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# Development of Pension Funds and Collective Investment in the Czech Republic

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## Supplementation Pension insurance

- Pension insurance is one form of savings that is supported by government in the Czech Republic.
- The main reason of this supplementation insurance is creation of fund for people when they get old .
- In the Czech Republic is pension insurance regulated by law no. 42/1992 Act on Supplementation Pension Insurance.

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## Supplementation Pension Insurance

- Pension insurance is based on **regular monthly payments** that are concentrated in account of pension fund.
- In addition to regular payment of clients there are added also
  - **state subsidy**
  - and also **share of profit** from investment activities of fund.
- There are also some **tax advantages** and **employer contributions**.
- All of this resources create fund of money that will be used by client when get old.

## Personal account

- In the personal account of pension insurance could come money for several resources.
  - **Personal monthly payment –**
    - particular height of personal payment is determined by insurance contract. During savings is possible to adapt payment according to client momental situation.
    - In the Czech republic according to current legislation is optimal to save at most 1500 CZK per month. With this height of payment client can maximally use benefits linked to pension insurance
- It means subject gets the maximal height of government benefit and also higher tax advantage that is 12 000 CZK per year.

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# Personal account

## ❑ **State subsidy**

- its value is based on height of personal monthly payment but the higher state subsidy obtain client if his personal payment is at least 500 CZK per month.

## ❑ **Possible employer contribution**

- this benefit is in some respects preferable then wage - increase in same amount because there is not paid social and health insurance and income tax but it is only if this benefit is lower than 5 % of gross wage.

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## Personal account

- ❑ **Revenues from fond activities** - money that are saved in pension fund are invested. To investments are used conservative strategies:
  - it means with limited risk and stable revenues.
    - ❑ usually are used government securities, bonds, stocks and time deposits.
  - Rules for investment are regulated and supervised by Ministry of Finance and Czech National Bank.
  - At least 85 % of fund annual profit is divided into fund clients.

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- The Pension funds can invest:
    - Public bonds, treasure bills etc. – without limitation
    - Stocks or unit trust – maximum 25%
    - Real estate or corporate property – 5%
    - Bank accounts – without limitation but at most 10% of resources in one bank

## Portfolio of pension funds

- Bonds - 77,2 %
- Shares - 6,8 %
- Money - 6,7 %
- Treasury bills - 3,8 %
- Unit certificates - 3,4%
- Other assets - 1,2%
- Real estates - 0,9 %



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## Tax advantage

- If the annual personal payments are at least 6 000 CZK per year it is possible applied tax deduction.
- Tax deduction is influenced by sum saved in fund but per year could be deducted at most 12 000 CZK.

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## Pay - off from fund

- Money that are saved in fund will be in future pay - off as a regular monthly payments or one time.
- Regular monthly payments are usually more profitable then one time payment.

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## Development of Pension Funds

- During the development phases, pension funds were subjected to strong regulatory measures and thanks to this measures they became healthy, credible and self-confident institutions.
- There was several margins in this area from 44 funds at the beginning of the 1990's and now there is only 10 funds (2009).
- The funds now managed more than 200 billion CZK from more than 4.5 million clients.

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# Development of Pension Funds

- Currently 40 % of population and 60 % of economic active population contributes to pension funds.

## Development of Pension Funds

- Chronic problems in pension funds.
  - The first problem is high average age of clients that exceeded 47 years old. The persons up to 29 years old are only little more than 10 % of the clients. The system has registered a high concentration of older-age clients from the beginning.
  - The second problem is low average clients contribution which is about 460 CZK per month.

# Development of Pension Funds

- ❑ Additional problem, that pension fund must resolved is its institutional framework. Several questions must be also before answered.
- Should they continue to be joint-stock company with the special status of shareholders guarantee and distribution of profit among participants and shareholders or
- should they be trust companies administering the fund of participants for fees?
- Should be role of pension funds be closer to insurance companies or mutual funds?

## Number of pension funds in the Czech Republic

- During 2006 there was 11 active pension funds from number of 46 that have a licence (two from this fund never begin its activities).
- At the end 2006 there was margin between Hornický penzijní fond and ČSOB penzijní fond Progress.
- No fund entered into liquidation, this is a testimony of consolidation of sector.
- By the end of 2001 there were 12 funds in liquidation but it were only small funds and losses were insignificant.

# Pension Funds in 2009

- AEGON Pension Fund
- Allianz Pension Fund
- Axa Pension Fund
- ČSOB Pension Fund Progress + Zemský PF
- ČSOB Pension Fund Stability
- Pension Fund - Česká pojišťovna
- Pension Fund - Česká spořitelna
- Pension Fund - Komerční banky
- ING Pension Fund
- Generali Pension Fund



# Problems with Pension Funds in the Czech Republic

- Nowadays pension funds earn lower than is a rate of inflation.
- The profit of PF decline at 1,5 billion CZK (2,6 billion CZK at the same time in 2007)
- Between 1995-1997 different situation average profit over 10 % per year.
- The most successful years:
  - PF CSOB Progress – 16,4 % (1996)
  - Generali PF – 14,6 % (1997)
- Since 1999 the profits from PFs are declining.
- The worst situation in 2007
  - Profit from 2,2 % p.a. (AXA) to 4,7 (Aagon, loss of 18,5 milion CZK, profit only as a marketing tool)

# Problems with Pension Funds in the Czech Republic

- Net profit of PFs in 2007 – 4 billion CZK.
- But 4,29 billion had to be written off (decline in price of several securities)
- Shareholder's capital of several PFs had to be risen up to be able to fullfil capital adequacy rule (PF of CP, CSOB or ING).
- The costs of PF are rising up as well.
- Provision costs rose up about 10 %, 0,37-4.29% from all financial resources managed by PFs.
- Total fees paid by PF are about 1,285 billion CZK.
- The main advantage of pension fund become state subsidy. Which results in investors does not save more than 500 CZK per month, because from sum 500 CZK per month clients obtain higher state subsidy and can also use tax deduction.

# Government benefit

## ■ Monthly payments in CZK

- ❑ 100
- ❑ 150
- ❑ 200
- ❑ 250
- ❑ 300
- ❑ 350
- ❑ 400
- ❑ 450
- ❑ 500 and more

## ■ Monthly state subsidy in CZK

- ❑ 50
- ❑ 70
- ❑ 90
- ❑ 105
- ❑ 120
- ❑ 130
- ❑ 140
- ❑ 145
- ❑ 150

# Problems with Pension Funds in the Czech Republic

- There is prepared reform in pension funds that should loose hand of pension funds
  - PFs do not necessary reach the positive profit each year but loss will be also acceptable.
    - The fonds will able realise higher yields because they will invest in shares more often.
  - PF clients will have several possibilities of investment programme according to risk related with investment (from conservative to aggressive programme).
  - Higher volume of financial resources available in PFs (Pension insurance will be mandatory). Nowaday there is about 200 billion CZK in PF (5% GDP)

# Problems with Pension Funds in the Czech Republic

- Nowadays in pension fund invested 4,5 million clients they appreciate they investment thanks to government benefit.
- Long-term profit is about 1-2 % above inflation rate.
- In 2007 average profit was 2,2 % it crossed over inflation only about 0,7 % in 2007 the worst profit in the history.
- In 2008 the profit will be lower than 2007 but inflation higher.
  - (first 6 months in 2008 profit 0.56%, in 2007: 1,41% )

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## Problems with Pension Funds in the Czech Republic

- Pension funds have relatively high costs that significantly lower profit from their activities.
- Better transparency should bring amendment of act that should separate property of funds and savings of clients.
- This show if pension funds have resources for their activity or how many money spend on provisions.

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## Problems with Pension Funds in the Czech Republic

- In long-term investment is important not only profit per year but also all fees that are linked to product.
- In case of pension funds there are no information about costs of this products. Officially the costs are zero but in reality this costs are only well discovered.

# Problems with Pension Funds in the Czech Republic

- The idea of using pension funds as tool for supplement money in older age is not possible according to current situation.
- In the Czech Republic is invested in pension funds 200 billion CZK it is 8 % of Czech GDP (in developed countries it is about 90 %) and also monthly payments are very low it is about 460 CZK.
- Pension funds have prescribed structure of investment 75 % must be in bond but it is offend more than 75 %.
- Pension funds do not invest their resources into shares very offend although this investment brings higher yields. One reason of this is that pension funds must end account year at worst case with black zero it means no losses are possible and they invest mostly in bonds with lower yields.
  - Loss is paid by owner, e.g. mother bank.



## Should be established guarantee fund?

- Generally, we can say that guarantee fund is created to settle possible losses. In this case this fund should contribute to trustworthiness of potential clients.
- European Union insists on creation of guarantee fund to banks and traders with securities not pension funds.
- Guarantee fund should guarantee part of own savings not state subsidy and yields.
- Nowadays is invested in pension funds more than 200 billion CZK and state budget is not able to cover potential losses.
- On the other hand contributions in guarantee funds must be high to be able to cover losses of middle pension funds.
- These contributions should lower pension fund profit from conservative investment actions.

# Situation in 2007

- The interest about pension insurance is stable growing.
- Every years is added about 10% new clients.
- Actual value of dispose property is about 200 billion CZK.
- The property of pension insurance companies rose about 23 billion CZK in 2007:
  - 16,4 billion CZK – from regular payments
  - 2,1 billion CZK – as a employer contribution
  - 4,4 billion CZK – as a state subsidy

## Situation in 2008

- The attractiveness of pension insurance is still promoted by state subsidy.
- During recruitment of new customers the pension insurance is supported by government media campaign:
  - if government speaks about pension reforms also pension insurance is mentioned as a kind how get money in old age without mention of other possibilities , or
  - pension insurance is one of the pillar of prepared pension reform, etc.

# Main problem

- Conservative investment strategy:
  - ❑ Limited investment possibilities of pension insurance companies – is not allowed decline in value of personal payment.
  - ❑ It is a reason why more than 75% of resources is invested in bonds
  - ❑ Nowadays because of rise of interest rates the prices of bonds decline and do not cover inflation.
  - ❑ The pension insurance companies are not allowed to investment more than 25% in stocks and this years there is also problem with very stormy situation in exchange markets.

## Warning of OECD about pension collapse in the Czech Republic

- If the Czech Republic does not take reform in pension policy till 40 years will pension consume so many money that it causes economic crisis.
- If the pensions will be subject of similar conditions after 40 years consume 16% of GDP.
- Two effects have a dominant role:
  - The Czech republic is one of the fastest elderly society in the world.
  - And does not reflect this situation

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## Characteristics of the Collective Investment Sector

- At the end of the 1990's foreign investment companies began entering in the financial market of the Czech Republic.
- The amendment to the Act on Investment Companies and Investment Fund determined that from 1.1. 2001 they must have a licence granted by the Commission.
- After the accession the Czech Republic into European Union investment companies with registration in EU can enter into Czech market on the basis of so called European Passport.

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## Characteristics of the Collective Investment Sector

- Standard funds it means funds under the law of the European Communities can be freely offered in all European countries.
- The entry of foreign funds to the Czech market
  - extended the offer of investment opportunities and
  - promoting competition in collective investment.
- A list of licensed investment companies and investment funds is available in website of the Czech National Bank.

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# Investment Company

- An investment company is a joint-stock company and their object of business is collective investment.
- Collective investment by
  - Unit trust
  - Investment fund
- Investment company creates and manages **unit trust** that are not a legal entity.
- Investment company collects money in a unit trust by means of issue of **unit certificates** of the unit trust.
- An investment company may also manage assets in unit trust of another investment company or assets of an investment fund on the basis of a management contract.



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## Investment Company

- The Act on Collective Investment determines which assets the unit trust can invest and specific rules for limiting and spreading the risk connected with investment.
- Management of assets in a unit trust is controlled by a depository.
- Only bank their banking licence includes the authorisation to perform the activities linked to depository may be a depository.

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## Collective Investment Fund

- There are open - end a close - end unit trust.
  - Open - end unit trust - an investment company may issue an unlimited number of unit certificates. A unit holder is entitled to sell their unit certificate back to the investment company at any time for price corresponding to the latest price. Latest price is price of day the company received the client request

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## Collective Investment Fund

- The investment company is obliged to redeem the unit certificate without undue delay, not later than 15 working days after the requirement was submitted.
- Close - end unit trust - an investment company that can issued only limited number of unit certificates. Unlike in the open - end unit trust, unit holders are not entitled to asked redemption of unit certificates.
- In 1998 process of establishing close-end unit trusts started. The Commission issued several licences and this process as finished in third quarter of 2002 was the last close-end unit trust were converted into open - end unit trust.

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## Collective Investment Fund

- ❑ Investment fund - unlike unit trust investment funds are legal entities. An investment fund collected money by issuing shares. An investment fund is established for a fixed term that is included in the statute.
  - Every collective investment fund has its statute. It is a document that contains information on the manner of investment of a fund and explanation of related risk.
  - Minimum requirements for statute of different kind of collective investment fund are determined by the law and a decree issued by CNB. All alternations to the statute must be agreed by the CNB.

## Standard and special funds

- The Act on Collective Investment distinguishes standard and special funds.
- A standard fund can only have the form of an open-end unit trust. It is fund that complies with the law of the European Communities.
- A special funds does not comply with law of the European Comities and may have the form of an investment fund, open - end unit trust or closed - end unit trust.

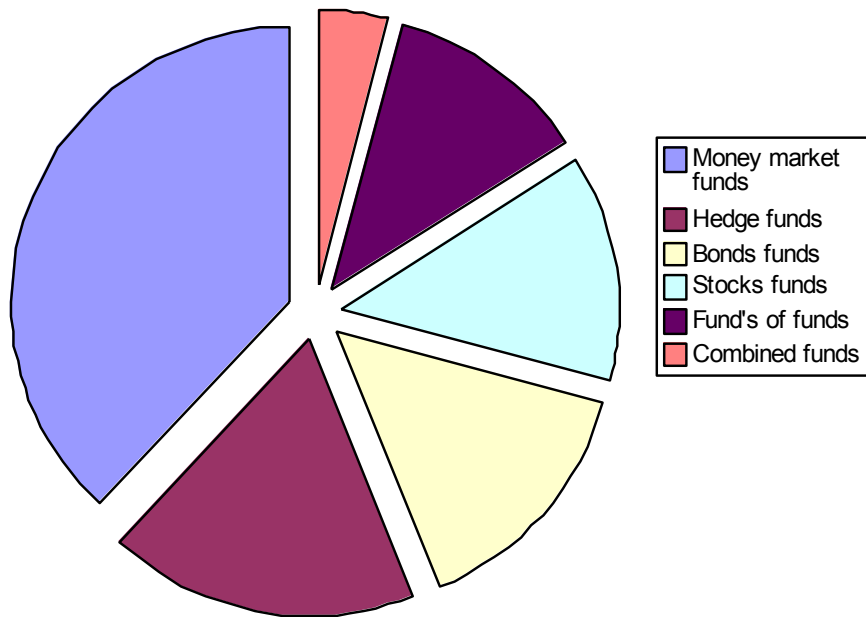
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## Standard and special funds

- Special fund can be classified according to type of assets in which they predominantly invest.
  - special funds trading in securities
  - special funds trading in risk capital
  - special funds trading in real estate
  - special funds trading in derivatives
  - special funds trading in fund
  - special funds trading in special assets
  - combined special funds

# Market share of funds in 2008

Market share of funds in the Czech Republic



- Collectively invested about 300 billion CZK.
- In domestic funds there is about 167 billion CZK.
- In foreign fund there is about 133 billion CZK.

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## Problems

- Other problem with stock funds is appreciating Czech currency.
- Because there is a little quality titles in PSE is necessary to invest in foreign countries
- Because of volatility of the Czech currency the yields from this investments are fluctuate.



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Thank you for your attention