PRIVATE PENSIONS IN THE RUSSIAN FEDERATION

By the Ministry of Economic Development and Trade of the Russian Federation

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I. Historical Background

1. Establishment of the private pension system in Russia started in the middle of the 19th century. By the beginning of the 20th century as many as over 200 emerital (retirement insurance), insurance and pension schemes were successfully operating in Russia, with emerital and insurance schemes functioning mainly on the funded and notional funded principles. The contributions to emerital and insurance schemes were made jointly by employers and employees. All major Russian industrial enterprises had their own, separate emerital schemes or established joint ones.

2. By 1902, with the Russian State revenue at 1 319.8 mln Rbl, the emerital schemes of Russia had the pension capital of 268,671,131 Rbl, and actuarial calculations in some schemes were made for the period till 2000.

3. After the revolution of 1917, the pension and medical insurance, as well as insurance against accidents systems formed in the pre-revolutionary period were in the 20-s consolidated into a single system subsidized from the State budget and called the public social security system. Social, including pension, insurance formally continued to exist, but the principles of individual’s personal responsibility and mutual aid solidarity were excluded from its basis. The socialist pension system was funded from contributions of enterprises, which, in their turn, were the property of the State. As a result, the State acted as a single subject of social protection; the State budget was, essentially, the only source for its financing, while individual and group forms of protection were practically completely denied for ideological reasons.

4. It should be noted that in 1987 there were several attempts to change the established system. Thus, the Council of Ministers of the USSR and the Central Council of Trade Unions adopted Resolution № 976 of 20.08.1987 “On introduction of voluntary insurance for supplementary pensions for workers, employees and collective farmers”, which from 1 January 1988 provided for the payout of supplementary pensions from the insurance fund formed by equal contributions of employers and the State budget. The assets of the insurance fund were to be deposited on accounts of the State Bank of the USSR, with the fixed return at 3% p.a.

5. So, the history of the private pensions in Russia took place, for the most part, in the period before the 1917 revolution.

II. Contemporary Pension System of the Russian Federation


8. The Law “On public pensions in the Russian Federation” declared its goal as ensuring the sustainability of the achieved level of pensions and increasing it as the wellbeing of employees grows, with the main criterion for differentiation of the conditions and norms of pension provision being work and its results. The pension system was built on the PAYG principles.
9. In the course of economic transformations of early 90-s, the financial status of pensioners was steadily declining, with the minimal pension being a little over half of the established subsistence level, which was connected with the inadequate level of revenue of the Pension Fund of the Russian Federation, as well as the demographic situation in the country, which made the PAYG principles increasingly difficult to implement.

10. The main problem of the pension system was the low level of the absolute and relative size of pensions, with a rather high rate of insurance contributions paid for the purpose of pension provision (29 per cent of the payroll). In 1994, an average pension was about 35 per cent of the average salary compared with 34 per cent in 1993 and 25 per cent in 1992, respectively. The minimum pension in 1992 was 84.6 per cent of the subsistence level, in 1993 – 78.5 per cent, in 1994 – 66.6 per cent. Moreover, with 79 per cent in January 1994, this ratio in December 1994 dropped to 52 per cent, and in March 1995 – to 45-47 per cent.

11. Over 1992-1993 and partially, 1994, it was possible to maintain the minimum pensions close to the subsistence level by reducing the differentiation in size of other pensions. In the first half of 1992, the pensions were paid out in practically the same amount: 342-410 Rbl.

12. The existing problems were in the first place caused by the reduced financial base of the pension system. In the overall income of the population, the share of the payroll from which pension contributions were collected decreased from 69.9 per cent 1992 to 46.6 per cent in 1994. At the same time, the share of funds provided to employees as social payouts increased. In relation to the average monthly salary, these payments in 1994 made up from 17 to 30 per cent in different sectors of economy. Meanwhile, these sums were not subject to pension contributions collection. Along with this, the number of employed people was constantly decreasing, from 75.8 mln in 1991 to 69.4 mln in 1994, while the scale of evading the contributions to the Pension Fund of Russia was growing. All these negative factors resulted in a situation where the estimated ratio of the number of contributors for the pension provision vs the number of pensioners was less than 1.4:1, while the statistical data on the number of employed population would suggest it at 1.8:1.

13. The situation with the pension provision was complicated by the new and quickly growing arrears in pensions in 1995-1998.

14. Over several years, different branches of power made multiple attempts to stabilize the pension system in the framework of the existing legislation, which consisted, mainly, in increasing the minimal pension, which did not comply with the declared principle of differentiating pensions depending on the work and its results. Over 10 years, the Law “On public pensions in the Russian Federation” changed more than 40 times, which finally resulted in inconsistency of the pension legislation. All these reasons led to the need to reform the pension system of the Russian Federation, to change its principles.

15. Taking into account that the crisis affected not only the pension system, but other social security sectors as well, the Government of the Russian Federation adopted the “Program of social reforms in the Russian Federation for 1996-2000”. It was approved by Resolution № 222 of 26 February 1997. To implement it, Federal Law № 165-FZ “On the principles of mandatory social insurance” was adopted on 16 July 1999. This Law defines general principles for the system of public social insurance and its Article 1 has it that:

“Mandatory social insurance is part of the public system of social protection of the population, specifically, the insurance of employed individuals, in compliance with the federal law, against possible changes in their financial and/or social status, including due to the circumstances beyond their control.
Mandatory social insurance is a system of legislative, economic and institutional measures established by the State to compensate or minimize the consequences of the changes in the financial and/or social status of employees and, in the cases provided for by the legislation of the Russian Federation, other categories of citizens due to their recognized status of unemployed, work injury or occupational disease, disability, disease, trauma, pregnancy and child-birth, survivors of a deceased worker, as well as old age, need in medical aid, sanatorium and health resort treatment and in other insurance risks defined in the legislation of the Russian Federation and subject to mandatory social insurance”.

16. Next step in the development of the pension reform in the Russian Federation was the Pension Reform Program adopted by Resolution of the Government № 463 of 20 May 1998. Its main result was transition from the PAYG pension system to a mixed-type system, based on the PAYG and funded principles.


18. The pension system of the Russian Federation includes both insurance institutions and social institutions of the State, and its design is defined in Federal Law №173-FZ of 17 December 2001 “On work pensions in the Russian Federation”. This Law has it that the work pension consists of three parts: the base part, the insured part and the funded part.

19. According to the Federal Law “On work pensions in the Russian Federation”, the fixed-size (flat) base part of work pensions is granted to all citizens of the Russian Federation who have a minimum qualifying period of five years when they become entitled to a pension. The base part is funded from a portion of the Single Social Tax allocated to the federal budget and transferred to the budget of the Pension Fund of Russia. The size of pension under mandatory pension insurance which includes the insured and funded parts depends on the work record and the insurance contributions paid to the Pension Fund of the Russian Federation. The insured part of the work pension depends on the size of employee’s salary and on whether the contributions were paid by the employer in time and fully, while the funded part depends also on the results of investment of the contributions paid for this specific person. So, the system of work pensions implements both the PAYG and the funded principles.

20. Until 2000, the pension system of the Russian Federation was financed from two sources: the contributions paid to the budget of the Pension Fund of Russia, and the transfers from the federal budget for pension payouts to certain categories of pensioners.

21. In 2001, when the second part of the Tax Code of the Russian Federation came into force, the financing of the pension system was made from the Single Social Tax (SST) coming to the federal budget. The Tax base is the payroll. The part of the SST equal 28% of the payroll was posted to the budget of the Pension Fund of Russia.

22. Since 2002, the payments for financing of the pension system consist of two equal parts of the SST: the part coming to the federal budget and then transferred as necessary to the Pension Fund of Russia to finance the payout of the base part of the work pension (14%); and the part coming to the budget of the Pension Fund of Russia and allocated to finance the insured (from 8 to 12%) and the funded (from 2 to 6%, depending on the age of the insured individual) parts of the work pension. The base for calculation of contributions is the sum of payments and other fees over the tax period made in favour of the individual,
and for the self-employed population (entrepreneurs, barristers) it is the sum of revenue received by such taxpayers over the tax period less the expenses made to receive the revenue.

23. Before the reform, the non-state (private) pensions existed mainly within corporate and regional supplementary pension programs, due to the main sources of financing such as the enterprises and regional budgets.

III. The Private Pension System in the Russian Federation

Evolution of the legislation

24. The private pension system in the Russian Federation was introduced by Presidential Decree № 1077 of 16 September 1992 “On non-state pension funds”, which enabled enterprises, institutions, organizations, banks, collectives, public associations to establish non-state (private) pension funds for the purpose of improving the financial status of pensioners and protecting their savings against inflation.

25. The Decree had it that private pension funds function independently of the public pension system; they cannot engage in profit-giving activities, they invest assets through specialized asset management companies financially liable for the safety of these assets. The relations between private pension funds, investors and asset managers are built on a contractual basis.

26. The adoption of the Decree caused a quantitative leap in the establishment of private pension funds whose number in 1993-1994 approximated one thousand. At that time, there was practically no developed legal framework of private pension system and this number of private pension funds was caused, mainly, by the tax preferences granted to them in the conditions of weak government regulation. The most common and fast-growing were the corporate private pension funds which are a core of the private pension system of Russia even today.

27. In 1995, with the adoption of Government Resolution № 792, which approved the Regulations for licensing the operations of private pension funds and companies managing the assets of private pension funds, the number of organizations called private pension funds fell significantly. Overall 408 licenses were issued during the period from 1995 to date. The legal framework regulating the operations of private pension funds was establishing, mostly in the form of normative regulations of the Inspection of Private Pension Funds under the Ministry of Social Protection of the Russian Federation (at present, the Ministry of Labour and Social Development of the Russian Federation).

28. Legislative institutionalization of private pension funds took place in 1998 when Federal Law № 75-FZ “On non-state pension funds” was adopted.

29. Federal Law № 75-FZ defined that “A non-state (private) pension fund is a special institutional legal form of a not-for-profit social security organization whose exclusive activity is private pension provision to the fund’s participants on the basis of private pension contracts with the fund’s investors in favour of the fund’s participants.”

30. The private pension activities of the fund include accumulation of pension contributions, investment of pension reserves, record keeping of pension obligations of the fund and paying out private pensions to the fund’s participants.

31. The Law fixed the legal principles for the establishment, operations, reorganization and liquidation of a private pension fund, its government registration and licensing, defined the requirements for the investment of pension reserves, for the guarantees of the fund for fulfilment of its obligations and the structure of the fund’s owned assets.
32. When the discussion of the social, including pension, reform in the Russian Federation started, one of the issues became possible participation of private organizations in the system of mandatory social insurance, along with the public institutions. It resulted in the Federal Law “On the principles of mandatory social insurance” adopted in 1999. This Law fixed the possibility of performing social insurance for a wide range of insurers established in the form of not-for-profit organizations, which in fact opened access to mandatory pension insurance for private pension funds.

33. As a follow-up to this norm, Federal Law № 167-FZ of 15 December 2001 “On mandatory pension insurance in the Russian Federation” established that “Along with the Pension Fund of the Russian Federation, private pension funds can act as insurers under mandatory pension insurance, in cases and according to the procedure provided for by the federal law. The procedure for accumulation of pension reserves in private pension funds and for their investment by these funds, the procedure for transfer of pension accumulations from the Pension Fund of the Russian Federation and payment of contributions to private pension funds, as well as the limits for private pension funds to act as insurers are established by a federal law”.

34. Federal Law № 111-FZ of 24 July 2002 “On investments for the financing of the funded part of work pensions in the Russian Federation” established that “Specifications of the legal status of private pension funds operating under mandatory pension insurance, and the regulations for private pension funds operating under mandatory pension insurance are established by a federal law”.

35. In this connection, on 10 January 2003, Federal Law №14-FZ made amendments in the Federal Law “On non-state pension funds” in order to regulate the operations of private pension funds for accumulation and investment of pension assets; in particular, it defined the requirements for private pension funds operating under mandatory pension insurance, requirements for mandatory pension insurance contracts between private pension funds and their participants, requirements for contracts for pension asset management under mandatory pension insurance in private pension funds, requirements for record keeping of pension accumulations under mandatory pension insurance, requirements for reporting of private pension funds.

36. Following the changes made by Federal Law №14-FZ, the Government of the Russian Federation will have to adopt several regulations by the end of 2003. Their development and approval is the responsibility of the Ministry of Labor and Social Development of the Russian Federation, the Ministry of Economic Development and Trade of the Russian Federation, the Ministry of Finance of the Russian Federation, and the Federal Commission on Securities Markets.

37. In particular, the following regulations need to be developed: the regulations for the responsibility and powers of the supervisory agency, the rules for private pension funds (PPFs) to operate in mandatory pension insurance, the requirements for investment of pension savings and reserves accumulated within PPFs, standard contracts between PPFs and asset managers, etc.

38. In addition, the current Russian legislation on work pensions has a number of gaps which need to be filled. In particular, the adopted laws do not regulate the procedure to finance the funded part of work pensions, with the first payouts due in 2012. Despite the remote timeframe, it is important to develop and adopt all the framework laws already today, in order to make the Russian pension system completed.

39. At present, the Ministry of Economic Development and Trade of the Russian Federation is working on the draft federal laws to regulate the payouts of the funded part of the work pension accumulated within the Pension Fund of the Russian Federation and private pension funds.
40. So, to date the legislation of the Russian Federation has fixed the institute of private pension funds as an integral part of the pension system of the Russian Federation.

**Government regulation of private pension sector**

41. In accordance with the Presidential Decree “On non-state pension funds” and in order to support the development and supervise the activities of private pension funds, Inspection of Private Pension Funds was established under the Ministry of Social Protection of the Population of the Russian Federation (presently, the Ministry of Labour and Social Development of the Russian Federation). It was entrusted with registration and licensing of private pension funds and their asset managers.

42. The Government of the Russian Federation in its Resolution № 1117 of 5 October 1999 approved the Regulations of the Inspection of Private Pension Funds under the Ministry of Labour and Social Development of the Russian Federation, whereby the responsibilities of the Inspection of Private Pension Funds, in addition to licensing, included:

- establish and maintain the register of licenses for fund operations;
- establish the procedure for registration of pension rules of the funds;
- establish a normative size of the funds’ pension reserves, define requirements for their composition and structure in accordance with the rules for investment of pension reserves approved by the Government of the Russian Federation;
- establish a normative size of the insurance reserve of the funds, the procedure for its creation and use;
- approve the requirements to be met by the contracts for management of pension reserves of the funds between the funds and asset managers;
- supervise the investment of pension reserves of the funds, fulfilment of obligations to their investors and participants, and operations of joint provident funds established by the funds;
- establish the procedure and deadlines for the funds to submit their reports on their operations;
- participate in the coordination of issues related to the reorganization of the funds;
- participate in the establishment of liquidation commissions of the funds;
- develop and approve regulations and methodological documents on activities of the funds within its sphere of responsibility;
- analyze the practices of activities in the private pension sector and submit to the Ministry of Labour and Social Development of the Russian Federation proposals regarding the improvement of the legislation regulating the above activities, as well as respective analytical information;
- participate in the development of draft laws and regulations for the private pension system;
- receive and review applications, letters, complaints and other documents of individuals applying to the Inspection on the issues within its sphere of responsibility;
- participate in the professional training and retraining of human resources working in the private pension sector;
- participate in international contacts and cooperation in the sphere of private pensions.

43. The Inspection performed the licensing of private pension funds until August 2002, when Resolution of the Government of the Russian Federation № 546 of 22 July 2002 nullified the Regulations for the licensing of operations of private pension funds № 792 of 7 August 1995. New Regulations for the licensing of operations of private pension funds were approved, which transferred the licensing functions directly to the Ministry of Labour and Social Development of the Russian Federation.

44. The licensing of operations of asset managers for private pension funds, in accordance with the Regulations for the licensing of activities on the management of investment funds, unit investment funds and private pension funds approved by the Resolution of the Government of the RF № 495 of 4 July 2002, was included into the responsibilities of the Federal Commission for Securities Markets.

45. So, in 2002 the responsibilities in the sphere of government regulation of private pension sector were divided between two federal executive agencies – the social and the financial.

46. Federal Law №14-FZ of 10 January 2003 amending the Federal Law “On non-state pension funds” established that monitoring and supervision of the operations of private pension funds should be performed by an authorized federal agency to be defined by the Government of the Russian Federation. At present, the activities of private pension funds are still regulated by the Inspection of Private Pension Funds under the Ministry of Labour and Social Development of the Russian Federation, except for the licensing of the newly established funds which is suspended. According to the Timetable for drafting the resolutions of the Government of the RF necessary for implementation of the Federal Law №14-FZ of 10 January 2003 “On amending the law “On non-state pension funds” approved by the Government of the RF on 26 May 2003, the authorized federal agency to perform government regulation of the activities of funds, asset managers, specialized depositaries and actuaries in the sphere of private pensions, mandatory pension insurance and occupational pension insurance should be defined by the Government of the Russian Federation by the end of 2003.

Activities of private pension funds

47. In its private pension activities, a private pension fund, on the basis of the private pension contracts with its investors and in accordance with the Rules approved by the Inspection of Private Pension Funds, collects contributions, maintains private pension accounts, invests pension accumulations according to the procedure defined by the Federal Law “On non-state pension funds” and pays out private pensions.

48. In its private pension activities, a private pension fund can independently invest pension reserves in government securities, bank deposits and types of assets allowed by the Government of the Russian Federation.

49. Investment of pension reserves in other types of assets is made by an asset manager on the basis of a contract for trust (fiduciary) management; the requirements for the composition and structure of investment portfolios of asset managers performing management of pension reserves are approved by the Government of the Russian Federation.
50. A specialized depositary, on the basis of a contract for specialized depositary services, performs safekeeping of securities certificates, their record keeping and transfer of rights to the securities in which pension reserves are invested, as well as daily supervision over the compliance of private pension funds and asset managers with the established limitations for the investment of pension reserves, rules for the investment of pension reserves, composition and structure of pension reserves. The specialized depositary must inform the authorized federal agency, the private pension fund and the asset manager about the violations discovered.

51. Government regulation of the activities of asset managers and specialized depositary is performed by the Federal Commission for Securities Markets.

52. The operations of the fund in private pension provision are subject to annual actuarial evaluation based on the results of the fiscal year. During this evaluation, the actuary evaluates the obligations undertaken by the private pension fund towards its investors and participants and the actuarial value of pension reserves.

53. The activities of private pension funds are regulated by the fund’s Rules, which, in their turn, should include descriptions of pension schemes lying at the basis of the private pension contract. The most widely spread pension schemes in the practice of Russian private pensions are the non-funded (partially funded) defined benefit pension schemes with the accumulation period of at least 5 years.

54. Administrative expenses of the private pension fund are covered by the revenue from the assets designed to support the operations of the fund and formed from the founders’ contributions, 15% of the investment return received by the private pension fund and other receipts not prohibited by law.

**Taxation**

55. In accordance with the existing tax legislation, the contributions made by enterprises-employers to the private pension funds and accumulated on the consolidated accounts are not subject to taxation. However, the contributions of individuals to the private pension fund from the fees they receive can only be made after they pay an income tax on the above sums, and if these contributions come to the individual participant’s account directly from the employer, these contributions are subject to the Single Social Tax.

56. The private pension payouts are not subject to taxation. In the event of an early termination of the private pension contract, the redemption sums paid out to the participant are not taxable either.

**The key indicators of the operations of private pension funds as of June 2003 (according to the Inspection of Private Pension Funds).**

57. Today, there are 289 private pension funds in the Russian Federation. 392,101 citizens receive private (supplementary) pensions. 4,970,019 participate in the private pension system. The total amount of pension reserves is 61,661,979.5 thousand Rbl. The total sum of investments made by the private pension funds is 83,063,353.1 thousand Rbl. (including pension reserves and assets to support the fund’s operations).

**IV. Participation of Other Private Organizations in Mandatory Pension Insurance in the Russian Federation**

58. From 01.01.2003, in accordance with the Federal Law “On investments for the financing of the funded part of work pensions”, insured individuals can transfer their pension savings to asset managers selected on the basis of a tender arranged by the Ministry of Finance of the Russian Federation.
59. The asset manager, which has won the tender arranged by the Ministry of Finance of the Russian Federation, enters into an asset management contract with the Pension Fund of the Russian Federation and a specialized depositary which is also selected by the Ministry of Finance on a tender basis. Following the applications of insured individuals regarding their choice of the asset manager, the Pension Fund of the Russian Federation annually transfers the pension savings for management to private asset managers. The savings of the individuals who failed to use their right to choose an asset manager are transferred by the Pension Fund to a public asset manager appointed according to the procedure defined by the Government of the Russian Federation (at present, the Vnesheconombank is appointed a public asset manager).

60. The government regulation, control and supervision in the sphere of accumulation and investment of pension savings is performed by the Ministry of Finance of the Russian Federation. Public supervision is performed by the Public Council for Investment of Pension Savings made up from representatives of employee/employer associations under a procedure defined by the President of the Russian Federation.

61. Based on the results of 2002, the overall amount of the funded part of work pensions accumulated within the Pension Fund of the Russian Federation was 38 bln Rbl. The Pension Fund of the Russian Federation made asset management contracts with 55 asset managers eligible to manage pension savings on the basis of the tender held by the Ministry of Finance of the Russian Federation.