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ADMINISTRATIVE COSTS OF PENSION FUNDS IN POLAND
IN INTERNATIONAL PERSPECTIVE

By Agnieszka Chlon

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Administrative costs of pension funds in Poland in international perspective[2]

Introduction

By the end of 20th century, many countries face the need to reform their pension systems. Following the example specified in the World Bank's *Averting the Old-age Crisis,* the pension reforms go towards implementation of multi-pillar schemes. Poland also followed the same path when the pension reform was introduced in 1999.

The new pension scheme in Poland is creating a close link between contributions paid for old age and size of future retirement benefits. There are two mandatory tiers of the pension system in Poland – first, pay-as-you-go, based on notional defined contribution principle and second, funded, also functioning in a form of defined contribution. The reform covers insured people that at the time of reform implementation were younger than 50 years of age. Of those, people younger than 30 had to split their old-age contribution between the two pillars. People aged 31-50 had a choice to split contribution or participate only in reformed pay-as-you-go pillar. Details of the pension reform are described, among others in Chlon, Góra, Rutkowski (1999) and Góra (2001).

Insured people have their individual pension accounts in both mandatory tiers. In the case of the pay-as-you-go pillar, contributions are registered on individual accounts and indexed by a factor equal to inflation plus ¾ of real wage bill growth. It means that all insured have the same rate of return on first pillar accounts. In the second, funded pillar contributions are transferred to pension funds, selected by insured. Here, future value of pension depends on the efficiency of pension fund's managers – the so-called pension fund societies (PTE). The most important measure of

efficiency for insured in the net rate of return on pension fund investment. It determines value of pension savings and – following that – value of future old-age pensions.

Return on investment from one hand and administrative charges on the other determine net rate of return. The aim of this paper is to analyse the administrative costs of the Polish pension system and compare the Polish experience with other countries, taking into account the legislative environment and two and a half years of operations of pension funds in Poland.

Administrative charges

Legislative environment. Activities of pension funds in Poland are regulated by the Law of 27 August 1997 on organisation and operation of pension funds. According to this law, pension funds managers can deduct two types of chargers from pension funds' members:[3]:

- Up-front fee, deducted upon a transfer of contribution to pension fund;

- Management fee, deducted from assets and charged for the entire time of participation in pension fund.

The size of up-front fee is not limited by the law on organisation and functioning of pension funds and is set in the articles of operation of pension fund society. The management fee cannot be higher than 0.6% of assets.

The fee structure, as envisaged, draws from the international experience, where fees based on contribution inflow and assets exist. Charging two types of fees simultaneously – one deducted from contribution and one deducted from assets is important for the pension funds' market in Poland. In the first years of operations, up-front fee is the most important source of income for pension fund managers. In the longer run, its role becomes smaller, compared to the management fee. In the longer run, the fee on assets creates an incentive for managers to better invest, as the revenues depend highly on performance of the fund. Evaluation of the two types of fees is presented in Table 1.

Table 1. Evaluation of different fee structures

Type of fee	Main advantage	Main disadvantage
% on contributions	Direct relationship with collection fees	Lack of incentive for better investment
% on assets	Direct relationship with brokerage fees	Growing trend over time

Source: Grushka (2001)

As both types of fees have advantages and disadvantages – combination of both types of fees benefits from their advantages for pension fund managers and members. The fee on assets in first years does not

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[3] Additionally, in the case of transfer from one pension fund to another during first two years of membership, a pension fund society can charge an exit fee. In this paper the impact of exit fee is neglected.

influence the size of pension funds assets. However, if only such fee existed, the period in which pension fund managers break-even would be significantly longer. As the market matures, the fee on assets will be dominating. Additionally, creating a link between fees and assets of pension fund may enhance efficiency of the market. Pension funds will be interested in keeping the best clients – not only high earners, but also those, with long working tenure that accumulated sizeable pension savings. Additionally, such fee creates incentives for PTEs for better performance – the higher rate of return, the higher revenues from management fee.

Administrative fees – first experiences

Fee on contributions has a character of up-front provision deducted for the entire period of savings in pension fund. Thus, its influence on pension saving should be measured for the entire period of savings, not only in the first years of operations. Currently, as a result this fee, pension savings of the pension funds' members in Poland are lower than the contributions transferred to pension funds. Thus, internal rate of return for the first two years of operations is negative for all funds in Poland. The fee on contributions in Poland is relatively diversified (Figure 1). The average fee (not weighted) in the first two years is 8.6% and standard deviation is 0.8%. In year three the average fee fells to 7.4% and standard deviation increases to 1.5%. After 25 years the average fee is lower by almost 3 percentage points compared to initial values and is equal to 5.7%. At the same time, the differences in the size of fees increase and standard deviation increases to 2.5%.

Fourteen out of twenty PTEs charge higher fees during first two years of participation and lower them for those members who stay longer with pension fund. One fund differentiates fees based on calendar year and five funds do not change fees on contributions over time.

Figure 1. Fees on contributions in Poland
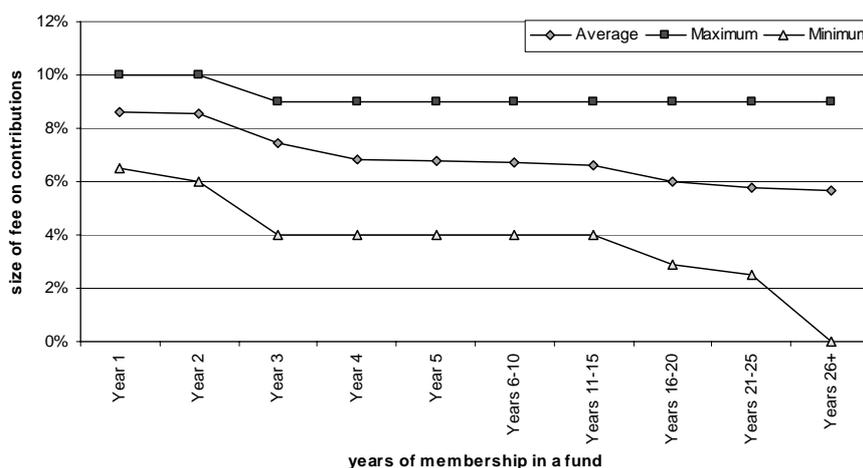
Note: The figure presents values calculated for 20 pension funds (as of June 2001)

Source: Author's calculations based on PTE information

Management fees are currently charged at the maximum level by all PTEs. However, in three cases, the annual size of fee is limited in nominal terms. It means, that in the future for those funds management fee will be lower than maximum.

Structure of the fees also has an impact on the total charges imposed on members with different periods of membership. Some of the cost components of PTEs are constant and do not depend on the time of participation, for example costs of sales. Thus, costs per member are higher for those with shorter time of saving and lower for those with longer time. These differences are also reflected in the fee structure. Consequences of fees on savings for different periods of membership are presented in Table 2.

As one can see, future pensions of pension funds members are lower by 10 to 20 per cent compared to gross returns, assuming current fees. Reduction of pensions caused by fees is lower in case of those who save for shorter periods. Reduction of rates of return, on the other hand is higher tor shoe persons and range from 2.03% for those with shortest membership (taking into account variable fee on contributions) to 0.88% of those with longest membership.

Table 2. Impact of fees on pension savings

| Assumptions:				
Savings period	10	20	30	40
Real gross rate of return	6.00%	6.00%	6.00%	6.00%
Fee on contributions (variant 2)	7.20%	6.70%	6.40%	6.20%
Fee on assets	0.60%	0.60%	0.60%	0.60%
Results:				
Variant 1. Constant fee on contributions at 6,20%				
% reduction of pension size	8.95%	12.37%	16.06%	19.94%
Real net rate of return	4.18%	4.81%	5.02%	5.12%
Reduction of rate of return	1.82%	1.19%	0.98%	0.88%
Variant 2. Differentiate fee on contributions				
% reduction of pension size	9.93%	12.83%	16.24%	19.94%
Real net rate of return	3.97%	4.77%	5.01%	5.12%
Reduction of rate of return	2.03%	1.23%	0.99%	0.88%

Note: Assumed flat earnings distribution
Source: Author's calculations

In a long run, fees related to total pension savings would be decreasing. After five years it should not exceed 2% of total assets and after twenty years it should be less than 1% of assets. Additionally, after about fifteen years of savings, annual management fee should exceed fee on contributions. After forty years of savings, assets of future pensioners may be reduced by around 16% as a result of deducted fees (
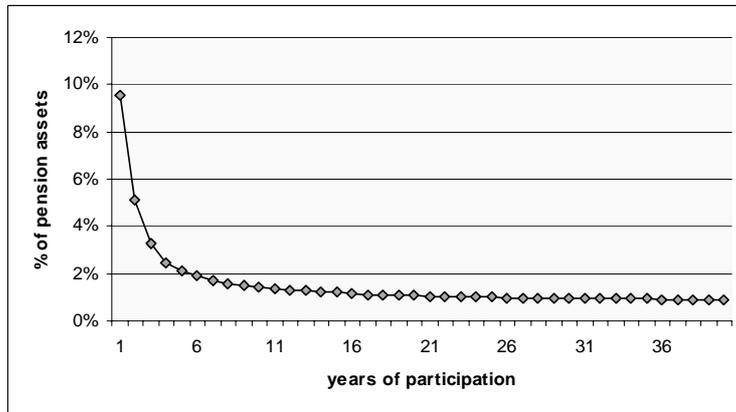
Figure 2).

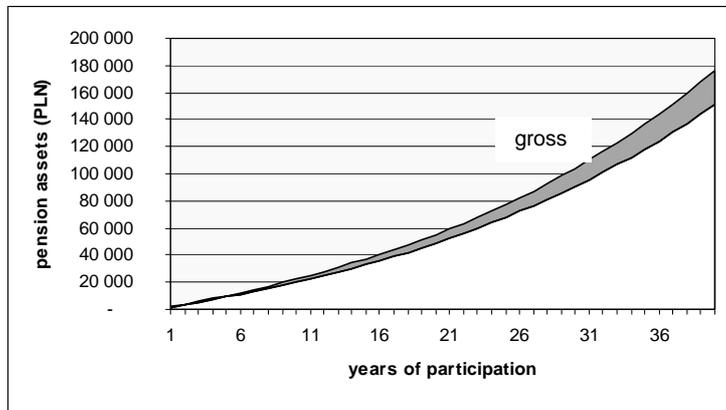Figure 2. Fees of pension funds and their impact on pension savings

2a. Fees on contribution and on assets
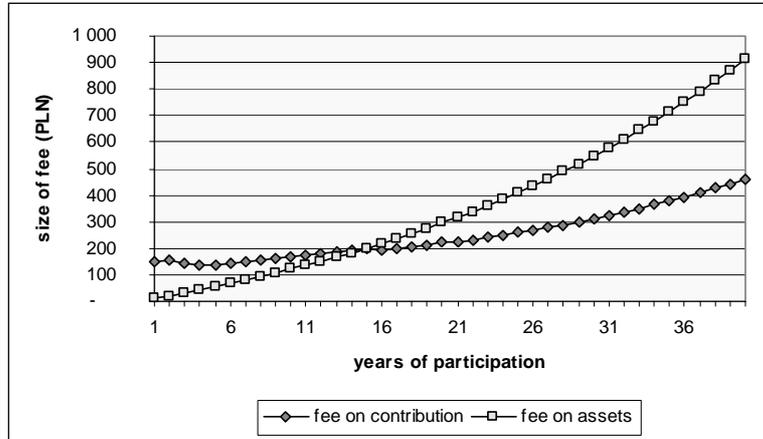
2b. Annual fees as % of pension assets

2c. Impact of fees on pension savings

Note: Simulations for a person with annual earnings equal to 24 000 PLN in the first year of participation. Wage growth: 4%, gross rate of return: 6%, no breaks in contributing.

Source: Author's calculations

International comparison

Construction of fees charged by PTEs in Poland is similar to international practices. Pension funds in Latin America usually charge fees on contributions. In European countries and in the United States fees are most frequently charged on assets. In the case of countries in Central and Eastern Europe, all countries decided to charge both fees on assets and on contributions. Kazakhstan allows for a charge on contributions and on returns. Similarly, Croatia is planning to introduce a success fee, which will be based on returns achieved by funds (Table 3).
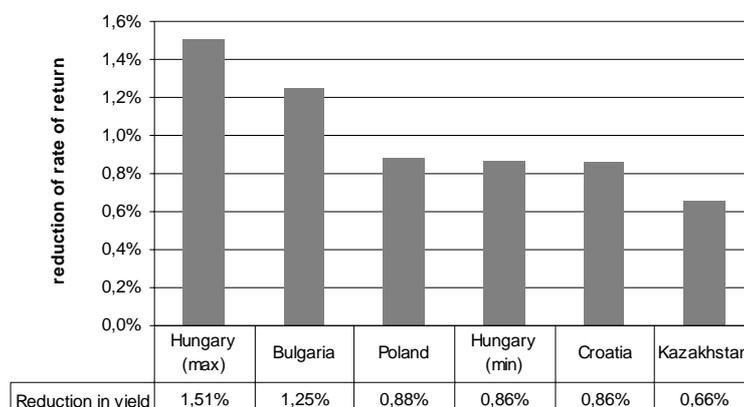
Table 3. Charge structure in ECA second-pillar accounts

Country/ Second pillar introduction	*Charge structure*					
	Contribution charge		**Asset charge**		**Transfer charge?**	**Other**
	Ceiling ?	**Level**	**Ceiling?**	**Level**		
Hungary (Jan 1998)	No	7.5-11%	No	0.5-1%	Yes - 0.2%	
Kazakhstan (Jan 1998)	Yes	1%	None		No	Charge on returns – max. 10%
Poland (April 1999)	No	8.6% (average for first 2 years) 7.6% (average after 2 years)	Yes	0.6%	Yes, for first 2 years	
Bulgaria (Jan 2002)	Yes	5%	Yes	1%	Yes	
Croatia (Jan 2002)	Yes	0.8%	Yes	0.8%	Yes for first 5 years, sliding scale	Success fee/yet to be specified

Source: M.Murthi (2002)

In order to compare the size of fees, the fees were used to assess the total reduction of rate of return for a person who saves for 40 years with flat earnings structure and the annual gross rate of return equal to 6%. In case of Hungary both minimum and maximum values were used for calculation. The impact of fees on pension savings is highest in the case of Hungary (maximum level of fees) and Bulgaria. In both countries net rates of return are reduced by more than 1 per cent. Poland, Croatia and Hungary (in case of minimal fees) have approximately the same costs, that reduce rate of returns by more than 0.8 per cent. Kazakhstan has the lower fees that reduce rates of return by less than 0.7 per cent.

Figure 4. Impact of fees on rates of return in CEE region

	Hungary (max)	Bulgaria	Poland	Hungary (min)	Croatia	Kazakhstan
Reduction in yield	1,51%	1,25%	0,88%	0,86%	0,86%	0,66%

Source: Author's calcualations

Table 4 presents the size of fees in selected Latin American countries. The fees charged in CEE countries range within the same values as in Latin American countries, where maximum fee is charged in Mexico (1.39 per cent reduction in rate of return, compared to 1.51 per cent reduction in Hungary) and minimum charged by Columbia that reduces rates of return by 0.65 per cent (compared to 0.66 per cent in Kazakhstan).

Table 4. Pension funds fees in Latin America and in Poland

Country	Number of funds	Reduction on the rate of return
Columbia	8	0,65
Uruguay	6	0,72
Salvador	5	0,85
Chile	8	0,88
Peru	5	0,96
Argentina	13	1,20
Mexico	13	1,39

Source: Whitehouse (2001)- data for 1999

Costs of operations

Financial results depend on revenues from fees described in previous section and costs of operations of pension fund societies. Size of fees is correlated with the costs incurred. In systems based on individual choice, like most of the funded schemes developed in CEE countries, including Poland, the costs are usually higher. James *et al.* (2000) estimate that in such systems, costs of functioning range from 0.8 to 1.5% of assets. As shown in the previous section, in most countries fees are within this range (0.66%-1.5% in case of CEE countries and Kazakhstan, 0.65%-1.4% in Latin America). Polish system with average cost at about 0.88% of assets is closer to the lower boundary.

Administrative fees in longer run should allow pension fund managers to achieve profits for their shareholders. However, as costs of operations are usually higher initially than revenues, it takes several years, before profits are registered. In Poland in 1999 all pension fund managers registered deficit and in 2000 only one out of 21 existing funds recorded surplus.

As published results show, there is a significant improvement in the size of deficit, which for most of the PTEs was lower in 2000 compared to the year before. However, these results are not fully comparable. For example, costs of transfer agent (running individual accounts) in some cases are transferred to other companies within a holding. Similarly, other cost elements may not be included in the balance sheet and profit and loss account of the PTE[4].

Table 5. Profit/loss of selected PTEs in 2000

PTE/fund	Net financial result (mio PLN)	
	2000	1999
AIG	2,4	- 82,4
Pekao	- 3,9	- 18,3
Nationale-Nederlanden	- 8,3	- 103,7
Arka-Invesco	- 11,9	- 34,6
PBK Orze•	- 16,4	- 135,4
Pioneer	- 17,5	- 60,8
DOM	- 20,0	- 134,6
Pocztowo-Bankowe	- 24,3	- 47,1
PKO/Handlowy	- 26,1	- 90,1
Kredyt Banku	- 32,6	- 54,0
Skarbiec-Emerytura	- 39,7	- 104,2
Commercial Union	- 54,9	- 90,2
H-M-C	- 55,9	- 22,7
Winterthur	- 59,5	- 49,1
Zurich	- 80,7	- 42,4
BIG BG*	- 148,6	- 170,1
Epoka	n.a.	- 53,9
Norwich Union	n.a.	- 55,0
Allianz	n.a.	- 58,7
PZU	n.a.	- 143,9
Polsat	n.a.	b.d.

* Result for 5 quarters. Result for 2000 PLN - 36,7 m
Source: Szymon Karpiński, *„Najwięksi liczą na zyski",* Rzeczpospolita*, 25.04.2001 r.

Costs of pension funds could be divided into several components. It could be written in the following formula[5]:

TOTALADMINCOST = STARTUPCOST+ R&C + INV + MARKETING + LEGAL, where:

> *TOTALADMINCOST* – total administrative cost for pension fund or a system

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[4] See: Szymon Karpi•ski, *„Najwi•ksi licz• na zyski",* Rzeczpospolita*, 25.04.2001 r.
[5] Formula based on the model presented in James *et al* (2000)

STARTUPCOST – capital costs incurred in the early years of a new system or fund

R&C – record-keeping and communication costs

INV – investment costs

MARKETING – marketing costs

LEGAL – costs incurred by a fund or a system imposed by existing legislation.

Each of the components is determined differently. As James *et al.* (2000) describe:

1. Start-up costs greatly accentuate total cost in early years.

2. Costs per account starts relatively low and rises through time as average account size grows, due to increased investment and/or marketing costs.

3. Cost as % of assets starts high and falls as average account size grows, due to constatn R&C costs per account; scale of economics in asset management would accentuate this effect.

4. R&C costs dominate at the beginning but their impact on net returns become much smaller in the long run, when investment and marketing costs dominate.

5. A higher contribution rate leads to a faster build-up of assets, and a lower costa as % of assets.

6. An expensive investment and marketing strategy, as in the retail market, increases cost per unit of assets and leads to faster growth in cost per account and per unit of assets.

Short characteristic of those costs incurred in Poland is presented below. With exception of start-up costs, analysis is based on 2000 data, as being more relevant. As 1999 was the first year of operations, the time taken into account in financial statements differs and some of the costs were of incidental character (such as increased marketing and sales expenditures). In 2000 for the first time consolidated budget and profit and loss statement of pension funds sector was published by Central Statistical Office (GUS), presented in Table 6. The largest cost items recorded in 2000 were: acquisition costs[6], costs of holding Members' Register and payments to Reserve Accounts. Total costs more than doubled revenues from fees and exceeded 16% of total assets of pension funds' at that period.

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[6] However, some of the PTEs spread acquisition costs in 1999 for several years, thus the figures presented are lower than actual sales costs in 1999.

Table 6. Profit and loss account of PTEs in 2000

	In PLN '000
Total revenues	**726 614,36**
Operating costs, including:	**1 646 007,34**
Acquisition (sales) costs	811 375,76
Transfer agent costs of holding the Members' Register	213 093,36
Advertising expense	68 041,27
Supervision fee	942,21
Reserve Account payment	103 951,07
Guarantee Account payment	7 135,47
OFE costs beared by PTE related to the transaction of investing and divesting of Fund's assets	1 229,91
Taxes and fees	31 946,93
Depreciation	38 558,21
Other costs	369 735,31
Profit/loss from sales	**- 919 392,98**
Operating profit/loss	**- 915 815,57**
Net profit/loss	**- 847 883,04**
Source: GUS	

Start-up costs in Poland were related mainly to the capital requirements stated in the law. In order to set up a pension fund a capital of at least EURO 4m was needed. Additionally, as revenues from fees were not high, most of the administrative costs were covered from the shareholders capital. Total shareholder's capital at the end of 1999 amounted to PLN 1644m (c.a. USD 411m). Almost 61% of this capital were financed by Polish shareholders (mostly banks). The rest came from international companies (Dutch, American, British, Swiss, German and French).

Record-keeping costs are usually standard, determined by technology. Those depend mainly on the quality of service and number of accounts. In Poland, pension funds either contract-out running individual accounts to transfer agents, or do that in-house. In 2000 total cost of R&C exceeded 200 million zloty. It means that annual costs per one account were around 20 PLN (c.a. 5 USD). However, as described earlier, in some cases it is difficult to assess R&C costs, as these are transferred to other companies in the holding, which means that total costs might have been higher.

Investment costs depend on the size and allocation of assets under management. These are usually higher in the case of active management (which is the case of Poland). Current reporting does not allow for the exact calculation of the investment costs. However, if we consider position 'other expenses' as financing mostly investment costs, then it represents approximately 20% of all expenditures.

Marketing costs are related to the necessity to attract new members and are related to the scale of advertising activities and the size of sales costs. In 1999 marketing costs (including sales and advertising) represented more than 60% of total operating costs. In order to attract one new member, PTEs had to spend an average of around 100 PLN for advertising and sales agents costs[7]. Share of marketing costs in total

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[7] UNFE estimates as of 31 October, 1999.

costs is decreasing and in 2000 it slightly exceeded 50% of total costs. Reduction of this cost item is most strongly observed in 2001, as for the first half of the year marketing costs represented 30% of total costs[8].

Legal costs are determined by existing regulations (laws and decrees). In the Polish case, those are mainly costs of guarantees, costs of using central collector (Social Insurance Institution - ZUS) and costs of supervision. The nature of those costs is different. For example, costs of reserves depend on the size of assets, costs of central collector on the flow of contributions. Based on the information gathered from 3 PTEs (one large, one medium-sized and one small), legal costs in 1999 equalled to a fifth of revenues from fees and in 2000 (when ZUS started to charge collection fee) – a quarter of revenues from contributions.

Structure of the operating costs in Poland compared to Latin America is presented in Table 7.

Table 7. Operating costs in Latin America and in Poland

| Country | Administrative (including R&C) | Marketing | | | | | |
		Total	Sales	Advertising	Other	Total	USD mio
Argentina	22	74	58	16	4	100%	614
Bolivia	42	2	0	2	56	100%	10
Chile	59	39	36	3	2	100%	277
Salvador	55	26	17	9	20	100%	44
Mexico	26	28	3	24	46	100%	342
Peru	49	51	N/A	N/A	23	100%	99
Uruguay	28	49	30	20	0	100%	32
Total	**34%**	**52%**	**34%**	**14%**	**15%**	**100%**	**1 418**
Poland*	**35%**	**53%**	**49%**	**4%**	**11%**	**100%**	**412**

* 1 USD = 4 PLN
Source: Data for Latin America for 1999 – Grushka (2001)
        For Poland: author's calculations based on ZUS data

As shown in Table 7 structure of operating costs in Poland is similar to the one in Latin America. The most significant difference can be noted in the distribution of the marketing costs. In Poland, larger share of costs can be attributed to acquisition and smaller – to advertising. The question arises, whether the total size of costs can be reduced allowing for the reduction of fees and which areas give the biggest potential for cost reduction.

The largest cost item is marketing cost. In the Polish legislation, there are legal regulations that prevent those costs from increases. For example, funds are not allowed to offer any additional benefits for participation in a fund. Additionally, those members that wish to transfer before two years of membership in a fund are required to pay an exit fee. As a result of those regulations few members transfer between funds. In each quarter less than 1% of all members change their pension funds. After initial period, there is a tendency to reduce marketing costs. Most importantly, costs of sales are reduced, as there is no need to upkeep large sales force necessary in the first year[9]. Thus further reduction of marketing costs can be expected in following years.

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[8] However, usually marketing campaigns are more intensive in second half of the year, when young people start their first jobs. Thus, for the entire year those costs may be higher.
[9] In 1999 number of regiestered agents exceed 400 thousand (for a description of sales and marketing campaign in 1999 see Chlon, 2000). Currently, this number is decreasing.

Another possibility of cost reduction is related to the record keeping. Members Registries are kept for those persons who are insured and also for those, who joined pension funds and are not insured (there is no contribution paid for them). PTEs pay not only for actual members but also for those, who are not insured. It means that those who pay contributions also contribute to financing accounts of those persons, who did not have a single contribution transferred. Those accounts are called 'dead accounts'. The scale of this occurrence is quite large. At the end of 2000 the share of dead accounts in total number of accounts was equal to 23.7%. By mid 2001 this share was slightly reduced to 21.6%[10]. The question arises, what can explain this fact. Probably some of accounts belong to persons who were insured for a short period of time (unemployed, people in mandatory military service who came from rural areas[11]) or those who were not insured at all (i.e. students). Probably there are also cases of fraud and forgery. If the database of members is properly cross-checked with database of insured people by ZUS and those who are not insured have their accounts closed, costs of R&C should be significantly reduced. However, PTEs cannot themselves influence this cost element, which depends on the improvement of databases held by ZUS.

Another important cost element is the cost of correspondence between funds and members. According to the law on pension funds, PTEs are obliged to send annual account statement by registered letter. Cost of such service is three times higher than the cost of regular letter. Additionally, PTEs have to send letters to all members – even if they know, that such person does not exist or had changed address. As a result, mailing costs are divided between those members who pay contribution, though they result from sending mail to 'dead accounts' owners and costs of return of those letters who were not delivered. Regular mail is used for correspondence by other institutions, such as ZUS or banks. Thus, it seems rational that PTEs could also use regular mail and send letters only to those members who have their addresses confirmed, which would significantly reduce the costs. Such cost reduction, however, requires changes in the law on pension funds and improvements in the quality of information.

There are also possibilities to reduce legal costs. The most important element of legal costs is cost of guarantees related to the minimum rate of return. Measurable costs of guarantees are most importantly payments to Reserve Fund and Guarantee Fund. According to the law on organisation and functioning of pension funds, each of the PTEs has to establish a Reserve Fund. Out of this fund, PTE replenish deficit resulting from having rate of return lower than the required minimum. The law sets the size of the Reserve Fund at 1.5% of OPF's assets. Similarly, funds accumulated in Guarantee Fund finance deficit, when PTE was not able to cover it from Reserve Fund and own assets[12]. Each of PTEs sends quarterly to the Guarantee Fund amounts necessary to keep the level of assets in that fund equal to 0.1% of assets in the sector. According to estimates based on data from three PTEs, costs of guarantees in 2000 amounted to almost 60% of all legal costs (Figure 5). When the regulations were build and in the initial period of pension funds' operations such level of reserves and costs seemed justified. However, as the system matures, the level of reserves should be carefully reviewed to find a balance between the costs and benefits of guarantees. Reduction of reserves could be introduced for example in the case, when minimum rate of return is calculated once or twice a year, instead of quarterly. A cost that cannot be measured, however is imposed on pension fund members is short investment horizon. Currently regulations encourage PTEs to concentrate investment efforts to maximise a rate of return in two-year periods, which do not correspond to the long-term character of pension savings. Extending the period for which minimum rate of return is calculated would also allow for reduction of reserve level and reduction of administrative fees.

Another cost determined by law is the fee that ZUS deducts for collection and transfer of contribution. This fee is set annually in the law budget law and should not exceed 0.8% of contributions due. In 1999 ZUS

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[10] See: UNFE, quarterly bulletins.

[11] Once they finish the military service, they come back to farming and are covered by farmers' social security.

[12] Equal to the lower of the two: half of the weighted average rate of return for past 24 months or weighted average rate of return for past 24 months less 4 percentage points. For description of guarantee system see for example Chlon, Góra, Rutkowski (1999).

did not deduct this fee, as it was not stated in the budget law. The fee in 2000 amounted to 0.76% of contributions and in 2001 – 0.8% of contributions. This level does not correspond to the actual costs of collection and transfer, which are not yet assessed by ZUS. In the case of similar services for other institutions (i.e. Health Funds or Labour Fund), collection fee is equal to 0.5% of contributions. Additionally, in the case of health insurance, the level of fee does not influence the quality of services for insured persons. Higher fee deducted from pension contributions means higher PTEs costs and lower old-age pensions. Thus, it is necessary to estimate actual costs of collections and transfer, so that the fee covers those costs and does not subsidise other activities of ZUS.

Finally, it is also possible to reduce costs of Supervision. Those include costs of providing information, costs of penalties and costs of legal services related to the penalties as well as supervision fee set by the law on pension funds. Those costs are to a large extent unforeseeable. For example in 1999 for one of analysed pension funds these costs represented 18% of legal costs, as PTE had to pay penalties and spent significant amounts of money on legal advise aimed at minimising costs of penalties. Most importantly, significant share of penalties was finally not paid, as High Administrative Court decided that there was no reason to pencils PTEs. As a result the average share of supervision cost in legal costs in the analysed sample was equal to 11%. In 2000 it was much smaller and did not exceed 2%. Costs of providing information to UNFE are also relatively high, as most of PTEs have to employ at least one person responsible for preparation of daily reports that are sent to UNFE. Extensive penalising of PTEs and extensive information requirements increase costs of PTEs, which are then reflected in fees that members pay. This cost element could be rationalised by establishing such level of information which would be sufficient and satisfactory to perform supervision functions and by amendment of the law on pension fund, which would lead to more precise formulation of those rules that cause unjustified penalties.

Other elements of legal costs are transfer fees paid to National Depository, obligatory information to the Polish Press Agency, costs of custodianship and brokerage fees. These do not exceed 0.5% of contribution transfer.
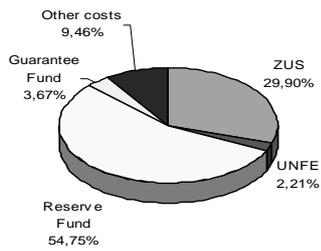
Figure 5. Structure of legal costs in 1999 and 2000 – based on sample information

Total costs: 19.15% of PTEs revenues
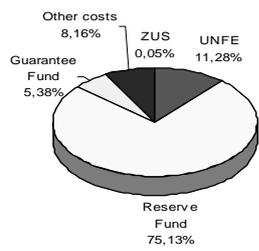
Legal costs in 1999

Total costs: 24.91% of PTEs revenues

Legal costs in 2000

Structure of legal costs does not depend on the size of fund. Table 8 presents decomposition of costs by funds in the sample. In the case of a big fund, total share of legal costs in the revenues from administrative fees is slightly lower than in the case of medium and small pension fund. However, these differences are rather small and might not persist in the long run.

Table 8. Costs of PTEs and OFEs related to legal requirements

| | 1999 | | | 2000 | | |
Fund size	big	medium	small	big	medium	small
Legal costs as % of PTEs revenues:	**16,82**	**21,74**	**18,89**	**23,31**	**26,38**	**25,04**
Share in legal costs:						
Payment to Reserve Fund	78,99	73,07	73,34	54,92	57,81	51,53
Payment to Guarantee Fund	5,76	5,20	5,18	3,73	3,93	3,35
ZUS fee	0,1	-	-	29,8	31,3	28,6
UNFE costs	6,21	18,76	8,86	1,41	4,07	1,15
Other costs	8,9	3,0	12,6	10,1	2,9	15,4

Note:
ZUS fee – includes costs of fee for collection and transfer of contribution;
UNFE – includes UNFE fee, activities related to information requirements, servicing of UNFE audits, cost of penalties and legal services related to penalties.
Other costs – incluđee transfer payments to National Depository, information obligations to Polish Press , costs of custodian and brokerage fees (the latter two are not costs of PTEs, as these are deducted directly form pension fund's assets).
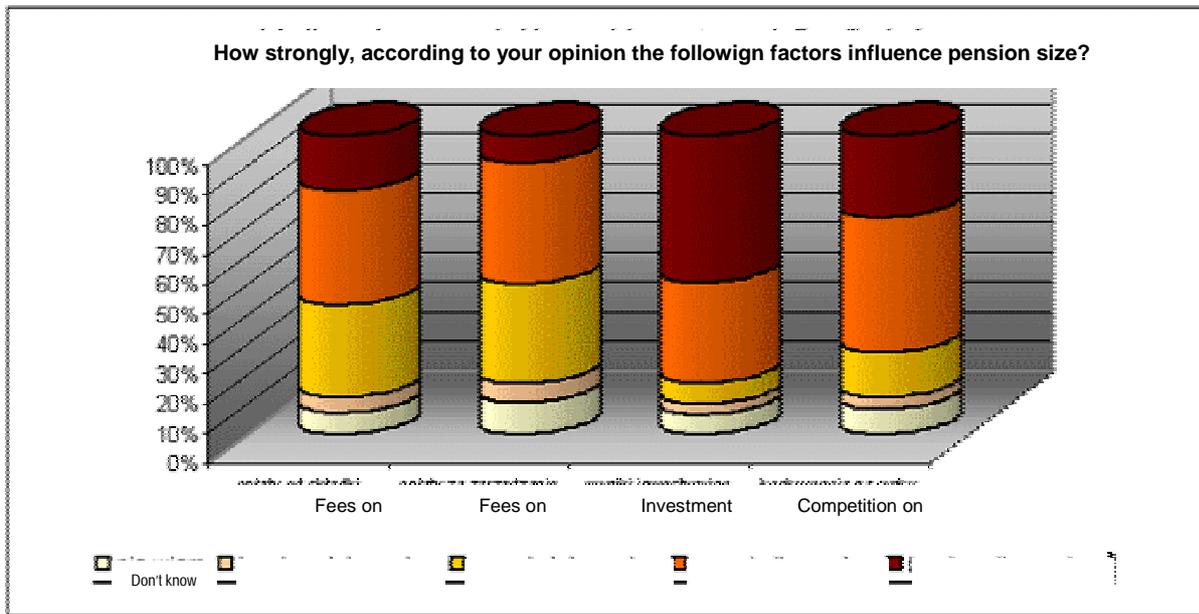
Source: Information from PTE

Expectations of pension funds' members

According to the opinion survey conducted by DEMOSKOP agency on the request of UNFE[13], pension fund members do not know enough about functioning of the sector. For example, a large share of surveyed does not know the existing fee structure. On the other hand, 60% of surveyed believes that the fee structure is clear. The size of fees, according to most of the surveyed, has a significant impact on future pensions, both in the case of fee on contributions and fee on assets. However, according to the surveyed, the rate of return has a very strong impact on future pensions, much stronger than fees (see Figure 6). Surveyed also indicated that competition on the market may influence future pensions to a larger extent than administrative fees.

Figure 6. Influence of selected factor on pension size

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[13] See: Monthly Bulletin UNFE, March 2001.

How strongly, according to your opinion the followign factors influence pension size?

| | 100% | 90% | 80% | 70% | 60% | 50% | 40% | 30% | 20% | 10% | 0% |

Fees on   Fees on   Investment   Competition on

Don't know

In the opinion or current and future pension fund members, existence of pension funds should increase their future pensions. As simulations show, decision to split the contributions may indeed increase pension size.

Figure 7 presents simulations of the size of replacement rates for participants in the new pension system[14]. Under listed assumptions, size of old-age pensions from two pillars is higher than pension from one pillar only. Only in the transition period, when mixed pension formula is used (in years 2009-2013), decision about not joining second pillar may result in higher old-age pensions. The younger the person, the higher difference between pension size. It is related to the fact, that pension from second pillar will be higher for younger persons who save longer.

New pension system also influences pensions of people with different salary level. For example, as simulations show, in case of persons who earn 250% of average wage, pension reform does not affect pension size and replacement rates will be on relatively constant level. In case of average wage earners, creating a link between contributions and pensions leads to the reduction of replacement rates by several percentage points.
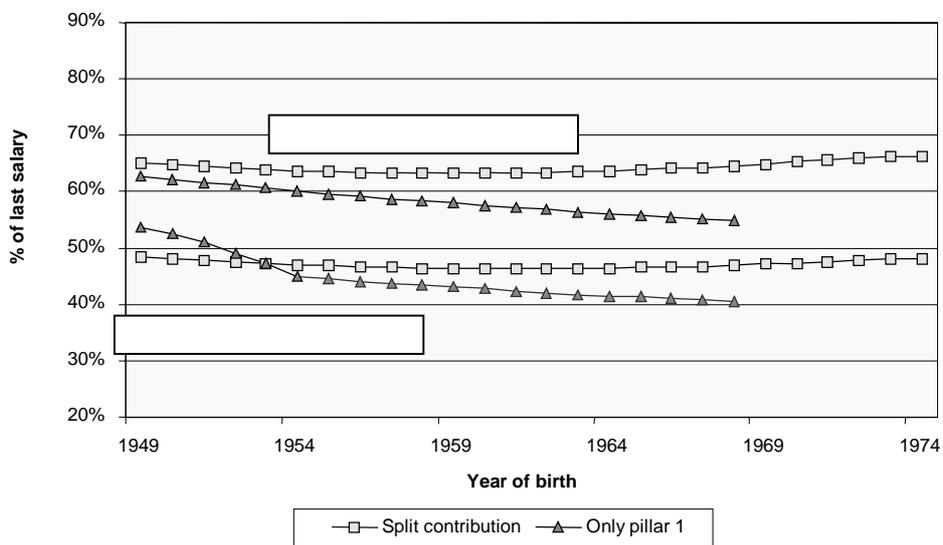
If the costs of pension funds are reduced, those results would be better. Lowering fee on contributions by one percentage point increases pension savings (thus, funded pensions) by 0.85%. Lowering fee on contributions by 10 basis points increases pension savings by more than 2 per cent.
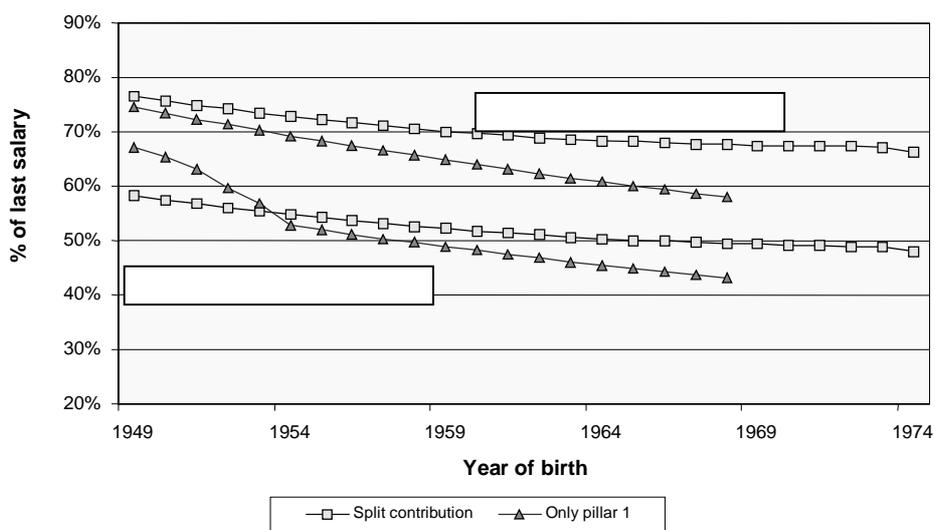
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[14] The results of simulations depend highly on the assumptions. Change in the assumptions may influence the obtained results.

Figure **7. Replacement rates in the new pension system in case of splitting and not splitting old-age contribution**

2a. Person earning 250% of average wage

2b. Person earning average wage

Conclusions

Two years of experiences allow for drawing first conclusions on the costs of functioning of the funded pillar in Poland and fees imposed on pension funds' members. Costs for participants in Poland are similar to the ones in Latin American schemes and existing or planned costs in central and eastern Europe. Fee structure in CEE countries includes both fees on contributions and fees on assets. In the Polish case, such construction seems to be satisfactory and allows for proper financing of costs for pension fund managers. PTEs have revenues large enough to finance significant part of start-up costs, which are relatively high. In the future, revenues from fees would be enough to finance higher costs of management, which would be increased with increase of assets under management. From the perspective of pension funds' members, fee on assets encourages PTEs to invest pension savings to maximise returns. As a result, they may expect higher old-age pensions in the future. In the nearest future it is important to take actions to reduce costs of functioning of pension funds. When costs are reduced, PTEs would have incentives to lower administrative fees. As a result – future old-age pensions could be higher. Analysis of operating costs shows options for cost rationalisation, mainly in the environment of pension funds. When institutions servicing pension funds work more efficiently and regulations are revised from cost perspective, administrative fees can be lowered. This should be on the agenda of reform improvements in the nearest future.

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