System of Mandatory Private Pensions

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Abstract

Pensions are an important part of a state's social policy, in the future perspective of reporting sustainability in modern organizations and in the personal life of each person.

The demographic tendency of the world's aging population brings attention to finding new effective solutions for the management of pension systems. The first interested in finding solutions is the state, because with the aging of the population, health and care expenses for the elderly will increase significantly, putting additional pressure on public budgets.

Pensions are a major expense in the annual budget of a state, so the pension system has been diversified by introducing two new components: mandatory private pension and voluntary pension. The paper presents the administration and functioning of the state pension administered privately.

Key words: pension system, mandatory private pensions**,** pension fund**,** participant, administrator
J.E.L. classification: G52, G51, H23

1. Introduction

We define the pension as an amount of money paid periodically on the basis of legal norms (within social insurance) to former employees, after exceeding a certain age limit or in case of illness or disability, as well as to the descendants of deceased employees or retirees.

The purpose of providing pensions is to enable the elderly and those who no longer have the capacity to work, to withdraw from the labor market with dignity. *(Ghintuiala, 2011)*

In most countries, however, pensions are organized using the funds method. This means that contributions are collected and managed (invested) by an autonomous organization. This organization may vary from country to country: an insurance company, an open investment fund, or a joint employer and employee organization. In developed countries (the Netherlands, Switzerland, Sweden and Ireland) a solution was found whereby employee contributions were given to an independent institution that professionally manages the amounts offered by the employer and employees. The promoter of this system was Jose Pinera, PhD in economics, the architect of pension reform in Chile.in Chile.

2. Theoretical background

The legal way in which a privately administered pension fund system is established, organized and operates is offered by law number 411/2004. This law also specifies how the organization and functioning of the administrators of privately managed pension funds and the coordination of the activity of other entities involved in this private field, separately, and which supplements the pension granted by the public system, based on the collection and investment, in the interest of the participants, of a part of the individual social insurance contribution.

Commission for the Supervision of the Private Pension System (CSSPP) ssued in addition to the law number 411/2004 a large number of norms to help the application of the law. These rules are: Norm no. 2 of 2007 regarding the authorization of the administrators in the pension system, Norm no. 3 of 2007 regarding the authorization, endorsement and operation fees, Norm no. 4 of 2007 regarding the authorization of the private pension fund, Norm no. 5 of 2007 regarding the origin of the share capital, Norm no. 8 of 2007 regarding the information contained in advertising materials regarding the private pension funds and their administrators, Norm no. 11 of 2007 regarding the financial auditor for the private pension funds and their administrators, Norm no. 9 of 2007 on the marketing of the private pension fund, Norm no. 12 of 2007 regarding the activity of depositing the assets of private pension funds. *(ASF, 2020)*

In Romania, this term of privately administered pension was introduced in 2007, being recommended by the World Bank and the European Union. In addition to the public pension system, which is called the first pillar, mandatory private pension funds have been added, being called the second pillar, and also the voluntary pension funds have been added, being called the third pillar.

For a better knowledge of the privately administered pension system, we will present in detail each of the two components.

3. Research methodology

In Romania, there are three important institutions that deal with the administration of private pensions. The research methodology is based on the official results that have been reported by Commission for the Supervision of the Private Pension System, The Association for privately managed pensions in Romania and Financial Supervisory Authority.

4. Mandatory private pensions (Pillar II)

Mandatory private pensions (Pillar II) are characterized by directing a share of the personal social insurance contribution, paid monthly in the public system, to privately administrated pension funds. Contributions are paid for the entire period in which the person earns income of a salary nature.

The institution that monitors the evolution, informs the taxpayers and presents the changes within the privately administered pension system is the Commission for the Supervision of the Private Pension System (CSSPP). If the CSSPP finds a decrease in the minimum number of participants to less than 50,000 for a quarter, it will withdraw the operating license of the fund that registered this decrease.

The contributions of each participant are deposited in a personal account by the fund administrator. These contributions are invested in various assets and are capitalized, bringing additional income to the beneficiary.

The taxpayer can choose his pension fund himself or he can be distributed randomly if he has not chosen himself. If he considers that the return of another pension fund is better than the one he opted for, he can transfer his account to the new administrator. He cannot have accounts with several pension funds.

Monthly contributions are withheld by the employer and are exempt from paying income tax. The annual contributions applicable to the monthly gross salary income gradually increased and were: 2% in 2008, 2% in 2009, 2.5% in 2010, 3% in 2011, 5% in 2015, 3.5% in 2012, 4% in 2013, 4.5% in 2014, 5% in 2015, 5.10% in 2016, 5.10% in 2017, 3.75% in 2018 reaching 3.75% in 2019 and 2020.

A person can benefit from the pension fund accumulated in the form of a single payment or a monthly pension when he reaches the standard retirement age required in the public pension system.

In case of death of the participant, the amount from the personal fund is inherited.

The verification of the situation of the contributor's personal account can be done at any time if he accesses the website of the fund administrator. In this way can be found the amount that was saved in the personal account for the entire contribution period.

In Romania, there are currently seven administrators of the second pillar pension funds (compared to 18 existing at the time of launch):

- Aegon pensions - private pension fund management company S.A.
- Allianz Țiriac private pensions - private pension fund management company S.A.
- BCR pensions - private pension fund management company S.A.

- BRD private pension fund management company S.A.
- Generali private pension fund management company S.A.
- Metropolitan life privately managed pension fund management company S.A.
- NN pensions- privately managed pension fund S.A.

The amount accumulated in the account of each participant is in the records of the pension administrator who annually sends the client a letter sending him what amount he registered in the personal account at that time.If the person does not know the pension administrator, then he / she will be able to find out this information by accessing the application launched by ASF (Financial Supervisory Authority): https://asfRomânia.ro/scr/petitiiFP.

Recently, the number of participants in the Mandatory Private Pension Funds (Pillar II) has increased, as a result of the increase in the number of employees, reaching over 7.4 million in 2019. The value of net assets increased to 13,059 million Euros.

The 7 mandatory private pension funds (Pillar II) achieved in 2019 an average yield of 11.8%, the best performance in the last 9 years, due to the recovery of depreciations caused by the effects of GEO 114/2018 on the economy and financial markets, as well as the evolutions beyond expectations of the Bucharest Stock Exchange *(APAPR, 2020)*.

The total return achieved by all Pillar II funds from the beginning (May 20, 2008) until the end of 2019 was 154%, meaning an average annual return of 8.35% for the entire period of Pillar II operation. This indicator is well above the total inflation rate in the analyzed period (41.8%), respectively the average annual inflation rate for exactly the same period (3.05%).

From the 13 billion euros administered by Pillar II at the end of 2019, over 2.6 billion euros (12.6 billion lei) represent the net income from investments, exclusively for the over 7.4 million Romanians who contribute to this system. This amount does not include the management fees charged by the management funds, which places the Romanian funds among the most competitive funds in Europe.

Fund managers invest the contributions of individuals in various portfolios based on: Government securities, over 60%; listed shares, with a percentage of 18% 20%; Bank accounts with a percentage of 4% 6%.

Lower shares are allocated for: Municipal bonds, Supranational bonds, Mutual funds, Derivatives Instruments, Alternative instruments.

Periodically, the Association for privately managed pensions in Romania (A.P.A.P.R.) highlights on the official website reports containing the results of privately administered pension funds

The following table shows their evolution in the last three years (*APAPR, 2020*). The first criterion presented is the number of participants. The second criterion is the volume of gross contributions transferred.

The average value of the euro for 2016 was 4.4908 lei, in 2017 it was 4.5681 lei, in 2018 it was 4.6535 lei, and in 2019 it was 4.7452 lei *(National Bank of Romania, 2020).*

Table no. 1. Number of participants and gross contributions transferred to privately managed mandatory pension funds

Gross contributions transferred to privately managed mandatory pension funds during the period 2016-2019								
Year/ Month	***Number of participants to privately managed mandatory pension funds***				***Gross contributions transferred to privately managed mandatory pension funds*(euro)**			
	2016	2017	2018	2019	2016	2017	2018	2019
IAN.	6.585.098	6.831.848	7.068.701	7.270.442	98.967.102	115.839.598	113.713.735	140.541.638
FEB.	6.613.730	6.856.291	7.091.531	7.290.600	114.206.084	120.974.675	153.335.186	154.704.697
MAR.	6.640.288	6.878.452	7.111.246	7.308.928	101.768.954	108.002.975	126.791.256	138.851.953
APR.	6.659.907	6.895.383	7.126.585	7.322.652	101.634.990	139.287.565	125.877.668	141.486.311
MAY.	6.671.423	6.904.732	7.134.267	7.329.858	106.299.991	132.104.327	139.737.327	148.656.527
IUN.	6.684.887	6.916.985	7.146.071	7.341.969	109.987.105	133.306.943	136.572.047	148.803.619
IUL.	6.699.008	6.929.282	7.156.905	7.354.404	108.925.855	132.381.662	138.726.928	162.419.527
AUG.	6.715.017	6.944.494	7.167.760	7.365.946	113.482.682	136.751.736	139.934.199	149.931.921
SEP.	6.730.810	6.956.716	7.178.497	7.376.859	112.036.334	135.636.587	138.915.088	147.878.333
OCT.	6.747.545	6.972.463	7.191.706	7.394.144	112.069.351	134.074.334	136.656.507	155.663.254
NOV.	6.762.385	7.000.018	7.216.302	7.423.848	116.222.350	138.624.576	140.253.804	152.122.585
DEC	6.798.439	7.042.179	7.250.299	7.462.359	114.355.879	136.604.918	140.990.574	147.539.555

Source: APAPR, 2020

According to the table above, in the last 4 years there can be an increase in the number of participants in this pillar of pensions. At the end of 2016, the number of participants in the Second Pillar of pensions was 6,798,439, reaching at the end of 2019 a number of 7,462,359 participants. Comparing the values related to the two years, is registered an increase of 663,920 participants in 2019 compared to 2016. In 2019 the number of participants in the Second Pillar of pensions increased by 10% compared to 2016.

In the table above, a gradual increase can be seen every year (December) in the volume of gross contributions paid to mandatory private pension funds. As of December 31, 2016, the volume of contributions was 114,355,879 euros, reaching 147,539,555 euros at the end of 2019. Comparing the values related to the two years, we can see an increase of 33,183,676 euros in the volume of contributions in 2019 compared to 2016. It is also noted that the volume of gross contributions transferred to mandatory private pension funds recorded an increase of 29 percent in 2019 compared to 2016.

The last criterion is represented by Net Assets of privately managed mandatory pension funds. That registered a considerable increase in value in the period 2016–2018. Thus, at the end of 2016, the level of assets was 7,007 million euros, reaching at the end of 2018 a level of 10,224 million euros in 2018 and 13,059 million euros in 2019. Within 3 years, net assets grew by 86 percent.

5. Conclusions

This pension is mandatory for any new employee who is up to 35 years old. It is an additional option compared to the state pension and brings a monetary benefit at the legal retirement age. The advantage of this pension is that the amounts collected cannot be enforced, cannot be assigned, may not be pledged or used for other purposes as may be the case with deposits and current accounts or other property you own.

The contributor is always informed about the value of his account: the amount accumulated in the individual account, contribution history, the investment results of the pension fund, the most recent annual information letter. In case of death of the contributor, the money accumulated in the fund is not lost because it is transferred in full to the legal heirs.

6. References

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