similar asset allocations
- Currently very limited possibilities to hedge portfolios
- All the assets must be managed internally by the pension fund management company
- It is strictly forbidden to buy securities issued by related parties

Average Asset Allocation of Pension Funds

Domestic Assets			Foreign Assets	
Total (%)	88,0		Total (%)	11,0
Shares (%)	12,4			5,0
Government Bonds (%)	64,7			1,3
Municipal Bonds (%)	0,3			0,0
Corporate Bonds (%)	3,7			0,4
Closed-end Funds (%)	0,2			0,0
Open-end Funds (%)	2,2			5,3
Short term Securities (%)	1,1			0,0
Deposits (%)	2,5			0,0
Cash (%)	0,6			0,0
Source: HANFA				

Investment limits (Croatia)

- **Up to 10% of the assets can be held in term deposits with the bank or certificates of the deposits**
 - Croatian and EU banks
 - Not more than 2,5% of the pension fund's assets can be held with a single bank
 - Only short term deposits (up to one year)
- **More than 50% of the assets pension fund must hold in securities issued by Croatian government**
 - Partly to cover transitional costs
 - Before pension funds were established, domestic fixed income market was almost non existent; all issues were either Eurobonds or for domestic market Euro linked bonds
 - Currently domestic pension funds are the main owners of government debt; secondary fixed income market is again illiquid but primary market is solid
- **Up to 30% of the assets can be invested into corporate bonds, municipal bonds and bonds issued by local governments**
 - In practice issues are small compared to pension funds' assets
 - Secondary market totally illiquid; even before crisis bid/ask spreads were very high; often the only traders on secondary market were underwriters

Investment limits (Croatia)

- Up to 30% of the assets can be held in domestic and foreign shares
 - Domestic shares
 - First tier quotation; pension fund can acquire up to 10% of the company and sum of pension fund's assets invested into companies where pension fund holds more than 5% of the company must not exceed 15% of the fund's assets;
 - Regular market; to be investible for pension fund market capitalization of the company has to be higher than 40 million EUR at a time of the first investment, there is also a limit concerning a free float of the company
 - Foreign shares
 - Shares must be listed on official market
 - EU and OECD countries with credit rating not bellow Croatian
 - Market capitalization must be higher than 300 million EUR
- ❖ According to the new Capital markets law, companies listed on regular market can easily delist (those companies were forced to list in a period of mass privatization)

Investment limits (Croatia)

- Up to 30% of the pension fund's assets can be invested into units of open-end investment funds and shares of closed-end investment funds registered in Croatia, EU or OECD countries.
 - Up to 5% of the assets can be invested into investment funds of a single management company
 - Net Asset Value of domestic investment fund must be higher than 100 million HRK (13,3 million EUR), Net Asset Value of foreign investment funds must be higher than 100 million EUR
 - Pension fund's share of a particular investment fund can not exceed 20% of NAV
- Up to 2% of the pension fund's assets can be invested into private equity funds

Investment limits

- Derivatives
 - According to the law pension funds are allowed to invest into (only for hedging purposes):
 - Futures
 - Options
 - FX Forward contracts

Currently pension funds can use only FX forward contracts. Concerning all other derivatives mentioned above precise regulation by Regulators must be issued

- Capital Guaranteed Products are allowed by the law but additional regulation is needed
- Hedge Funds are not allowed
- Direct investments into real estate is not allowed
- Up to 20% of the assets (25% for voluntary pension funds) can be invested into eligible foreign securities (EU and OECD countries)

Changes

- After Croatia joins EU concerning investment limits Croatia and EU countries will, be equalized