Investment Opportunities for Management Companies: Growth with the Pension Reform
(Room Document N°27, Session 5)

OECD Conference on Pension Reform in Russia
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PIOGLOBAL
Proven Performance in the Russian Market

- Established financial Services and Real Estate operations since 1992
- More than $130 million in assets under management
- Provides a full range of services
  - PIOGLOBAL Investment Fund - the largest privatization fund
  - Five mutual funds - about 20% of the open-end mutual fund industry
  - Private wealth management - extensive network of contacts
  - Real estate operations - Meridian Commercial Tower
- Client base - more than 2 million Russian investors
- Rated Number One Asset Management Company in 2002 in the RBC, Business Open and Euromoney survey
- Passed the tender to manage pension money in 2003
Russian economic and political landscape

Positive developments

- The second-fastest growing economy
- Impressive macro and fiscal fundamentals
- Growing domestic and foreign investment, capital flight curtailed
- Growth in real earnings and increased consumer confidence
- Decline in public debt, foreign debt repaid ahead of schedule

Possible concerns

- Dependence on commodities price is a major and often-cited risk
- Weak banking system does not allow for efficient flow of funds in the economy
- Low pace of structural reforms
- Politics ahead of elections might slow capital inflows
Russia Stands Tall
Selected GEM Indicators

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Brazil</th>
<th>South Africa</th>
<th>Poland</th>
<th>Russia</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP growth</td>
<td>3.4</td>
<td>2.9</td>
<td>2.1</td>
<td>4.3</td>
</tr>
<tr>
<td>Domestic Investment (% growth)</td>
<td>4.6</td>
<td>7.0</td>
<td>3.0</td>
<td>14.9</td>
</tr>
<tr>
<td>Current account balance</td>
<td>-5.5</td>
<td>-0.4</td>
<td>-6.1</td>
<td>11.2</td>
</tr>
<tr>
<td>Reserves (% of Imports)</td>
<td>30.2</td>
<td>15.6</td>
<td>45.3</td>
<td>72.0</td>
</tr>
<tr>
<td>External Debt (% of GDP)</td>
<td>47.6</td>
<td>31.3</td>
<td>38.3</td>
<td>44.0</td>
</tr>
<tr>
<td>External Debt (% of exports)</td>
<td>351.9</td>
<td>89.0</td>
<td>158.3</td>
<td>132.0</td>
</tr>
<tr>
<td>Debt Service (% of GDP)</td>
<td>9.3</td>
<td>4.3</td>
<td>4.1</td>
<td>4.2</td>
</tr>
<tr>
<td>Debt Service (% of exports)</td>
<td>69.1</td>
<td>12.3</td>
<td>16.8</td>
<td>13.0</td>
</tr>
<tr>
<td>S&amp;P Rating (November, 2002)</td>
<td>B+</td>
<td>BBB-</td>
<td>BBB+</td>
<td>BB</td>
</tr>
</tbody>
</table>

Source: S&P, Moody’s Rating Agency
Russia Still Remains Attractive in Comparison to other GEMs

Source: UBS estimates
Market for Great Opportunities

- Russia continues to be among the world’s best performing markets in 2001-1H03
- Stocks are still inexpensive compared to GEMs
- Growth is yet to be priced into the market
- Further re-rating to investment grade inevitable
- Russian sovereign debt is mature, corporate debt market is growing
- Corporate governance is improving
- Increasing flows into the funded portion of the state’s pension system will provide extra liquidity
Russian mutual funds in 2002-1H03:
Important Vehicle for the Market Development

- Total assets under management - more than $500 mn
- Of these 21% are in open-end funds, 2% in closed-end and 77% in interval funds
- Fragmented industry: out of 103 management companies in Russia 42 were registered in 2002 and 20 in 1H2003
- Low barriers to entry: 19 unit funds were registered in 2002 (3 closed, 4 interval, 12 open) – compared to 14 in 2001 and 11 in 2000
- Assets are highly concentrated: top 5 companies occupy 90% of assets, compared to even higher concentration of 95% in 2001
- Growing customer base: around 11,100 investors in all funds by the end of 2002 compared to around 6,300 at the end of 2001
- Short investment horizon: individual investors are still “trading funds”

Source: National League of Fund Managers. 2003 update
Reputation and Performance are Important: Average Investor’s View

- “Past Performance” – 30%
- High reputation and good brand name – 47%
- “Foreign Roots” – 5%
- “Hard to answer” – 6%
- “Other” – 12%

Source: PIOGLOBAL in-house survey based on polling 4052 respondents
Average Investor Profile

Average purchase size is rising

Average Purchase as Function of Investor Age

Source: PIOGLOBAL in-house survey based on polling 4052 respondents
Pension Reform in a Nutshell

- Switch from the current pay-as-you-go (PAYG) system, where today’s worker pay today’s pensions, to funded schemes, where they invest for their own futures

- Participants
  - Men born before 1952
  - Women born before 1956

- Employers pay according to the following plan:

<table>
<thead>
<tr>
<th>Pensioners</th>
<th>Base</th>
<th>Insurance</th>
<th>Funded</th>
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</thead>
<tbody>
<tr>
<td>Men 1953-1966.</td>
<td>14%</td>
<td>12%</td>
<td>2%</td>
</tr>
<tr>
<td>Women 1957-1966</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Men 1967+</td>
<td>14%</td>
<td>8%</td>
<td>6%</td>
</tr>
<tr>
<td>Women 1967+</td>
<td></td>
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</table>
Challenges for the management companies

- Flexible requirements for the management companies
- The market is small and overcrowded - 55 management companies for an estimated $300 mn of potential investment in 2004
- Absence of proven track record: out of these 55 companies, 26 were created in 2002 and 9 in 2003
- Pressure to show short-term outperformance
- Lack of information from the government, asymmetric information
Securities Permitted for AMCs
percentage in portfolio

- RF Federal bonds up to 100%
- RF Subfederal bonds up to 40%
- Municipal bonds up to 40%
- Corporate bonds up to 50% in 2004 and up to 80% in 2007
- Russian Equities up to 40% in 2004 and up to 65% in 2007
- Mortgage securities up to 40%
- Up to 20% may be kept in cash and on the bank deposits
- Investments in foreign index funds up to 5% will be permitted in 2005, maximum share in the portfolio may reach 20% in 2010
MICEX Index Fund
the Most Suitable Product
for a Pension Fund’s Equity Portfolio

- The first index-based interval mutual fund in Russia. Registered by FCSM on January 22, 2003
- A unique opportunity to enter and exit the market at a low cost
- High transparency and diversification
- Passive management, free of individual bias
- Low costs: management fee 0.5%, overall costs below 1%
- Expected dividend yield in the range of 2.0-3.5%
- The Fund is opened for purchases and redemptions 4 times a year
- Units are traded as individual stocks in the secondary market
Steps for Further Growth

- Active participation in the pension reform
- Education of population, building trust with the new Russian investor
- Increasing horizon for individual and institutional investors
- Development of the national distribution network
PIOGLOBAL Asset Management

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