Costs and charges of pension funds in transition economies
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Design of funded systems:

■ Countries tend to limit:
  – types of charges
    • contribution based
    • asset based
    • performance based
    • transfer fee
  – levels of charges
    • for all or for selected charge types

■ Charges deducted only by managers

■ In few cases: specific charges can be paid directly from pension fund assets
Charge design in the region:

<table>
<thead>
<tr>
<th>Country</th>
<th>Limits on charge structure</th>
<th>Types of charges</th>
<th>asset management fee</th>
<th>performance fee from investment return</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>admission fee</td>
<td>contribution-based fee</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hungary</td>
<td>✓</td>
<td>✓</td>
<td>☒</td>
<td>✓</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>✓</td>
<td>✗</td>
<td>✓</td>
<td>☒</td>
</tr>
<tr>
<td>Poland</td>
<td>✓</td>
<td>☒</td>
<td>✓</td>
<td>☒</td>
</tr>
<tr>
<td>Latvia</td>
<td>✓</td>
<td>☒</td>
<td>✓</td>
<td>☒ ¹</td>
</tr>
<tr>
<td>Croatia</td>
<td>✓</td>
<td>☒</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Bulgaria</td>
<td>✓</td>
<td>☒</td>
<td>✓</td>
<td>☒</td>
</tr>
<tr>
<td>Estonia</td>
<td>✓</td>
<td>☒</td>
<td>✓</td>
<td>☒</td>
</tr>
<tr>
<td>Macedonia</td>
<td>✓</td>
<td>☒</td>
<td>✓</td>
<td>☒</td>
</tr>
</tbody>
</table>

Charges have an impact on pension wealth:

Simulation for Poland: pension assets with and without charges:
Asset-based charges are more important in long run:

Simulation for Poland: size of contribution and asset charges:
Impact of fees in selected countries:

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Up-front fee (% contribution)</strong></td>
<td>8.5*</td>
<td>from 7.0 to 3.5</td>
<td>1</td>
<td>0</td>
<td>0.8</td>
<td>0.8</td>
</tr>
<tr>
<td><strong>Management fee (% assets)</strong></td>
<td>0.6</td>
<td>Up to 0.54</td>
<td>None</td>
<td>0.6</td>
<td>None</td>
<td>1.2</td>
</tr>
<tr>
<td><strong>Rate of return fee/‘performance fee’ (% return)</strong></td>
<td>None</td>
<td>Up to 0.06</td>
<td>10</td>
<td>15</td>
<td>25</td>
<td>None</td>
</tr>
<tr>
<td><strong>Reduction in assets</strong></td>
<td>17.4</td>
<td>14.4</td>
<td>10.3</td>
<td>16.5</td>
<td>29.3</td>
<td>26.4</td>
</tr>
<tr>
<td><strong>Reduction in yield</strong></td>
<td>0.82</td>
<td>0.65</td>
<td>0.37</td>
<td>1.13</td>
<td>1.61</td>
<td>1.19</td>
</tr>
</tbody>
</table>

Charges - actual performance:

- Charge levels are different across countries
- They reflect the legal design, supervision practices and competition
- Economies of scale are hardly observed
Charges vs. size of pension funds
Kazakhstan and Poland:

**Kazakhstan 2001**

- $y = -0.1209 \ln(x) + 2.926$
- $R^2 = 0.0389$

**Poland 2002**

- $y = 10.502 \ln(x) - 71.521$
- $R^2 = 0.1763$

- Charge level does not depend on the pension fund size
- Some economies can be seen in Kazakhstan
- In Poland - bigger funds charges are higher

Source: Agnieszka Chlon-Dominczak, Funded Pensions in Eastern Europe and Central Asia: Design and Experience
Early experience with costs:

- Costs of initial year high:
  - driven by sales and advertising
- Reductions in following years
- Some costs imposed by the law
  - costs of guarantees and mandatory reserves
  - costs of reporting
  - costs of supervision
Charges vs. size of pension funds
Kazakhstan and Poland:

- More economies of scale than in the case of charges
- In Kazakhstan - stronger than in Poland

Costs and Charges in Poland:

Charge structure: Polish example:

Cost structure: Polish example:

Source: Agnieszka Chlon-Dominczak, Funded Pensions in Eastern Europe and Central Asia: Design and Experience
Conclusions:

- Most countries regulate the structure and partially level of charges
- There are significant differences between countries in the overall level of charges
- Costs can be caused by legislative requirements
  - Eventually all costs are paid by members
  - For the regulator it is necessary to balance the costs and benefits of guarantees
- The structure of costs changes
  - In the long run the impact of sales and marketing costs is reduced