

IMPROVEMENT OF PENSION ASSETS INVESTMENT PROCESS AND ISSUES. EXPLORING DEFERRED ANNUITY OPTIONS

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1. Review of Pension Reform Progress (2002 - 2004)

1.1. Pension System Data Before the Reform Start

In 2001, before the start of the current stage of the pension reform 38.6 million individuals received pension benefits administered by the social protection authorities. Most of those people were old-age pensioners. Beneficiaries of survivors pension and disability pension made up 6.8 % and 12.5 % of the total number, respectively. About a million and a half received social pensions¹. Besides, the RF Ministry of Defense, RF Ministry of Internal Affairs, RF Federal Security Service, Federal Penitentiary Service, RF Federal Service for Drugs and Psychotropic Turnover Control ensure pension provision.

Expenditures on provision of pensions to people receiving benefits through the social protection bodies made up 5.4 % of the GDP in 2001 - slightly less than the 1992 - 2001 decade average of 5.7 %. The average benefit size was 1023.6 rubles² (or 31.6 % of the average wage).

The benefit size to pensioner's minimum living subsistence **ratio** was 89 %.

Non-state pension funds (NSPF) dominated on the voluntary pension insurance market. Insurance companies may offer pension products, however, *de facto* this sector is only scarcely involved in voluntary pension insurance operations³. By end of 2001, the number of NSPF participants amounted to almost 4 million (6 % of the employed). NSPF offered both individual pension schemes and collective schemes. The latter were used for payment of additional benefits not only by enterprises but also by the local government authorities. In 2001, NSPF paid benefits to 0.3 million participants, however, the average size of a non-state pension benefit was about one fourth of the average pension benefit provided by the government.

Institutional scheme before the reform start. The pension system performed its functions through a number of various structures. The Pension Fund of the Russian Federation (PFR) established in 1991 collected pension insurance contributions. The RF Ministry of Labor and Social Development was responsible for strategic planning of the pension system development. Regional social protection authorities under this ministry were in charge of benefit assessment and payment. Besides, ministries and agencies of so-called "power block" providing pensions to their former staff were to various extent involved in pension provision, as well as the RF Ministry of Finance because taxes reallocated through the federal budget rather than pension insurance contributions are the source of funds for a part of pensions.

¹ Social pension is granted to the disabled who for some reason are not eligible for the labour pension. The size of the social pension benefit is established within the range of 85 to 100 % of the base benefit size.

² US\$ 35 at the dollar exchange rate of 29.2 rubles.

³ Pension insurance information from the insurance companies is incomplete and irregular; however, the existing data prompts a conclusion that insurance companies have weak interest in this type of insurance. See, e.g. A.A. Tsyganov "Russian Insurance Market in the First Nine Months of 2003" (www.ins-union.ru).

In 2001, over 250 NSPF operated on the non-state pension provision market with the total amount of pension assets of 33.6 billion rubles (US\$ 1.1 billion).

1.2. Basic Elements of the Pension Reform

The reform objective is to move to a new model of relations between the pension system subjects based on true insurance mechanisms and technologies. This would improve pension provision of citizens through growing financial sustainability of the pension system¹. The reform is focused on implementing the principle of a link between the future benefit and insurance contributions, i.e. on defining the pension benefit size depending on PFR revenues. This objective would be achieved through two pension pillars: the insurance and the funded pillars. Implementation of the funded pillar was also viewed as a tool for a long-term fiscal stabilization of the pension system because significant pension accumulations could reduce financial dependence of the pension system on the proportion between workable population and pensioners and thus significantly improve its resistance to unfavorable demographic changes.

Recognition of life expectancy at retirement is also a new principle for the Russian pension system².

Yet, in contrast to other countries that introduced a three-pillar model of the pension system, the first pillar (pay-as-you-go component) has a more complicated structure than only the notional defined contribution principle as, for example, in Poland. Part of the benefit based on the distributive principle has two components: base and insurance. The base part of labour pension is a fixed value. Initially it was established by law “On Labour Pensions in the Russian Federation”; thereafter the Government has been regularly adjusting the base part size. Differentiation of the base part is associated not with the working life or wages, but with external factors, specifically with geographic circumstances. The insurance part of labour pension is based on the notional defined contribution principle.

Such approach to assessment of benefits in the pension system pay-as-you-go scheme determined the complicated structure of funding of the pay-as-you-go pillar. Contributions intended for the base part financing are initially directed to the federal budget, and the PFR receives funds from the federal budget on the annual basis to deliver benefits. Contributions intended for the insurance part of labour pension are directed immediately to the PFR budget.

According to the PFR 2004 budget, federal budget subventions for targeted financing under the current law³ should account for 49.9 % in the overall PFR revenues⁴.

In accordance with Federal Law “On Labour Pensions in the Russian Federation”, the base part of labour pension is adjusted depending on the inflation rate within the limits of funds allocated for this purpose in the federal budget and in the PFR budget. The insurance part of labour

¹ Draft Pension Reform Program in the RF, 2001

² Although legislative establishment of this indicator in the form of a fixed number (such approach is applied in assessment of the insurance part of labour pension) does not comply with the nature of such risk.

³ Single social tax collected by the federal budget and transferred to the PFR, federal budget funds allocated for financing of pension benefits and allowances under the state pension provision system, as well as funds transferred to the PFR for financing of early pensions for the unemployed and for the additional pension provision program.

⁴ During the first six months of 2004, federal budget grant transfers amounted to 48.8 %. (Vestnik pensionnogo fonda Rossii”, 4’ 2004).

pension is also indexed by inflation, however, in this case both growth of wages and PFR financial capacity are taken into account. Adjustment indices approved by the RF Government for the past period are provided in Annex 1.

The second pillar of the pension system is based on the funding principle and covers the employed both in the private and in the state sector, including civil servants. According to the initial reform plan, the only restriction for participation in the funded pillar of the mandatory pension insurance was age. The system covered employed men born not earlier than in 1953 and women born not earlier than in 1957. No restrictions are set for the self-employed.

The funded pillar is to become an addition to the benefit paid from the pay-as-you-go system. Insurance contribution tariffs for the insurance and funded parts of labor pension are provided in Tables 1.2.

Tables 1.2. Tariffs of Insurance Contributions for Financing Insurance and Funded Parts of Labor Pension

- under Law “On Mandatory Pension Insurance in the Russian Federation”, 2001 version

Table 1.2.1. Tariff Rates

Worker's income charged with insurance contributions (progressive total from year start)	Tariff					
	Men, born in 1952 and earlier and women born in 1956 and earlier		Men born from 1953 to 1966 and women born from 1957 to 1966		For individuals born in 1967 and younger	
	Insurance part	Funded part	Insurance part	Funded part	Insurance part	Funded part
Up to 100 000 rubles	14 %	9.9 %	12.0 %	2.0 %	8.0 %	6.0 %
100 001-300 000 rubles	14 000 rubles + 7.9% from amount exceeding 100 000 rubles	0.0%	12 000 rubles + 6.8% from amount exceeding 100 000 rubles	2 000 rubles + 1.1% from amount exceeding 100 000 rubles	8 000 rubles + 4.5% from amount exceeding 100 000 rubles	6 000 rubles + 3.4% from amount exceeding 100 000 rubles
300 001-600 000 rubles	29 800 rubles + 3.95% from amount exceeding 300 000 rubles	0.0%	25 600 rubles + 3.39% from amount exceeding 300 000 rubles	4 200 rubles + 0.56% from amount exceeding 300 000 rubles	17 000 rubles + 2.26% from amount exceeding 300 000 rubles	12 800 rubles + 1.69% from amount exceeding 300 000 rubles
Over 600 000 rubles	41 650 rubles	0.0%	35 770 rubles	5 880 rubles	23 780 rubles	17 870 rubles

Table 1.2.2. Transition Period Tariffs for Individuals Born in 1967 and Later

Worker's income	Tariff		
	2002 - 2003	2004	2005

charged with insurance contributions (progressive total from year start)	Insurance part	Funded part	Insurance part	Funded part	Insurance part	Funded part
Up to 100 000 rubles	11.0%	3.0%	10.0%	4.0%	9.0%	5.0%
100 001-300 000 rubles	11 000 rubles + 6.21% from amount exceeding 100 000 rubles	3 000 rubles + 1.69% from amount exceeding 100 000 rubles	10 000 rubles + 5.64% from amount exceeding 100 000 rubles	4 000 rubles + 2.26% from amount exceeding 100 000 rubles	9 000 rubles + 5.08% from amount exceeding 100 000 rubles	5 000 rubles + 2.84% from amount exceeding 100 000 rubles
300 001-600 000 rubles	23 420 rubles + 3.1% from amount exceeding 300 000 rubles	6 380 rubles + 0.85% from amount exceeding 300 000 rubles	21 280 rubles + 2.82% from amount exceeding 300 000 rubles	8 520 rubles + 1.13% from amount exceeding 300 000 rubles	19 160 rubles + 2.54% from amount exceeding 300 000 rubles	10 640 rubles + 1.41% from amount exceeding 300 000 rubles
Over 600 000 rubles	32 720 rubles	8 930 rubles	29 740 rubles	11 910 rubles	26 780 rubles	14 870 rubles

- **New Tariffs of Insurance Contributions for Financing Insurance and Funded Parts of Labor Pension**

Table 1.2.3. Tariff Rates

Worker's income charged with insurance contributions (progressive total from year start)	Tariff		
	Individuals born in 1966 and earlier	Individuals born in 1967 and later	
	Insurance part	Insurance part	Funded part
Up to 280 000 rubles	14.0 %	8.0 %	6.0 %
280 001- 600 000 rubles	39 200 rubles + 5.5% from amount exceeding 280 000 rubles	22 400 rubles + 3.1% from amount exceeding 280 000 rubles	16 800 rubles + 2.4% from amount exceeding 280 000 rubles
Over 600 000 rubles	56 800 rubles	32 320 rubles	24 480 rubles

Table 1.2.4. Transition Period Tariffs for Individuals Born in 1967 and Later

Worker's income charged with insurance contributions (progressive total from year start)	Tariff	
	2005 - 2007	
	Insurance part	Funded part
Up to 280 000 rubles	10.0 %	4.0 %
280 001- 600 000 rubles	28 000 rubles + 3.9% from amount exceeding 280 000 rubles	11 200 rubles + 1.6% from amount exceeding 280 000 rubles
Over 600 000 rubles	40 480 rubles	16 320 rubles

Second pillar pension assets may be inherited by the assignees of the insured before the date of assessment of the funded part of labor pension, but they may not be used or borrowed by the insured himself for some other purposes. Savings are not subject to inheritance after the date of benefit payment start.

Contributions to the funded part of labor pension are viewed as property of the Russian Federation while they are set aside in the PFR. If the insured chose a NSPF, the pension assets accumulated on his behalf become the NSPF property. The insured choosing a NSPF have to send to the PFR an application whereby they request to stop setting up the funded part of labor pension in the PFR.

Besides mandatory funded pension insurance, the second pillar may also include so-called occupational pensions introduced to resolve problems of pension provision to persons eligible for early pensions. However, the law on financing these has not yet been passed.

Setting up a centralized accounting system for contributions and benefit payments in the PFR has become an important condition of implementation of the insurance and funded pillars of the pension system (participants database covering individual data for purposes of the state pension insurance, including accounting of contributions made, size of the estimated pension capital of the insured, return on investment, benefits delivered).

The third pillar of the pension system represents voluntary pension schemes provided primarily by non-state pension funds. There was no qualitative change in the voluntary pension schemes market in 2002 - 2004. The legislative framework for NSPF operation was set in 1998 by passing Federal Law "On Non-State Pension Funds". Amendments to this federal law adopted in 2002 mainly concerned the NSPF participation in the second pillar of the pension system. The only substantial provision that has an impact on the prospects of this sector was the minimum capital requirement¹. Based on the adopted amendments, the RF Government established that to receive a pension provision and pension insurance license a fund has to meet the following requirements:

- Head of the fund executive body should have at least three years of practical experience in management of funds, insurance companies or other financial organizations, higher legal or economic finance education (in case of other background - special training); he should not have previous convictions for economic crime or average gravity crime, heinous crime or particularly heinous crime;
- Chief accountant of the fund should have at least three years of practical experience in accounting and higher education; he should not have previous convictions for economic crime or average gravity crime, heinous crime or particularly heinous crime;
- Assessed property value securing the charter activities of the fund should be at least three million rubles, and starting January 1, 2005, at least 30 million rubles, July 1, 2009, at least 50 million rubles. The aggregate cash contribution of the fund founders should equal at least 3 million rubles, and starting January 1, 2005, at least 30 million rubles.

At the same time the above period demonstrated substantial changes in NSPF regulation and oversight. In 2003, the status of the NSPF Inspectorate was changed - it was included in the RF Ministry of Labor and Social Development. However, it is impossible to evaluate the effect of such reorganization because after a few months the administrative reform shifted the NSPF oversight and control function to the newly established Federal Service for Financial Markets (FSFM), the Inspectorate was dissolved, and the non-state pension provision regulation was handed over to the newly established RF Ministry of Health and Social Development.

Institutes participating in new pension system model

¹ Rather requirement to property acting as security of the charter activities, because according to the Russian legislation NSPF are granted a status of non-profit organizations and they do not have the capital as it is. The NSPF founders provide these funds to them. However, according to the legislation the founders do not enjoy property rights in respect of these funds - these rights belong to the NSPF.

The new pension system model preserves the central role of the RF Pension Fund, though its functions notably differ from those performed by it before 2001. The function of pension insurance contributions collection was moved from the PFR to the Ministry of Taxes and Collections (from 2004 - Federal Tax Service). An in-depth discussion of the possible reasons and issues related to such financial flows arrangements in the pension system is provided in the World Bank document “Pension Reform in Russia: Design and Implementation”, 2002.

At the same time the PFR acquired the benefit assessment and payment functions that earlier were performed by the territorial social protection bodies. The PFR also received a function of accounting and organization of pension assets investment within the pension system second pillar.

Thus the PFR:

- Accumulates part of the amounts contributed by employers as the single social tax and insurance contributions intended for labor pensions financing;
- Keeps individual accounts of contributions and ensures benefit payment;
- Under the second pillar of the pension system, invests collected money within the period before their personification;
- With participation of the tax authorities controls receipt of insurance contributions in the PFR and spending of these funds;
- Organizes and keeps the government database covering all categories of insurance contribution payers to the PFR;
- Organizes and conducts scientific research in the field of state pension insurance;
- Organizes and conducts public information campaigns among population and legal entities covering issues within its jurisdiction.

Besides, the PFR may participate in financing of social protection programs aimed at the elderly and disabled.

Besides the Headquarters, the PFR has 85 regional departments. The PFR Headquarters includes the board, executive directorate, audit commission and individual accounts information center. The organizational scheme of the PFR regional branches includes departments, units and benefit payment centers.

Starting 2004, the RF Ministry of Health and Social Development coordinates the PFR activities. The Ministry:

- Submits proposals to the RF Government regarding appointment and release of the PFR heads;
- Adopts regulatory acts pertaining to the PFR areas of activities;
- Submits to the RF Government drafts of legal acts regulating the PFR activities;
- Submits to the RF Government upon submission of the PFR heads drafts of federal laws on the PFR budgets and on execution of these budgets;
- Sets checks of the PFR activities in cases established by the federal law;

The PFR budget and its execution are to be approved annually by the State Duma of the RF Federal Assembly in the form of a federal law.

The funded pillar of the mandatory pension system involves both the state and non-government structures, though the process of accumulation of funds for future pensioners remains in the government hands. Contributions made towards the funded part of labor pension are accumulated in the PFR. The PFR also keeps accounting of contributions on individual accounts. Only at this stage non-state pension funds may be involved in the system. Starting 2004, workers may choose whether to save in the PFR or in a NSPF.

Investment also has a mixed nature. So far, the prevailing part of funds is invested by a government structure (Vneshekonombank), but workers may also choose a private management company. NSPF may invest only through non-state management companies. In both cases asset managers are to be selected from the operating companies¹, and not to be established specially for managing assets of a pension fund.

While an asset management company has to go through a public bidding procedure (though with rather mild and quite formal criteria) to enter into a pension assets management agreement with the PFR, the pension assets investment by NSPF and asset managers is not legally regulated. Same refers to selection of a specialized depository. In the funded pension system this structure performs functions similar to those performed by it in the scheme of collective investment through investment funds. It combines functions of keeping securities in which the fund has invested and checking the asset management company compliance with the legal investment norms.

The PFR has to competitively select one specialized depository; each NSPF also has to work with one specialized depository.

Non-state pension funds are also expected to participate at the stage of benefit payment, i.e. in contrast to the Swedish model, the insured who have selected a NSPF will not have to return to the PFR in case of annuitization of their pension assets.

1.3. Changes During the On-Going Pension Reform

In terms of the pension reform implementation, it was expected that the range of institutions participating in the pension system funded pillar would expand in 2004. Since this year the insured were granted a right to choose a place where they would accumulate their savings - in the PFR or in NSPF. By end of the year the PFR had to process the submitted applications and transfer the funds to the NSPF. However, in fact there were much more changes, including those that have an impact on the system basic parameters, although the purpose of these changes did not include specific adjustment of the pension system funded pillar *per se*. Rather they were forced and were used as means of achieving other objectives.

Due to various reasons the pension reform started before reforms in other social areas and before the administrative reform. In 2004, when the social policy priorities were somewhat changed, a decision was made to revise the tax policy and the administrative reform started, a question was raised about introduction of changes in the funded pillar of the mandatory pension insurance and about reorganization of the government regulation, control and oversight in the area of pension provision. Administrative changes also mainly concerned relations in setting aside and

¹ Those that have licenses for management of investment funds, mutual investment funds and non-state pension funds.

investment of pension assets, but besides that they also included changes in the PFR status and reorganization of the NSPF supervision system.

The declared changes in the second pillar of the pension system were the consequence of the need to resolve problems in other social policy areas. Late in the 20th century, many legislative acts were adopted at the federal and regional levels that grant benefits (l'goty) in use of public transport, in coverage of cost of communal services, telephones, etc. to various categories of citizens, including pensioners. On the other hand, budget allocations for compensation of expenses incurred by the organizations providing such services normally were not enough to fully cover these expenses. Same as in practice citizens could not realize all l'goty established by law - again primarily because of inadequate financing¹.

Federal Government estimates the amount required for partial conversion of l'goty into cash at the level of about 170 billion rubles. Part of pensioners' l'goty, including housing and communal services, will continue, and part will be left at the regional authorities discretion.

In parallel, also starting from 2005, the maximum rate of the single social tax (that finances the first pillar of the pension system) will be reduced from 35.6 to 26 % (the proportion of the tax that was directed to financing of the base part of labor pension will reduce from 14 to 6 %). The pension system funded pillar parameters were changed to partially cover the PFR deficit in the pay-as-you-go component projected in connection with the SST rate reduction and partial monetization of l'goty granted to pensioners in kind. Starting 2005, insurance contributions rates in the insurance and funded parts of labor pension will change in such a way that contributions made on behalf of workers born in 1967 and earlier would be directed to financing of benefits under the pay-as-you-go pillar (the insurance part of labor pension), which is reflected in Tables 1.2.1 - 1.2.2 and 1.2.3 - 1.2.4. Thus middle-aged workers were excluded from the funded pillar and the number of the system participants was reduced by more than 20 million (1.3 of all employed).

The declared changes postpone the start of massive payment under the funded pillar of the pension system from 2012 to 2022.

As a compensatory measure the RF Ministry of Health and Social Development announced development of a draft law that would allow workers to make contributions to the mandatory pension system on their own behalf. It is expected that they would be able to transfer up to 4 % of wages to the PFR. However, the new component would not be purely funded - at retirement (rather upon reaching a certain age somewhat higher than the generally established retirement age) the government would make additional payments from the budget to such individuals that would exceed the size of the insurance part of labor pension through increasing the base capital in assessing the labor pension size.

Thus as the basic area of reform are developed and implemented certain changes take place in the very concepts of the system to be created. This is particularly true about the occupational pensions reform and configuration of the funded pillar. On the other hand the government failed to fully achieve a number of objectives. The PFR status is still not fully clear (the draft law aimed at resolving this issue has been considered by the State Duma for several years); early pension provision reform has not started (respective draft law is still being considered by the State Duma); principles for arrangement of benefit payment under the labor pension funded

¹ According to estimates prepared by Ye. Gontmaher, Director, Russian Centre of Social Surveys and Innovations, all in all non-funded budget mandates amount to about 6 trillion rubles. ("Komsomolskaya Pravda", September 2, 2004)

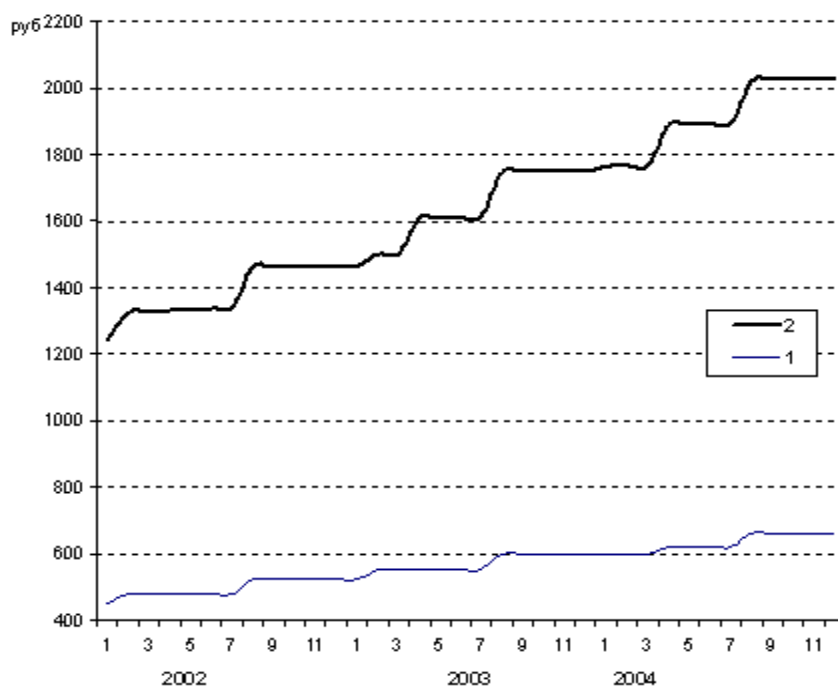
pillar are still not legally established; an incomplete package of government resolutions following the Law “On Investment of Funds for Financing the Funded Part of Labor Pension in the Russian Federation” and amendments to Law “On Non-State Pension Funds” has been adopted. Most difficulties are confronted in passing such issues as conflict of interests and professional ethics code, as well as investment in foreign markets.

1.4. Pension System Data in 2002 - 2004

Pay-as-you-go pillar

The dynamics of the average benefit size and the base part pension size established by the government in 2002 - 2004 are illustrated in Fig. 1.4.1. The ratio of the average benefit to the minimum subsistence level grew from 89.5 % in 2001 to 101.9 % in 2003. It is important that the subject period showed relatively high rate of wage growth¹, and despite regular indexation of the pension base and insurance parts the ratio of the average benefit to average wage reduced from 31.6 % in 2001 - 2002 to 29.7 % in 2003.

Funds on the notional funded accounts of the working insured (base pension capital) were also indexed during this period. As of January 1, 2002, the adjustment factor was 1.307, as of January 1, 2003, 1.177.



- 1 - Size of pension benefit base part established by law
- 2 - Average pension benefit size

Fig. 1.4.1. Change of Average Pension Benefit Size in 2002 - 2004

¹ In real terms the average wage grew by 16 % in 2002 and by 10 % in 2003.

Pension System Funded Pillar Performance

According to the PFR data, in 2002, the pension system funded pillar received in the form of insurance contributions made towards the funded part of labor pension about 38 billion rubles, in 2003 - 50 billion rubles¹. In the end of the 1st quarter of 2004, the PFR transferred to asset management companies 47.2 billion rubles² consisting of contributions collected in 2002, and 13.5 billion rubles of investment return on these assets.

Based on the data about temporary investment returns on the insurance contributions made towards the funded part of labor pension in 2002 (that amounted to 1.5 billion rubles quoted in Federal Law “On Execution of the PFR Budget in 2002”, see Table 1.4.1), the overwhelming part of these incomes were received in 2003 and early 2004. However, it is impossible to make a strong judgment of this because there is no information about the accounting methods used in the PFR. In particular, it is unclear whether unrealized growth of securities prices was taken into account or these incomes were shown only based on the securities sales, while the accounting showed the buying prices, and the return on temporary investment in 2002 was not fully reflected.

Returns on contributions collected in 2003 were assessed by the PFR at the level of 2.015 billion rubles³, but it might be that as in case of the 2002 insurance contributions the final yield of these investments would substantially differ from the tentative data.

The PFR could not allocate quite a substantial part of contributions collected in 2002 among participants' accounts and referred them to the unidentified funds (33.68 billion rubles were allocated to individual accounts out of the total amount of 37.85 billion rubles⁴).

Table 1.4.1. PFR Budget Revenues and Expenditures Related to Mandatory Funded Financing of Labor Pensions, 2002

Item	Million rubles
Revenues associated with mandatory funded financing of labor pensions, total	39 414.71
including:	
- Insurance contributions to funded part of labor pension, total	37 528.45
including:	
- insurance contributions accounted in special part of participants' individual accounts according to the RF legislation	33 364.64
- insurance contributions not accounted in special part of participants' individual accounts	1 426.40
- advance payments	2 737.41
- Insurance contributions in the form of a fixed charge made towards the funded part of labor pension, total	337.36
including:	
- those accounted in special part of participants' individual accounts according to the RF legislation	319.01
- advance payments	18.35
- Amounts of fines and other financial sanctions	24.98
- Return on temporary investment of pension assets by the PFR	1 523.92

¹ 2003 data are tentative.

² US\$ 1.66 billion at the exchange rate as of the end of March 2004.

³ “Kommersant” April 16, 2004

⁴ “Rossiyskaya Gazeta” March 31, 2004

Item	Million rubles
Expenditures associated with mandatory funded financing of labor pensions, total	34 927.08
including:	
- Pension assets transferred for temporary investment in assets allowed by the RF legislation	34 902.04
including:	
- received coupon income	416.80
- cost of temporary investment of pension assets	25.04
Pension assets as of January 1, 2003, total	38 972.87
including:	
- pension assets transferred for temporary investment in assets allowed by the RF legislation	34 485.24
- balance of funds related to mandatory funded financing of labor pensions not transferred for temporary investment as of January 1, 2003	4 487.63
including:	
- advance payments of 2003	2 755.76
Pension assets of 2002, total	34 790.71
including:	
- insurance contributions to funded part of labor pension, including the fixed charge, accounted in special part of participants' individual accounts	33 683.65
- financial outcome of temporary investment of pension assets	1 107.06

Source: Federal Law "On Execution of PFR Budget in 2002"

Collections of contributions to the PFR by months are very volatile during the period with available monthly data (see Table 1.4.2).

Table 1.4.2. Insurance Contributions under Mandatory Pension Insurance to Funded Part of Labor Pension

Month	Collection of insurance contributions in PFR, billion rubles		
	2002	2003	2004
January	0.05	2.8	No data
February	3.2	3	No data
March	3.61	3.2	No data
April	3.89	No data	No data
May	3.05	No data	No data
June	3.33	No data	No data
July	3.64	No data	6.4
August	3.31	No data	5.8
September	3.07	No data	6.0
October	No data	4.1	No data
November	3.2	3.9	No data
December	4.2	5.7	No data
Total	37.85	50.2	81.7 *

* PFR's projection in Federal Law "On PFR Budget in 2005". In 9 months of 2004, collections amounted to 51.8 billion rubles.

Sources: Report of the RF Chamber of Accounts on the thematic audit of formation and use of funds of the funded part of labor pension under conditions of the pension reform in the PFR covering 9 months of 2002 with field visits to regions (Bulletin of the RF Chamber of Accounts No. 2, 2003); Federal Law "On Execution of the PFR Budget in 2002"; Federal Law "On the PFR Budget for 2005"; "Vedomosti" April 1, 2003; "Kommersant" April 16, 2004; MEDT

The investment yield on the insurance contributions made towards the funded part of labor pension collected by the PFR in 2002 was 40 %. This high indicator may be easily explained by the dynamics of prices on the RF eurobonds, which absorbed a substantial part of collections. Only in 2003 eurobonds prices in the PFR portfolio grew as follows:

Issue RF10 by 5.7 %
 Issue RF28 by 20.3 %
 Issue RF30 by 21.2 %

The PFR invested the funds for a longer period. As Fig 1.4.2 shows the period was very favorable both for buying and selling the eurobonds. The PFR could start investing funds in summer - fall 2002 when prices for the most liquid issue RF30 were at 70 % of the nominal value, and sell at a price close to the nominal value, i.e. the yield was about 43 % in US dollars only due to the RF30 issue price growth during this period.

Ruble grew in relation to dollar by about 7.5 % in 2003, and by about 9.5 % during the entire period. Thus in ruble terms the yield due to eurobonds price growth was somewhat lower.

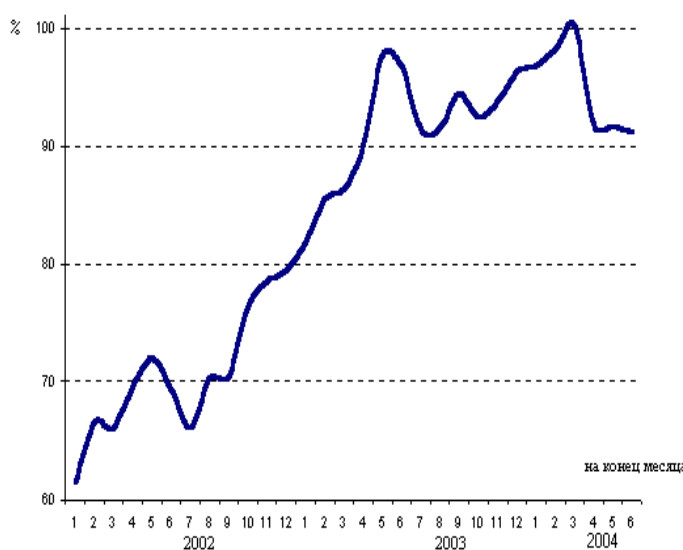


Fig. 1.4.2. Prices of RF Eurobonds with Retirement in 2030

Period for which the net financial outcome was published is not a standard one for financial reporting. The obtained result was not presented in an annual format to be compared with the market indicators for the respective period, to assess the yield in real terms, etc. It is impossible to make such calculations without the PFR or MOF databases because there is no official information about the date when the PFR started to invest the insurance contributions made towards the funded part of labor pension. Legally the PFR was authorized to invest these contributions from mid march when a respective government resolution was adopted. Judging by the first information in press, the PFR entered the government borrowings market in early April

2002. Therefore the insurance contributions were invested during about two years, and the annual investment yield was a bit more than 18 %.

Management companies investment data regarding pension assets received from the PFR are also sporadic. In 2003, 704 thousand participants chose asset management companies. Thus the management companies received 1.6 billion rubles from over 47 billion rubles of total assets. The remaining funds went to Vneshekonombank appointed as a state management company (SMC).

Data on allocation of funds among management companies after the first “selection campaign” are provided in Table 1.4.3. Management companies are sorted by the amount of funds transferred from the PFR; when these data are not available the companies are sorted by the number of participants’ applications. Among private management companies, only two - “Kapital” and Rosbank Management Company - received 37 % of pension savings for asset management.

Table 1.4.3. Transfer of Funds by PFR to Management Companies in 2004

Rating	Company name	Region	Number of participants’ applications*	Amount of funds transferred from PFR, million rubles**
SMC 1	Vneshekonombank	Moscow	-	45570
	Kapital	Moscow	85940	304.5
2	Rosbank Management Company	Moscow	105248	283.0
3	Solid Management	Moscow	85564	148.2
4	NSPF Management Company	Chelyabinsk	48153	112.3
5	Ak Bars Capital (former B26 “Sovremennye Investitsionnye Strategii”)	Yakutsk	98205	105.8
6	Park Avenue Capital	Moscow	35957	81.9
7	NIKOil Management Company	Moscow	22572	75.5
8	Management Company “Troyka Dialog”	Moscow	19405	67.7
9	Management Company of Promyshlenno-Stroitelniy Bank	St. Petersburg	20811	53.0
10	PH-Trust Management Company	Moscow	18642	51.0
11	Leader	Moscow oblast	13012	40.7
12	Alfa-Capital	Moscow	11031	33.2
13	Aton-Management	Moscow	15826	29.3
14	Montes Auri	Moscow	6158	17.8
15	Regiongazfinans	Moscow oblast	6841	10.9
16	Metallinvestrast	Moscow	5745	9.7
17	PIOGlobal Asset Management	Moscow	2353	9.0
18	Creative Investment Technologies	St. Petersburg	3796	8.8
19	Pifagor	Moscow	2536	8.7
20	Accord Asset Management	Moscow	2632	8.2
21	Interfin Capital	Moscow	2927	6.1

Rating	Company name	Region	Number of participants' applications*	Amount of funds transferred from PFR, million rubles**
22	Pallada Asset Management	Moscow	1064	3.8
23	RTK-Invest	Moscow	1262	3.4
24	Region Asset Management	Moscow	1224	3.3
25	Portfelnye Investitsii	Moscow	1211	3.1
26	NIKOil-Sberezheniya	Moscow	1535	2.7
27	Natsionalnaya Upravlyayushchaya kompaniya	Moscow	1280	2.6
28	Joint Finance Group "Invest"	Moscow	667	2.6
29	Yermak	Perm	1270	2.3
30	Yamal	Moscow	899	1.7
31	Analyticheskii tsentr	Moscow	587	1.5
32	Promyshlennye traditsii	Moscow	744	1.3
33	Trinfiko	Moscow	615	1.2
34	VIKA	Moscow	496	1.1
35	Finam-management	Moscow	460	1.0
36	Metropol	Moscow	354	0.8
37	Interfinans	Moscow	273	0.4
38	Professional	Moscow	152	0.1
39	Pensionny rezerv	Moscow	26376	No data
40	Brokerekreditservis***	Novosibirsk	3583	No data
41	Doveriye Kapital***	Moscow	2353	No data
42	Petrovskiy Fondovy Dom	St. Petersburg	2024	No data
43	St. Petersburg Tsentralnaya Upravlyayushchaya Kompaniya	St. Petersburg	1950	No data
44	AVK "Dvortsovaya Ploshchad"	St. Petersburg	1406	No data
45	Aleamar	Novosibirsk	1128	No data
46	Sistema-Investments	Moscow	998	No data
47	NVK Management Company	Moscow	924	No data
48	Invest-Tsentr	Moscow	825	No data
49	Management. Investitsii. Razvitiye	St. Petersburg	705	No data
50	Natsional	Moscow	517	No data
51	Rostovskaya trastovaya kompaniya	Rostov-on-Don	477	No data
52	Agana***	Moscow	474	No data
53	Basis-Invest	Moscow	462	No data
54	Zolotoye Secheniye	Moscow	254	No data
	Total		236	No data
			672139****	

Notes:

* According to newspaper "Moskovskaya Pravda", March 15, 2004

** According to "Vedomosti", March 25, 2004; "RBS Daily", March 30, 2004; Kommersant, April 16, 2004

*** Companies offering more than one investment portfolio

**** Preliminary data

In 2004, 376 thousand more out of 42 million insured individuals decided to move their pension assets to private management companies and non-state pension funds¹. The major part of applications (256 thousand) was submitted to the non-state pension funds. The leader in terms of clients (over 60 thousand) is LUKOil-Garant Fund; 38 funds failed to sign into any agreement; 22 funds has less than a thousand² (according to the PFR 81 funds have a right to attract pension assets - see Annex 1). The actual number of those who decided to entrust their pension assets to non-state management entities within the two years is so far unknown; however, it is obviously less than the number of applications submitted to the PFR. By information published in mass media, part of the clients who chose private management companies last year moved to the NSPF this year.

Trends in NSPF Market in 2002 - 2004

During the reporting period, quantitative indicators of NSPF performance grew rather quickly. While the number of operating funds changed insignificantly, total pension assets increased in 2002 by 53 %; in 2003 by 74 %; in the first six months of 2004 by 11 % more. However, the sector is relatively small: NSPF pension assets do not exceed 1 % of the GDP. Impressive dynamics of inflow of funds to a large extent reflect the overall favorable economic situation in the country during this period. For comparison, in the same periods, cash deposited in banks by individuals grew by 52 %, 47 % and 17 %, respectively, while the absolute number of the total amount of such deposits was incomparably higher than pension assets: 1.54 trillion rubles vs. 99 billion rubles of NSPF pension assets.

As of mid 2004, NSPF had about 5.5 million participants (8 % of the total number of the employed) and less than 0.5 million beneficiaries. Over 40 % of pension assets were invested in the Russian economy.

Sources of statistical data used in Section 1:

Federal Statistics Service (former Goskomstat, www.gks.ru)

Vestnik (news) of the RF Pension Fund

Bulletin of Banking Statistics

Federal Service for Financial Markets (www.fcsm.ru)

Inspectorate of non-state pension funds (abrogated)

2. Recommendations on Issues of Control over Movement of Assets when Management Company Manages More than One Investment Portfolio in a System with More than One Specialized Depository

2.1. Issues of Management Company Offering a Choice of More than One Investment Portfolio to the Insured

¹ “Gazeta” of October 26, 2004. Natalia Biyanova “Citizens are not ready for pension reform”

² “Finans”, November 8, 2004. “No trust to private entities”

The topicality of this issue stems from the concept of Federal Law “On Investment of Funds for Financing Funded Part of Labor Pension in the Russian Federation”, that did not provide for an asset management company to offer to the insured a choice of investment portfolios. However, the structure of one of the articles allowed for interpreting it as stipulation of several portfolios option. Documents regulating asset managers tendering developed by the RF Ministry of Finance are based exactly on this norm, and several companies offered more than one portfolio (see Table 1.4.3). Then the PFR signed with them not one but several asset management agreements (to match the number of investment portfolios). It was extremely difficult to set up an investment portfolio with secure make out when the insured were passive; therefore there was no economic urgency in multiple portfolios. Table 1.4.3 shows that less than 30 asset managers out of 55 competitively selected companies could attract an amount exceeding 3 million rubles (over US\$ 100 thousand). Fragmentation of such amounts between investment portfolios does not have economic rationale. However the concept of amendments to Federal Law “On Investment of Funds for Financing Funded Part of Labor Pension in the Russian Federation” includes the multiple portfolio principle. Such approach may be explained by interpretation of the rights of the insured: they have already chosen this product and the asset manager has to support it during the asset management agreement period.

The initial concept of multiple portfolios in asset management companies included the following conditions:

1. The *system of agreements* of asset managers with the PFR and of asset managers with a specialized depository remains unchanged (the asset manager signs one agreement with the PFR and one - with the specialized depository irrespective of the number of portfolios).

One asset management agreement between the PFR and a competitively selected asset manager is signed whatever number of portfolios the asset manager offers, and the investment portfolio is viewed as a reflection of its investment strategy.

This approach is primarily based on the principle of competitive selection reflected in Federal Law “On Investment of Funds for Financing Funded Part of Labor Pension in the Russian Federation” that does not include assessment of the asset manager capacity to effectively manage the assets indicated in the investment declarations, but only certifies that asset managers and their staff meet mainly quantitative criteria: amount of managed assets, past experience in investing collective funds (mutual funds or managed NSPF assets), etc.

The legal part of this issue is that relations between the PFR and an asset management company may be built without any link with the investment strategy. Because in contrast to classical funded pension schemes, the PFR is not responsible for and does not influence the investment policy of an asset manager. Neither the management nor scheme trustees select an asset manager for implementation of the investment strategy that they consider adequate for pension assets or their part at a given time, but the insured themselves choose investment portfolios. In this respect the Russian model of relations between the asset management company, the PFR and the participant is closer to the Swedish model (see Annex 1).

The PFR is the only client for all portfolios of the asset manager.

Arguments pro such approach to agreement relations:

- Preservation of the Federal Law provision focused on the overall responsibility of the asset management companies; mechanism of withdrawing (exit) of an asset management company from the market in case of misconduct; control over expenditures, liability insurance;
- A more flexible procedure of setting up a new portfolio. A tender may be skipped this time. The asset manager just declares a new investment portfolio but not earlier than, for example, 2 to 3 years after the tender (not to provoke “a simplified procedure”);
- No need to revise the agreement termination procedure, including transfer of assets. In case of one investment portfolio - one asset management agreement approach, amendments are necessary because if the agreement is terminated the asset manager may (as an extreme case) insist on transferring the assets to it again but under another agreement.
- Administrative and other costs of the PFR and specialized depository grow less if the number of the agreements does not increase.

Arguments contra:

- A state asset management company may have several portfolios¹, and they would differ in criteria other than investment strategy risk. **Possibly** with a state management company separate agreements would be required (PFR investment practice currently builds around the principle of isolation of contributions collected in different years in separate portfolios);
- The need to define asset managers’ violations leading termination of the asset management agreement, to sanctions and closing of the portfolio

2. ***Investment portfolio classification*** by the degree of risk. This proposal was based on study of international practice and recommendations of experts in issues of choice in pension systems². Ranking by risks of products offered by the asset managers to the insured was also proposed by S. Bates, World Bank expert under the SPIL Project, even before the issue was raised about asset managers offering several portfolios³.

The negative side of absence of such requirement in the Russian legislation has already affected the initial stage of implementation of the pension system funded scheme. Asset managers avoided describing their investment portfolios in the risk - return terms. They basically limited themselves to quantitative criteria set by Federal Law “On Investment of Funds for Financing Funded Part of Labor Pension in the Russian Federation”. Investment declarations of asset management companies - AGANA, Doveriye Kapital, and Sistema Investment, who managed to secure a right to conclude several agreements with the PFR - do not allow clearly differentiating the offered investment portfolios by risks.

Currently investment or mutual investment funds are not rated by independent rating firm or by self-regulated organization similar to common practice, for example, in the USA or Italy⁴. Rating in the area of collective investment and securities management followed the path of giving

¹ While preparing amendments to Federal Law “On Investment of Funds for Financing Funded Part of Labor Pension in the Russian Federation”, an option is considered of shifting the function of investing the insurance contributions towards the funded part of labor pension before their personification in asset management of the state management company (currently the PFR deals with their investment).

² See, for example, Monika Queisser and Edward Whitehouse. Individual Choice in Social Protection: The Case of Swiss Pensions. OECD social, employment and migration working papers. Aug. 2003

³ S. Bates. “Regulation of composition and structure of the Investment Portfolio of the funded component of the Russian Federation pension system – development of the composition of the pension saving of the investment portfolio”. Final report by consultant, 2002

⁴ Published ratings are rather raking of mutual investment funds by the investment results at end of defined period.

ratings to the asset management and investment companies, non-state pension funds¹. No doubt, rating of companies dealing with securities management also has a right to exist and has its users. However, this is an institutional investor rather than a mass retail one. Therefore the issue of approach to rating (risk ranking) of investment portfolios under the mandatory funded pillar of the pension system requires further elaboration. A widespread practice is to refer these issues to the self-regulating organizations, however, the federal law may not force these organizations to do appropriate work and asset management companies do not have to be members of a self-regulated organization.

3. ***Opening new investment portfolio*** it to be agreed with the supervision agency (an investment portfolio is to be registered in the FSFM) if the asset manager would want later (after the tender) to form a new portfolio. It may do it but after some minimum period of time. If the asset manager does not have experience in pension assets management, the stated portfolios are to be registered after the tender. Thus asset managers that declare only one portfolio for the first tender receive a right to form new portfolios if they wish without having to pass through a new tender and thereby they obtain equal conditions with those who have already offered several investment portfolios.

4. ***If the amount of funds to be shifted to a new portfolio by applications*** is less than the amount required for formation of an interval mutual investment fund as set by the FSFM, such interval mutual investment fund is not opened. This issue seems to be important not only at the time of formation of an investment portfolio but also for resolving issues of economic efficiency of asset management companies if the major part of the insured who have chosen them earlier leaves them.

Based on these grounds the consultant of the RF Ministry of Economic Development and Trade (MEDT) made respective recommendations at the initial stage of development of amendments to Federal Law “On Investment of Funds for Financing Funded Part of Labor Pension in the Russian Federation” jointly with other experts involved by the MEDT for work in this area. In their discussions participants of the working group dealing with amendments to Federal Law “On Investment of Funds for Financing Funded Part of Labor Pension in the Russian Federation” have changed the above approach in several ways.

Regarding the first issue, during the discussions of the working group dealing with amendments to Federal Law “On Investment of Funds for Financing Funded Part of Labor Pension in the Russian Federation”, the approach one asset manager - one asset management agreement with the PFR irrespective of the number of investment portfolios held by the company did not find support. Summarizing the discussion two main reasons may be formulated:

- Precedent of the 1st tender, when the PFR concluded separate asset management agreements for each investment portfolio with asset management companies that declared more than one portfolio.

The PFR lawyers took a strong stand saying that closing a specific portfolio may not be determined by economic expediency. Closing of any portfolio following their logic may only be a consequence of obvious violations on the part of asset management companies because otherwise the rights of the insured who chose such asset management company (investment portfolio) would be violated. Under the circumstances it is absolutely important to differentiate violations in terms of grounds for the agreement termination.

¹ “Expert” No. 39, 2003; “Dengi” No. 45, 2003; www.raexpert.ru

What violations lead to termination of all agreements with the misconducting asset management company? What violations lead to termination of agreements with the misconducting asset management company covering the portfolio in respect of which violation occurred?

Since there are no examples of agreement termination for violation of requirements of Federal Law “On Investment of Funds for Financing Funded Part of Labor Pension in the Russian Federation”, it seems inexpedient to deduct a classification.

As result amendments to Federal Law “On Investment of Funds for Financing Funded Part of Labor Pension in the Russian Federation” describe a model that stipulates competitive selection every time an asset management company offers a new investment portfolio. The concept and procedures of such tendering remain unchanged as compared with the current rules. These rules are still focused on screening of asset managers that do not meet the elementary requirements.

Regarding shift of pension assets to asset managers before their personification, it was recognized expedient to follow the PFR accounting practice and isolate investment of contributions towards the funded part of labor pension collected by the PFR within one fiscal year. In accordance with the current practice, the period before funds are shifted on the request of the insured extends in fact to two years; therefore there will be at least two investment portfolios formed through the insurance contributions before they are personified. Besides, not the entire amount of collected contributions is identified and allocated among individual account by the time of the shift; therefore the portfolio is not liquidated, but remains in the hands of the state management company for some more time. It is expected that the PFR would conclude a separate asset management agreement with the state asset management company for each such portfolio.

Hence, it is clear that the state asset manager that would deal with investment of these funds would not fully take advantage of the scale effect and it would be more difficult for it to organize preparation for shifting the funds in accordance with applications of the insured. However, such approach has certain positive points because a whole range of other issues is resolved associated with personification of insurance contributions and returns on their investment.

Second issue

The mechanism of conveying information to the insured about the difference of investment portfolios in terms of risks is still not defined. One of the options in this respect is involvement of self-regulated organizations (SRO). Consultations with National Association of Capital Market Participants showed that the need for public access to such information find understanding. SRO may rate investment portfolios made up of pension assets that are held by the management companies - SRO. On the other hand management companies are not bound to be members of a SRO.

Third issue is resolved by a competition procedure that a management company wishing to open a new investment portfolio has to go through. As noted above the solution is not optimal because selection criteria do not evaluate asset management quality. At the same time it seems premature to introduce criteria without clear objectives and desirably quantitative parameters while the government structures are short of adequate qualification staff and regulation practices regarding conflict of interests are weak. However, it seems that mismatch of the competitive selection criteria and objectives is the weak point of the amendments under preparation.

Fourth issue: the proposed approach was supported by the FSFM and RF Ministry of Finance, however, representatives of the RF Ministry of Health and the PFR spoke out against setting any quantitative criteria requirement for opening a portfolio and also against recognizing inadequate amount of funds in the portfolio or some other economic parameters as a basis for its closing. So again showed up the differences in approaches to interpreting interests of the insured in the social and financial sectors of the Russian legislation¹. The draft amendments did not include norms on the minimum size investment portfolio and liberalization of the market exit for an asset management company.

Besides, it is proposed to liberalize transfer of assets between management companies. The current version of Federal Law “On Investment of Funds for Financing Funded Part of Labor Pension in the Russian Federation” provides for transfer of funds from the PFR to an asset management company, between the management companies and from a management company to the PFR only in cash.

This approach was chosen because of concerns related to the selected model when the insured may annually change their investment preferences in the investment portfolios of asset managers. This is particularly important in case of state management companies which many accumulate a large amount of unidentified illiquid securities unless there is a need to sell them for transferring the assets upon request of the insured. The system may face a serious financial problem when first massive payments start.

These concerns were not groundless because the PFR confronted this problem in investing the free balance of the pay-as-you-go pillar. Same problems may arise if the RF Ministry of Finance implements its plans to issue government saving bonds (convertible into federal loan bonds), separate issues of which may be bought exclusively by the PFR (primarily through the state asset management company)².

At the same time implementation of the approach providing for pension assets transfer exclusively in cash is complicated by a pronounced seasonal nature of assets shifting with low capacity of the financial market and low liquidity of permitted assets.

The problem of assets sales was particularly urgent at the time of the system launch in 2003 - early 2004 because after that the PFR adopted a practice of transferring assets as they get

¹ Most of the management companies confronted problems of same genesis after transfer of pension assets to them. Management companies that by “voting” had only scarce assets to manage cannot voluntarily exit the market. While an agreement between economic entities may be terminated upon mutual agreement of the parties, the choice of the insured is viewed a self-sufficient and not subject to economic efficiency evaluation in case of a pension asset management agreement. Based on this, the PFR does not consider inability to secure full diversification of investment and obvious loss of profit for the insured due to high cost of administration of insignificant pension assets to be sufficient grounds for termination of the agreement.

² MOF plans to issue government savings bonds worth 60 billion rubles in 2005. One-year bonds will be offered to the PFR and 8-year bonds, to other institutional investors. These securities will not be traded in the market: therefore they may be either exchanged for federal loan bonds or bought out by the MOF. It is expected that the major part of government savings bonds would be placed in the second half of 2005 with account of the pension legislation peculiarities. A. Chumachenko emphasized, given the market does not need large volumes and the security is unlisted, 5 - 7 billion rubles will be offered in the second quarter of 2005. In 2006, this amount would possibly be increased to 10 billion rubles (January 25, 2005, RBK and Finmarket information agencies).

identified to asset management companies, which hold pension assets as of the date of personification¹.

Given the pension assets investment limitations established by regulatory acts adopted pursuant to Federal Law “On Investment of Funds for Financing Funded Part of Labor Pension in the Russian Federation”, the working group found it feasible to secure through amendments a norm that would stipulate shifting of funds between portfolios of one asset manager both in cash and in securities.

2.2. Arranging Control over Movement of Pension Assets in Multiple-Portfolio System

It is expected that to control movement of funds in a multiple portfolio system the management company would open a separate banking account to carry out cash transactions under each portfolio, and the specialized depository would open a separate depot account on behalf of the management company also for each investment portfolio. Moreover, it is expected that specialized depositories would enter into a service agreement with management companies under each investment portfolio.

It is also established that a broker serving the management company has to keep separate accounting book of cash received from the management company by each investment portfolio.

The management company has to do the following:

- Develop an investment declaration for each investment portfolio;
- Isolate each pension assets investment portfolio from assets from other investment portfolios, other assets held by the asset manager on any legal grounds as well as from own property of the asset manager;
- Keep individual accounting of assets making up the investment portfolio and reflect this on a separate balance sheet;
- Submit a pension assets investment report and investment returns report to the PFR and to the federal executive authorities in charge of control and supervision in the area of formation and investment of pension assets by each investment portfolio;
- Estimate current market value and net asset value by each investment portfolio held by the asset manager in accordance with regulatory acts of the federal executive authorities in securities market (currently the FSFM).

As in case of structure “one management company - one asset management agreement”, approach “one investment portfolio - one agreement” has both advantages (high transparency of financial flows) and disadvantages (higher administrative, depository and other expenses).

Norms on disclosure of investment information are aimed at higher transparency and ultimately at control over movement of funds. In principle, it is possible to arrange the necessary activities in this area on the basis of the current provisions of Federal Law “On Investment of Funds for Financing Funded Part of Labor Pension in the Russian Federation”. Functions of information

¹ In its turn, by reducing the problems related to the need to concentrate large amounts of money by 1 moment of time, such approach aggravates the issue of accounting and rights of the insured because amounts of different individuals are transferred at different times.

disclosure regulation belong to the RF Ministry of Finance, but the process of development of a respective regulatory act has been delayed. Since the RF Ministry of Finance failed to adopt the necessary regulatory act by end of 2004, and there is no RF Government decision on the audit procedures for asset management companies, publication of the financial results of pension assets investment in 2004 may be seriously delayed.

The proposed amendments are aimed at clarification of participant information responsibilities of the subjects of relations in pension assets investment. *Inter alia*, it is proposed that the specialized depository provides access to investment outcomes data of different management companies on its site.

2.3. Issues of Transition to Several Specialized Depositories

In contrast to the issue of multiple portfolios, the issue of transition to the system with several specialized depositories has not been raised in practical terms. Such amendments are not being prepared for the Federal Law “On Investment of Funds for Financing Funded Part of Labor Pension in the Russian Federation”.

In time of development of the configuration for pension assets investment in Russia, the issue of specialized depositories was one of the most disputable. The institute of specialized depositories was relatively new. Most of the operating specialized depositories received licenses only in 2000 (see Table 2.3.1). Hence, during development of the basic elements of the pension system funded pillar the choice of these institutes was extremely small, and the major part of those available did not have the required experience. This was one of the factors determining a one-specialized-depository system to serve the PFR. There are, certainly, technical complications in such arrangements. In particular, there will be difficulties if the specialized depository loses its license or if its founders make a reorganization decision. A new specialized depository has to be competitively selected, which requires time.

Table 2.3.1. Non-Bank Organizations with Licenses issued by FSFM for Activities of Specialized Depositories of Investment Funds, Mutual Investment Funds and Non-State Pension Funds

Full name of Specialized Depositories of Investment Funds, Mutual Investment Funds and Non-State Pension Funds	Date of issue of SP License	Capital size as of Oct. 1, 2004, thousand rubles*
1. ZAO “Perviy Spetsializirovanny Depository”	08.1996	27 779
- ZAO “Ob’yedinennaya Depositorynaya Kompaniya”	11.1997	5 012 564
- ZAO “Spetsializirovanny Depositoryny Tsentr”	06.2004	64 007
- ZAO “Depositorynaya Kompaniya UralSib”	09.2000	119 706
- OOO “Tsentralny Moskivskiy Depository”	09.2000	32 517
- OOO “Spetsializirovannaya Depositorynaya Kompaniya “Garant”	09.2000	289 646
- OOO “Spetsializirovanny Depository Pensionnikh, Payevikh Investitsionnikh Fondov “Spetsializirovanny Depository”	10.2000	49 938
2. ZAO “Investitsionnaya Kompaniya AVK” (broker)	10.2000	98 168
3. ZAO “Raschetno-Depositorynaya Organizatsiya” (Novosibirsk)	12.2000	No data
4. ZAO “Investitsionnaya Kompaniya “PEKO-INVEST”	12.2000	52 035

(broker)		
5. OOO "Tsentralniy Surgutskiy Depository"	12.2000	No data
6. ZAO "Finansovaya Kompaniya "INTRAST"	12.2000	622 330
7. OOO "Depository Irkol"	12.2000	26 223
8. OOO "Severo-Zapadnaya Finansovaya Kompaniya"	12.2000	No data
9. ZAO "Vostochnoyevropeyskaya Investitsionnaya Kompaniya" "VIKA" (broker)	No data	No data
10. OOO "Investitsionnaya Kompaniya "Polis-Invest"	01.2001	No data
11. OOO "Yakutskiy Depository Tsentr"	01.2001	26 972
12. ZAO "Baltiyskoye Finansovoye Agentstvo"	02.2001	70 178
13. OOO "Kompaniya "Brokerkreditservis" (broker)	05.2001	No data
14. ZAO "Credit Swiss First Boston Custody (Moscow) AO"	1996	No data
15. OOO "Profit Haus" (Kalmykiya)	10.2002	No data
16. ZAO "Depository Kompaniya "REGION"	05.2004	101 651
17. ZAO "Investitsionnaya Kompaniya "RIKAM-TRAST"	01.2004	101 987

* Data provided by the Professional Association of Registrars, Transfer Agents and Depositories (PARTAD)

Notes:

1. Due to limitations established by Federal Law "On Investment of Funds for Financing Funded Part of Labor Pension in the Russian Federation" banks may not perform as specialized depositories in the funded pension system though there is no direct prohibition of these activities for the banks with specialized depository license;
2. Word "broker" in brackets indicates that this specialized depository has a broker license, which precludes its participation in the funded pillar as a specialized depository.

An issue of organization of information flows was another factor *pro* the one-specialized-depository system besides inadequate development of specialized depositories services market. In a system with several management companies the PFR will inevitably face an issue of obtaining summary information about the aggregate investment portfolio status and unification of asset managers' reports. This issue became particularly urgent when the PFR concluded an agreement with more than 50 management companies. Contact with all managers and tracking their operational information become complicated, and the PFR relies on data provided by the specialized depository.

Identified disadvantages of the one-specialized-depository system include a monopolistic position of this institute in the system that may have a negative impact on the service quality and prices.

It seems that in transition to a system with more than one depository the main focus should be given to unification of interaction procedures for asset managers that have respective agreements with the PFR. Under the current law the specialized depository has to agree its internal regulations with the FSFM. Possibly in transition to a system with several specialized depositories the regulator will have to formulate some standards to provide equal conditions for all asset management companies having asset management agreement with the PFR irrespective of its specialized depository.

Regarding reporting on the status of the part of pension assets accumulated in the PFR, currently the specialized depository (in contrast to international practice) does not have a function of preparing investment reports for supervision agencies. Therefore no restructuring of relations in this area will be required in case the system moves to several specialized depositories.

Low capitalization of the operating specialized depositories is one of the obstacles for transition to several specialized depositories. The minimum capital requirement established by the FSFM is

very low (25 million rubles). Possibly, at the current level of development of mutual investment funds and NSPF markets this requirement is adequate, but this is obviously not enough for dealing with the state asset management company. Out of the total number of specialized depositories - non-banks besides ZAO "Ob'yedinennaya Depositarnaya Kompaniya" (a specialized depository of the PFR and asset managers under the funded pillar) only one specialized depository has recently substantially increased the capital ("Finansovaya Kompaniya "INTRAST").

3. Creation of Incentives for Later Annuity of Pension Assets

The issue of increasing retirement age in Russia appears to be quite acute. On the one hand, it is a necessary measure, given a forecast of the demographic situation in the country, on the other hand, society is not ready for this step, as life expectancy is such that the retirement age of men is already higher than life expectancy at birth (in accordance with the Rosstat data, for men who were born in 2003, life expectancy at birth will be 58.82 years, and for five subsequent years this indicator was recorded below 60 years¹). In these conditions a decision of statutory increase in retirement age can be postponed due to political considerations. Consequently, the issue of creating economic incentives for people to continue working beyond a normal pension age seems to be especially relevant.

In theory, two factors are considered to be decisive in making decisions to continue working at a later age. It is the age at which a person becomes entitled to pension benefits for the first time in accordance with legislation and the way the pension benefit is increased (raised) if the person who reaches a normal pension age continues to work.

In practice governments use different measures to create incentives for people to increase a period of labor activity. For example, in Germany the reform of the pension system stipulates that an employee will be entitled to receive a full pension benefit after 45 years of service instead of 37 years. In Italy, in its turn, in accordance with a draft pension reform, those employees who reach a normal pension age and continue working receive supplemental payments in the amount of 32.7% of their salary out of money that otherwise would be allocated to pay out a pension benefit to them.²

In responding to the question as to how a certain configuration of the funded pillar of the pension system can impact decisions made by the insured (within the framework of existing legislation), one needs to take into account that as studies indicate³ the income level at retirement age as such is not a decisive factor. People started reducing the period of their labor activity as soon as they could afford it and it happened long before substantial social compensations were made available. Nevertheless in Russia a low rate of pension benefit appears to make an impact on decisions made by people regarding continuation of their labor activity. Around 20% of all retired persons continue to work and among people who receive old age labor pension this figure increases up to 22⁴. The said figure in early pension cohorts is, of course, even higher. In developed countries it is lower. For comparison, in the USA less than 20% of men continue working by the age of 65⁵, while in continental Europe it is 4%⁶.

The new Russian pension legislation sets out mechanisms for creating incentives for people to apply for a funded part of labor pension benefit at a later age. For example, the legislation does

¹ Russian Statistical Yearly, Moscow, 2004

² The Economist Oct 9th 2003

³ See Dora L. Costa. The Evolution of Retirement: An American Economic History, 1880-1990. NBER Series on Long-Term Factors in Economic Development. Chicago: University of Chicago Press, 1998

⁴ Calculated on the basis of Vestnik, Pension Fund of Russia, No.3, 2004

⁵ In the USA the minimal early retirement age is 62.

⁶ The Economist, March 25 2004

not set out a maximum age when an individual can apply for a funded part of the labor pension benefit. Application for the funded part at a later age reduces an expected payout period, it is an indicator used in the equation to calculate the size of the insurance part and the size of the funded part of the labor pension benefit. Therefore, even given the same amount of accrued pension assets, the expected monthly size of the funded part of the labor pension benefit increases. Since expected periods of payout of the funded part of labor pension benefit are not set out in legislation, it is possible to estimate a degree of increase only on the basis of characteristics of the insurance part of the labor pension benefit set out in the Federal Law on Labor Pensions in the Russian Federation. Since in conformity with point 1 of Article 32 of the Federal Law On Labor Pensions in the Russian Federation, starting from 2011, the expected labor pension payout period exceeds 200 months, the reduction in the expected payout period by two months, all other conditions being equal, leads to an increase in the size of payments for the insured person roughly by 1%.

Besides, when the insured person reaches retirement age, he or she continues making contributions to the mandatory pension insurance system. If a person who has reached retirement age works, the employer continues making contributions for this person, including contributions to finance a funded part of the labor pension benefit. Consequently, pension assets set aside for the benefit of the individual will increase not only because of returns earned on investment but also because of new contributions. It is clear that continuation of labor activity in a job receiving a salary that is higher than the average salary earned during life will result in a substantial increase in pension assets. For such individuals possibility to increase pension assets will be a more important factor in making decision to terminate/to continue working upon reaching the age at which the individual becomes entitled to receive a pension benefit than for individuals who would like to change working conditions and find a relatively low paid job to increase the overall income level or change working conditions, i.e. to find a job with fewer working hours and easier work at a more convenient or safe place. But the same factor, i.e. a higher salary that encourages the employee to continue working, makes such individuals less desirable for employers. In this sense, only a shortage of labor in the market can change employers' attitude to elderly employees.

From the point of view of ensuring a future income level under the funded pillar, employees who plan to continue working beyond retirement age or who intend to defer application for the funded part of the labor pension benefit to a later age for some other reasons can afford to be more tolerant to market risks inherent to investments in equity or other instruments with a potentially higher yield.

The concept of investing pension assets set aside for the benefit of the insured persons of pre-retirement age is built on the idea of a gradual reduction in risks associated with an investment portfolio, in which pension assets are invested for those insured who have reached the age five years below the age set out in the Federal Law On Labor Pensions in the Russian Federation as the age that entitles people to receive an old age labor pension benefit (60 years for men and 55 years for women)¹. That is why, it is advisable that an exception to this general rule be made for those insured individuals who do not intend to annuitize pension assets right upon reaching retirement age. To this end, an application based approach can be used, i.e. submission of a relevant application to the Pension Fund of the Russian Federation.

¹ For details see Section 4 of the Final Report

An application to defer assignment of the funded part of the labor pension benefit can serve as a ground to defer to a later period a transfer of pension assets set aside for the benefit of a given insured person to the asset managing company with an investment declaration that is consistent with requirements set forth for the asset managing company by annuity reserve, if the period between the year this application is submitted and the expected year of application for the funded part of the labor pension is six and more years. As a switch to a more conservative investment strategy is planned to begin five years in advance, this application is to be submitted six years in advance.

If subsequently the insured person changes his/her decision and advises the Pension Fund of Russian Federation of this decision, procedures for accelerated transfer of pension assets to the asset managing company by annuity reserve can be used in such cases. This transfer is envisaged for cases when the insured person makes decision to reduce the period of continued labor activity regarding five years indicated previously.

To implement the aforesaid approach, the Pension Fund of the Russian Federation is to inform all insured one year before they reach pre-retirement age that their rights to choose an investment portfolio of the asset managing company are changed.

The provisions described earlier in the text are provided in Annex 4 in the form of a draft Federal Law.

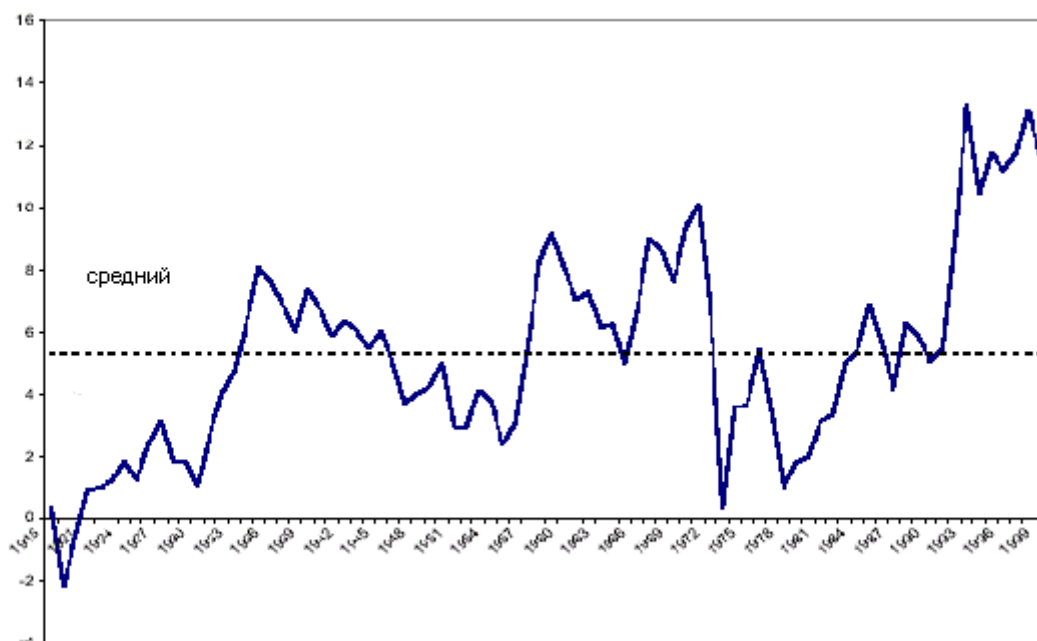
4. Recommendations on Investment Portfolio Profile for Investment of Pension Assets Formed to Benefit Participants of Pre-Retirement Age

A starting point in developing this issue was a provision of the Federal Law On Investment of Assets to Finance Funded Part of Labor Pension in the Russian Federation that sets out specific conditions, under which the insured person can enjoy his/her rights to select an investment portfolio of the asset managing company and a non-state pension fund at pre-retirement age. The law says that procedures describing how insured persons who have reached the age that is five years below the age set out in the Federal Law On Labor Pensions in the Russian Federation and entitles them to receive an old age labor pension can enjoy these rights are described in a separate federal law. Therefore, the law sets out that, with respect to persons who have reached pre-retirement age, investment of pension assets should be characterized by certain features and limitations regarding the right to choose an investment portfolio should be imposed. This provision is aimed to use more conservative investment during a period that precedes retirement of the insured person and annuitization of pension funds set aside to benefit this person. But the mechanism of using this approach is not described and there is reference to a separate law that should be adopted in developing a funded pillar of the pension system.

The approach that defines specific features of investment of pension assets of the insured persons who reach pre-retirement age makes it possible to take into account risks of investing pension assets in stock markets, and, first of all, volatility typical for the equity market and to reduce a potential negative impact of price volatility on income the insured persons will receive when they retire.

In principle, it is clear that a higher return on investments is achieved by a higher risk that is, first of all, reflected in a higher volatility. The extent to which this issue is relevant even for developed stock markets is shown by calculations conducted for equities of British companies. Figure 4.1 shows that while an average rate of return on investments in equity is 5% within 20-year periods, in some years it is close to zero, in other years, for example, in early 1990s it exceeds 12%.

Figure 4.1. Volatility of Return on Investments in Equity



Note. The Figure presents an average rate of return earned on investments in equity of British companies during 20-year periods. The return has been calculated taking into account reinvesting.

Source: FSA. Financing the future: mind the gap! The implications of an ageing population – key findings and proposed actions. 2002

For people who are at the age far from retirement age it is natural to seek higher investment returns usually earned on investments in equity, and short-term periods of downturn and upswing of the market do not have an immediate impact on the size of the benefit under a defined contribution scheme. But as retirement approaches, scheme members do not want a potential downturn caused by current conditions in the economic cycle or the capital market to have an impact on their future income. Their risk tolerance reduces. Therefore, a pension scheme member wants assets from his/her account to be invested in non-volatile instruments, such as bonds or instruments of the cash market even if returns on investments are lower than in case of investments in more risky assets.

In practice awareness of this pattern has led countries with established funded pension schemes to develop an investment strategy that takes into account age of the pension scheme member called Life Style Investment Strategy.

Life Style Investment Strategy can be defined as a strategy of asset allocation used mostly under defined contribution schemes when investments of a pension scheme member are adjusted depending on age and term to retirement. Usually assets are switched to bonds and high liquid instruments instead of equity as retirement approaches. The period during which such a switch should take place is something to discuss. In Great Britain it extends over ten years. An example of using this approach in the defined contribution scheme is provided in Annex 5.

Therefore, in defined contribution funded schemes there is a need to gradually switch assets/investments from equity, including units of mutual funds that invest in equity, to investments in bonds and cash market instruments.

At the same time Life Style Investment Strategy is not without its flaws. These flaws became quite apparent during a decline in the stock market that was observed at the turn of the twentieth and the twenty first century. For example, members may hold equity for too long and a downturn in the stock market can have a negative impact on expected earnings even though a strategy of gradual switch to other assets is applied. An unexpected early retirement can result in a substantial decrease in pension income.

To eliminate these flaws, a British consulting company Lane Clark & Peacock LLP (LCP) has proposed an upgraded version of Life Style Investment Strategy that it has called DCisive. The company argues that compared to a conventional Life Style Investment Strategy, its approach increases chances of receiving a reasonable rate of return on investment by more than 20%. The process is fully automated, but is carried out separately for each member.

The strategy proposed makes it possible to focus on a long-term objective and capture good investing results when the equity market goes through an upswing period. When the market starts declining, it creates a certain degree of protection for members, which is not provided by a conventional Life Style Investment Strategy. As an initial step, it is required to set a desirable level of investment return for the pension scheme. When a scheme member's earnings exceed a set value, assets are switched so that the earnings made can be preserved and future risks can be reduced. It is done by switching a carefully calculated percentage of assets from equity to bonds (usually on a quarterly basis). This technique protects these assets from any future decline in the equity market. Monitoring is conducted as an additional measure of risk reduction so that a percentage of equity in the member's portfolio under DCisive Strategy does not exceed a percentage of equity that this portfolio would have in case a conventional Life Style Investment Strategy is applied.

The use of Life Style Investment Strategy is not mandatory for pension scheme members who can choose investment instruments. Moreover, advisability of its use depends on a number of factors that include, among other things, such factors as what other sources of income the person will have upon retirement; what percentage of his/her income pension benefits paid out of the DC scheme will constitute. If it is a small part of assets that a scheme member has, it is not recommended that he/she be forced to use Life Style Investment Strategy, at least, in those countries where the practice of individual savings is quite common.

Information on a member's age is a prerequisite for investment with the use of Life Style Investment Strategy approach. As a rule, the asset manager of relevant investment funds has such information. Based on the information on the member's age and the age set for annuitization of pension accruals, a decision is made regarding both a switch of assets accrued and allocation of new contributions among instruments.

Another requirement for efficient application of Life Style Investment Strategy is a developed stock market. H. Twiss puts the right emphasis to this issue in his report on Issues of incorporating mutual investment funds and investment funds in funded pillar of pension system¹. In order to organize investments using principles of Life Style Investment Strategy, a number of

¹ Final report of Hugh Twiss, international consultant for the World Bank project "Issues of incorporating mutual investment funds and investment funds in funded pillar of pension system", 2004

investment funds that have different investment strategies and risk level are used. When funds are selected, managers of assets of scheme members should keep track of the situation to ensure that historical changes over time of instruments, in which assets of different funds are invested, do not correlate.

Given the Russian configuration of the pension system, not all preconditions for using Life Style Investment Strategy exist. It is also necessary to weigh all pros and contras of a mandatory requirement to follow the strategy aimed to reduce risks of the investment portfolio as retirement approaches. One should take into account that in the Russian pension system the funded pillar is supplemental to the basic part and the insurance part of labor pension benefit based on a “pay-as-you-go” principle and do not depend on fluctuations of the stock market. Besides, the current contribution rate paid to the funded part of the labor pension benefit is such that this part of the benefit will not be a main source of income for the insured when they retire. Consequently, from this point of view, the insured are less sensitive to fluctuation of this part of the benefit compared with the systems where the funded part of the benefit prevails.

The overall size of the benefit (taking into account all components of the system) for most pensioners will not be high. From this point of view, exclusion of equities (that have the highest potential for increase in price) as people reach pre-retirement age is a controversial decision. Of course, there is temptation to ignore basic laws of the stock market relying on the upward potential of Russian enterprises’ shares so that the insured that can only count on a relatively small size of the labor pension benefit can get as high supplemental payment to their pension accruals as possible and not to switch investments from equity to more conservative instruments.

At the same time the funded pension system is a state system, and the state bears responsibility, though indirectly, for the size of income the insured person will get when he/she retires on the basis of investment of mandatory contributions that were made by his/her employers in the past. It applies especially to those insured who did not switch to a non-state pension fund.

That is why, a cautious investor strategy looks more logical; moreover it is this approach that was adopted when the Federal Law On Investment of Assets to Finance Funded Part of Labor Pension in the Russian Federation was being prepared. Though the funded part of the labor pension benefit is only one of the components of future pension income of the insured persons that supplements income received from the basic part and the insurance part of the labor pension benefit, this law imposed rather tough limitations on investment of pension assets. On the one hand, this approach was intended to demonstrate to the population that the government is aware of all risks associated with investment of assets in the stock market. On the other hand, this law took into account, to the maximum extent possible, the current level of the Russian stock market development and its infrastructure that do not have a long history, rich traditions and are often subject to speculative moods.

Besides, it is necessary to take into account that an overwhelming majority of population does not have personal experience of investing pension assets in the stock market, systematic knowledge of fundamental principles underlying investment decisions. In such conditions investment legislation performs a public education function as well. To a certain extent, through legislation on investment of pension assets the state sets standards of behavior for a prudent and cautious investor. In this context, it is quite justified that the life cycle factor is taken into account.

Taking into account considerations mentioned earlier, it is advisable that basic principles of Life Style Investment Strategy be used to organize investment of pension assets set aside for the

benefit of the insured persons of pre-retirement age, i.e. to use the philosophy of gradual change of asset allocation in favor of less risky as the insured persons reach pre-retirement age. At the same time this principle should be applied only to those insured who have not selected a non-state pension fund and continue accumulating pension funds in the Pension Fund of the Russian Federation. In addition to that, a differentiated approach should apply to this group of the insured as well. If an insured person intends to continue working upon reaching a normal retirement age or for other reasons intends to defer application to collect a funded part of the labor pension benefit, switch of his/her accruals to more conservative assets should be deferred.

At the same time not all elements of Life Style Investment Strategy, and an advanced version of Life Style Investment Strategy can apply to the Russian system. For example, individualized data on the insured are maintained in the Pension Fund of the Russian Federation and asset managing companies do not have access to such data. Data on the assets are recorded in a special part of individual accounts of the insured by the Pension Fund of the Russian Federation only once a year, while the Fund reviews applications submitted by the insured persons once a year as well. In these conditions application of an individual approach to the insured persons is limited and employees of the Pension Fund of the Russian Federation cannot perform functions that are assigned to administrators and pension consultants in corporate pension schemes. In their turn, Russian asset managing companies do not yet apply Life Style Investment Strategy for individual investors in the retail market.

Nevertheless, the very principle of gradual reduction in the risk level associated with the investment portfolio for those insured who are of pre-retirement age can be used.

Main conditions are as follows:

1. Accrued pension assets of the insured persons of pre-retirement age are gradually switched to instruments with low volatility.
2. The period, during which risk level of investments is reduced, is five years (it follows from already adopted provisions of the Federal Law On Investment of Assets to Finance Funded Part of Labor Pension in the Russian Federation).
3. The profile of the assets in which accrued pension assets of the insured persons of pre-retirement age are invested gradually becomes similar to the profile of the assets, in which assets of the annuity investment portfolio are allowed to be invested (See Table 4.1). Equity is excluded from the investment portfolio of such insured persons by the time they reach a normal retirement age.
4. At the same time due to specific features of the Federal Law On Investment of Assets to Finance Funded Part of Labor Pension in the Russian Federation, the investment portfolio of those insured persons who have retained their assets in a state asset managing company turns out to be less diversified as the investment portfolio of the state asset managing company can include only government papers of the Russian Federation, cash in rubles and foreign currency kept in accounts in banking institutions, mortgage securities issued in conformity with Russian Federation Law on securitization if they are guaranteed by the Russian Federation.

Table 4.1. Comparison of Types of Assets Allowed for Investment of Accrued Pension Assets by the State Asset Managing Company and for the Annuity Investment Portfolio

Asset Categories Allowed for Investment	
of accrued pension assets set aside for the benefit of the insured persons who have not used their right to select an investment portfolio of the asset managing company in conformity with the Federal Law On Investment of Assets to Finance Funded Part of Labor Pension of the Russian Federation	of assets of the annuity investment portfolio in conformity with the Federal law On Procedures for Financing Payments from Funded Part of Labor Pension and Specific Features of Investment of Pension Savings Set Aside for the Benefit of Individuals of Pre-retirement Age and Retirement Age in the Russian Federation
1) government papers of the Russian Federation; 2) cash kept in accounts in banking institutions; 3) mortgage securities issued in conformity with Russian Federation law on securitization if they are guaranteed by the Russian Federation	1) government papers of the Russian Federation; 2) government papers of regions of the Russian Federation; 3) municipal bonds; 4) cash kept in accounts in banking institutions; 5) deposits in rubles in banking institutions; 6) bonds of Russian companies; 7) units (shares, stakes) of mutual funds that place assets in government papers of foreign states and bonds of other foreign issuing entities

That is why, in principle, assets from a state asset managing company do not necessarily have to be switched to a conservative investment portfolio. Accrued pension assets can be transferred from the state asset managing company directly to an annuity investment portfolio when a funded part of the labor pension benefit is assigned to the insured persons. But earnings from a conservative investment portfolio may be expected to be higher. That is why, in the interests of the insured persons it is possible to choose an option when assets from the main portfolio of a state asset managing company are gradually switched to a conservative investment portfolio and from this conservative investment portfolio are then switched to the investment portfolio of the asset managing company by annuity reserve.

5. A conservative investment portfolio can be offered by any asset managing company that has a trust management agreement with the Pension Fund of the Russian Federation¹.
6. Accrued pension assets are transferred from the asset managing company selected by the insured persons if its investment declaration turns out to be more risky than the investment declaration set for a conservative investment portfolio.
7. Assets of the insured persons who have reached pre-retirement age and accumulate the funded part of their labor pension benefit in the Pension Fund of the Russian Federation

¹ In order to implement this provision, changes need to be introduced to the Federal Law On Investment of Funds to Finance Funded Part of Labor Pension in the Russian Federation. Such changes are at the stage of agreement by ministries and agencies and have been reviewed in section 2 of the report. But the issue of ranking investment portfolios by degree of risks remains pending.

but intend to apply for the funded part of the labor pension benefit at a later age are not to be switched to a conservative investment portfolio.

8. Accrued assets of the insured persons who have already selected an investment portfolio that is similar to a conservative portfolio with respect to the level of risk are not to be switched to a conservative investment portfolio.
9. In the event an insured person does not submit an application to transfer accrued pension assets to a conservative investment portfolio that this insured person has selected and does not express intention to defer application for the funded part of the labor pension benefit, the Pension Fund of the Russian Federation transfers accrued pension assets set aside for the benefit of this insured person to a conservative investment portfolio of a state asset managing company if the investment declaration of the asset managing company that has already been selected by this insured person does not correspond to the risk level of a conservative investment portfolio.
10. After accrued pension assets of the insured persons are switched to instruments with low volatility, these assets will still be invested using conservative investment portfolios selected by the insured persons until they apply for the funded part of the labor pension benefit, after which these assets are switched to an annuity investment portfolio.
11. The profile of the assets in the annuity investment portfolio is the same as that of conservative investment portfolios, but there is only one annuity investment portfolio for the whole system and it is managed by the asset managing company by assets of annuity reserve (in conformity with the Federal Law On Procedures for Financing Payments from Funded Part of Labor Pension and Specific Features of Investment of Pension Savings Set Aside for the Benefit of Individuals of Pre-Retirement and Retirement Age in the Russian Federation approved by the Government of the Russian Federation, it should be an entity whose founder and the only owner is the Government of the Russian Federation).
12. It is planned to ensure a free selection of an investment portfolio of the asset managing company for those insured persons, whose pension assets have not been switched in full amount to a conservative investment portfolio, with respect to the balance of assets that are not to be switched during the current year.

Proposals for using this approach have been presented in the form of the text of a draft law in Annex 6.

To implement this approach, the recording and accounting system for accrued pension assets kept on individual accounts in the Pension Fund of the Russian Federation should be improved as the current philosophy behind its organization does not imply that accrued pension assets set aside for the benefit of the insured persons can be kept in several asset managing companies at the same time.

Given changes in age limitations for participants of the funded pillar of the mandatory pension system introduced in summer 2004, the issue of implementing the principle of reduction of investment risk level for the insured persons that approach retirement age will not become relevant in the practical context until several years from now.

ANNEX 1 Adjustment coefficients for basic and insurance parts of labor pensions and for estimated pension capital

Table 1. Adjustment coefficient for the basic part of the labor pension

Date from which adjustment is made	Adjustment coefficient	Basis
March 1, 2005	1.3636	Calculation in accordance with Table 2
August 1, 2004	1.0628	Calculation in accordance with Table 2
April 1, 2004	1.038	Calculation in accordance with Table 2
August 1, 2003	1.08	GoR Resolution No. 428 dated July 16, 2003
February 1, 2003	1.06	GoR Resolution No. 47 dated January 24, 2003
August 1, 2002	1.09	GoR Resolution No. 535 dated July 18, 2002
February 1, 2002	1.065	GoR Resolution No. 42 dated January 24, 2002

Table 2. Adjusted amount of the basic part of the old-age labor pension

Date from which adjustment is made	Amount of basic part, rubles	Basis
March 1, 2005	900	<i>Law On Introducing Amendments to the Federal Law 'On Labor Pensions in the Russian Federation' in View of Determination of the Amounts of the Basic Parts in Labor Pensions and of the Procedures for Indexing Basic and Insurance Parts of the Labor Pension in 2005, No. 3-Φ3</i>
August 1, 2004	660	GoR Resolution No. 363 dated July 21, 2004
April 1, 2004	621	GoR Resolution No. 142 dated March 15, 2004
August 1, 2003	598.02	
February 1, 2003	553.72	
August 1, 2002	522.38	
February 1, 2002	479.25	
January 1, 2002	450	<i>Federal Law On Labor Pensions in the Russian Federation</i>

Table 3. Adjustment coefficient for the insurance part of the labor pension

Date from which adjustment is made	Adjustment coefficient	Basis
August 1, 2004	1.0628	GoR Resolution No. 363 dated July 21, 2003
April 1, 2004	1.09 (additional increase in accordance with subparagraph 5 of	GoR Resolution No. 142 dated March 15, 2004

	paragraph 7 of Article 17 of the Law <i>On Labor Pensions in the Russian Federation</i>)	
August 1, 2003	1,08	GoR Resolution No. 428 dated July 16, 2003
April 1, 2003	1.126 (additional increase in accordance with subparagraph 5 of paragraph 7 of Article 17 of the Law <i>On Labor Pensions in the Russian Federation</i>)	GoR Resolution No. 152 dated March 13, 2003
August 1, 2002	1.09	GoR Resolution No. 535 dated July 18, 2002
February 1, 2002	1.065	GoR Resolution No. 42 dated January 24, 2002

Table 4. Adjustment coefficient for the estimated pension capital of the insured persons

Date from which adjustment is made	Adjustment coefficient	Basis
January 1, 2003	1.177	GoR Resolution No. 141 dated March 15, 2004
January 1, 2002	1.307	GoR Resolution No. 152, dated March 13, 2003

ANNEX 2 List of non-state pension funds (NSPF) authorized to carry out mandatory pension insurance activities

No	Name of NSPF	License number	License issue date	Founders	Number of branches	City	Website
1	NSPF <i>INTERROS-DOSTO-INSTVO</i>	1	09.10.95	AKB Rosbank, Finkom – Investitsii i Upravlenie OOO, Interros Estate ZAO	4	Moscow	www.dostoinstvo.ru
2	Power Industry NSPF	3	09.10.95	Astrakhanenergo OAO, Vladimirenergo OAO, Dal'energo OAO, Kostromskaya GRES OAO, EES Rossii RAO, Mordovenergo OAO, and others (42 founders in all)	19	Moscow	www.powerindustry.ru
3	NSPF <i>Iset'-Fond</i>	9/2	09.10.95	N/a	N/a	Ekaterinburg	
4	NSPF <i>LUKOIL-GARANT</i>	11	27.10.95	LUKOIL Oil Company OAO, Petroleum Fund for Industrial Rehabilitation and Development OAO, International Association of Trade Union Organizations at LUKOIL Oil Company, Flims Engineering AOZT, Pressinvest-1 OAO, V. A. Invest OOO	8	Moscow	www.lukoil-garant.ru
5	NSPF <i>Gefest</i>	12/2	26.04.04*	N/a	N/a	Moscow	http://sheks.ru
6	NSPF Promstroibank Pension Fund	15	27.10.95	N/a	N/a	St. Petersburg	
7	NSPF <i>SURGUTNEF-TEGAZ</i>	22/2	26.04.04	N/a	N/a	Surgut	
8	NSPF <i>Almaznaya Osen'</i>	23	30.11.95	N/a	N/a	Yakutia	
9	NSPF <i>Sotsialnaya Zashchita Starosti</i> (Social Protection of the Elderly)	27	03.01.96	Magnitogorsk Metallurgical Combine OAO, Magnitogorsk City Administration, SKM Insurance Company, Metallurg Charity Public Fund, Trade Union Committee at MMK OAO, Mekom OOO, Chelyabinsk Metal Works ZAO, Magnezit	2	Magnitogorsk	www.magnitogorsk.ru

No	Name of NSPF	License number	License issue date	Founders	Number of branches	City	
				Combine OAO, ChTPZ Group 3AO			
10	NSPF <i>Promagrofond²</i>	28/2	16.04.04	Mikhailovskii Mining-Concentration Combine OAO, Stoilenskii Mining-Concentration Combine OAO, <i>Stoilenskaya Niva</i> APK	3	Moscow	www.promagrofond.ru
11	NSPF <i>Capitan</i>	29	03.01.96	N/a	N/a	St. Petersburg	
12	NSPF <i>Parma</i>	36	07.02.96	N/a	N/a	Perm	
13	Non-state Pension Fund <i>Resurs</i>	40/2	07.02.1996	N/a	N/a	N/a	
14	NSPF First Pension Fund	52/2	16.04.04	Management Tsentra Managing Company, Management Consulting OOO	-	Moscow	www.management-tsentra.ru
15	NSPF Siberian Interregional	55	20.02.96	N/a	N/a	Krasnoyarsk	
16	Khanty-Mansiiskii NSPF	56	20.02.96	N/a	N/a	Khanty-Mansiisk	
17	NSPF TNK-Vladimir	57/2	21.05.04	Tyumen Oil Company OAO	2	Vladimir	www.tnk.ru/tnk
18	NSPF Reiffeisen (former <i>Dobroye Delo</i>)	67/2	16.04.04*	Reiffeisen Bank	-	Moscow	
19	NSPF <i>BLAGO</i>	71	15.03.96	Russian Trade Union of Nuclear Industry and Power Sector Workers, TVEL, <i>Russian Funds</i> Investment Group	1	Moscow	http://www.russianfunds.ru
20	NSPF St. Petersburg	75	28.03.96	N/a	N/a	St. Petersburg	
21	Interregional Non-state <i>Greater Pension Fund</i> (noncommercial social welfare organization)	78/2	26.04.04*	N/a	N/a	Moscow	
22	NSPF <i>VERNOST³</i>	79/2	16.04.04*	N/a	N/a	Moscow	
23	NSPF <i>GARMONIYA</i>	81/2	27.07.04*	N/a	N/a	Moscow	
24	Moskovskii Gorodskoi	86/2	21.05.04*	Bank Moskvyy, <i>Stankoinstrument</i>	-	Moscow	www.bankmoskvy.ru

No	Name of NSPF	License number	License issue date	Founders	Number of branches	City	V
	NSPF			Manufacturing Enterprise OOO, <i>Stroikcontract</i> OOO, <i>Promkondensator</i> OOO, <i>Akkumulyator</i> Production Association OOO, <i>KIB</i> Information Engineering Firm			
25	NSPF <i>Erel</i>	89	02.04.96	N/a	N/a	Yakutsk	http://
26	NSPF <i>Telecom-Soyuz</i>	94	09.04.96	N/a	N/a	Moscow	
27	NSPF <i>Port-Garant</i>	102	16.04.96	N/a	N/a	Vladivostok	
28	NSPF PENSION FUND OF SIBERIA	103	16.04.96	N/a	N/a	Mezhdurechensk	
29	NSPF for the Defense and Industry Complex ⁴	106/2	21.05.04*	N/a	N/a	St. Petersburg	
30	NSPF <i>Semeinyi</i>	118/2	26.04.04*	<i>Vanadii Kachkanar</i> Mining-Concentration Combine, <i>Uraltransbank</i> OAO, <i>Mayak Urala</i> ZAO, <i>Ekaterinburgskaya telefonnaya set'</i> OAO, Media Star Producers Firm ZAO, and others (13 Urals companies in all)	3	Ekaterinburg	www.r
31	<i>Lefko</i> Non-state Pension Fund	132	26.04.1996	N/a	N/a	Moscow	
32	Intersectoral Professional NSPF	138	03.06.96	N/a	N/a	Tula	
33	NSPF <i>APK-Fond</i>	140/2	21.05.04*	N/a	N/a	Moscow	
34	NSPF Independent Professional Pension Fund	151/2	21.05.04*	National Reserve Bank AKB, <i>Promdorimport</i> ZAO, <i>Resursfinprom</i> ZAO, <i>VTK Promexim</i> ZAO, <i>TRANSSTROI</i> Corporation OOO, Moscow City Public Organization of Retirees – Veterans of Wars, Labor, and the Army, Consolidated Guarantee Fund <i>NARFOND</i>	-	Moscow	http://

No	Name of NSPF	License number	License issue date	Founders	Number of branches	City	
35	NSPF <i>Rostvertol</i> ⁵	158/2	21.05.04*	N/a	N/a	Rostov-on-Don	
36	NSPF <i>Soglasnye</i>	163/2	26.04.04*	N/a	N/a	Moscow	
37	NSPF <i>Strategiya</i>	166	25.06.96	BiS Financial Group	1	Perm	www.np
38	NSPF <i>Kooperatsiya</i>	181	26.06.1996	N/a	N/a	Moscow	
39	NSPF <i>Ural-AIL</i>	182/2	21.05.04*	N/a	N/a	Perm	
40	NSPF <i>Garantiya</i>	184	28.06.96	Russian Development Bank, <i>Russkiye Pensii</i> Company, <i>Energostroikomplekt</i> ZAO, <i>Deklait</i> OOO	1	Moscow	www.n
41	<i>DOROGA</i> , Interregional Transport NSPF	192	09.07.96	Interregional Transport Commercial Bank, Roads Committee at the Railways Trade Union, Rostovskaya Trastovaya Kompaniya OAO, <i>Donkhlebbank</i> Commercial Bank, <i>Trastferta</i> OOO, <i>Finansovyi Dom</i> OOO, and others (16 founders in all)	12	Rostov-on-Don	www.n
42	NSPF <i>SAMPO</i>	195	09.07.96	N/a	N/a	Moscow	
43	National Non-state Fund for Pensions and Social Welfare Provision to Metallurgy Workers	200	18.07.96	International Union of Metallurgists, <i>TEKhNOMET</i> AO, West-Siberia, Novolipetsk, Nizhnii Tagil, and Kuznetsk metallurgical combines, Oskol electrometallurgical factory, Electrostal' metallurgical factory, Zlatoust, Vyksa, and Ashinsk metallurgical works	5	Moscow	www.rusmet.ru/
44	NSPF <i>Blagodenstvie</i>	201/2	18.07.96	East Siberia Railways Company, Roads Trade Union at the East Siberia Railways, East Siberia Transport Commercial Bank, East Siberia Railways Joint-Stock Insurance Company	13	Irkutsk	www.bl
45	NSPF	203/2	21.05.04*	N/a	N/a	Moscow	

No	Name of NSPF	License number	License issue date	Founders	Number of branches	City	V
	<i>Nadezhda</i>						
46	Interregional NSPF for Workers of Automotive, Tractor, and Agricultural Machine Building	219/2	26.04.04*	N/a	N/a	Moscow	
47	<i>Pensionnyi Kapital</i> NSPF	222/2	16.04.04*	LUKOIL-Nizhegorodnefteorgsintez OAO, Firma Varya subsidiary company	N/a	Moscow	www
48	NSPF for Transport Builders (<i>Transstroj</i>)	227	02.12.1996	N/a	N/a	Moscow	
49	<i>Zheleznodorozhnyi</i> NSPF	229	02.12.96	N/a	N/a	Nizhnii Novgorod	
50	<i>BLAGOSOSTOYANIE</i> NSPF	234	02.12.96	Russian Railways OAO	18	Moscow	
51	<i>Pension-Invest</i> NSPF	263	22.04.97	N/a	N/a	Chelyabinsk	
52	NSPF <i>GAZFOND</i>	274/2	21.05.04*	Gazprom, Gazprombank ZAO, <i>Urengoigazprom</i> OOO, <i>Yamburggazdobycha</i> OOO, <i>Yugtransgaz</i> OOO	-	Moscow	www
53	<i>Natsionalnyi</i> NSPF	288	22.07.97	N/a	N/a	Moscow	
54	NSPF <i>Generalnyi Pensionnyi Fond</i>	291/2	21.05.04*	N/a	N/a	Reutov	
55	<i>StalFond</i> NSPF	296	28.07.97	N/a	N/a	Cherepovets	N/a
56	<i>INITSIATIVA</i> NSPF ¹	300/2	21.05.04*	N/a	N/a	St. Petersburg	
57	<i>SEVERNYI</i> Pan-regional NSPF	307	01.12.97	Koryak Autonomous Okrug Administration, Leningrad Oblast Administration, Magadan Oblast Administration, Murmansk Oblast Administration, Nenets Autonomous Okrug Administration, Taimyr (Dolgano-Nenetskii) Autonomous Okrug Administration, Chukotka Autonomous	-	St. Petersburg	www

No	Name of NSPF	License number	License issue date	Founders	Number of branches	City	
				Okrug Administration, Yamalo-Nenets Autonomous Okrug Administration			
58	<i>Sotsialnoye razvitiye</i> NSPF	308/2	21.05.04*	N/a	N/a	Lipetsk	
59	<i>Victoria-Fond</i> NSPF	311/2	26.04.04*	N/a	N/a	Saratov	
60	<i>Dorozhnyi</i> NSPF	313/2	21.05.04*	N/a	N/a	Moscow	
61	NSPF <i>Budushee svoimi rukami (Your Future Is in Your Hands)</i>	315/2	21.05.04*	N/a	N/a	Moscow	
62	NSPF First National Pension Fund	317	31.12.97	<i>Elemash</i> Machine Building Factory, Khrunichev State Scientific-and-Production Center for Outer Space, Moscow Polymetals Factory, Research Institute for Chemical Machine Building, <i>MAX</i> Moscow Joint Stock Insurance Company, <i>Conversbank</i> ZAO, and others	4	Moscow	www.nspf.ru
63	NSPF <i>Sotsium</i>	320/2	26.04.04*	<i>Bazovyyi Element</i> Company	5	Moscow	www.nspf.ru
64	<i>AKVILON</i> Interregional NSPF	326	11.02.00	N/a	N/a	Moscow	
65	<i>SBEREGATE-LNYI</i> NSPF	331	30.03.00	Leningrad Oblast Government, <i>Metallurg</i> OAO, Syaskii Pulp and Paper Mill, <i>Vyborgskaya Tsellyuloza</i> OOO, <i>STEK Gruppya</i>	-	St. Petersburg	www.nspf.ru
66	<i>Sistema</i> NSPF	341	02.10.02	<i>AFK Sistema</i> OAO, <i>Mobilnye Telesistemy</i> OAO, <i>MGTS</i> OAO, <i>MTU-Inform Kompaniya</i> ZAO, <i>AKB MBRR</i> OAO, <i>ROSNO</i> OAO, <i>Medsi</i> ZAO	-	Moscow	www.nspf.ru
67	<i>Neftegarant</i> NSPF	344/2	26.04.04*	N/a	N/a	Moscow	
68	NSPF of Alfa-Bank OAO	345/2	27.07.04*	N/a	N/a	Moscow	
69	NSPF <i>Defense</i>	347	29.10.00	N/a	N/a	Moscow	

No	Name of NSPF	License number	License issue date	Founders	Number of branches	City	
	<i>and Industry Fund</i>						
70	NSPF <i>ROSNO-Wimm-Bill-Dann</i>	351	22.12.00	<i>ROSNO Company, Wimm-Bill-Dann Produkty Pitaniya OAO</i>	-	Moscow	www
71	NSPF <i>First Industrial Alliance</i>	359	20.03.01	N/a	N/a	Kazan	
72	NSPF <i>PROFESSI-ONALNYI</i>	360/2	21.05.04*	N/a	N/a	Surgut	
73	NSPF <i>Ural-Siberian Pension Fund</i>	361/2	16.04.04*	Ural-Siberian Bank OAO	2	Moscow	http://npf
74	NSPF <i>PROM-REGION-SVYAZ</i>	362	21.05.01	Promsvyazbank AKB, <i>Argumenty i Fakty ZAO, Reebok Rossiya ZAO, Babaevskii Confectionery Factory OAO, Aviaservis OAO, and others</i>	14	Moscow	www
75	NSPF <i>VNIIEF-GARANT</i>	364	14.06.01	N/a	N/a	Sarov	
76	NSPF <i>Moskovskii Delovoi Mir</i>	372/2	27.07.04*	N/a	N/a	Moscow	
77	NSPF <i>PROGRESS-DOVERIE</i>	373	25.10.01	<i>Business i Pravo Consulting Group</i>	-	Moscow	www
78	NSPF <i>PENSION-NAYA KASSA</i>	375	16.11.01	N/a	N/a	St. Petersburg	
79	NSPF <i>Volga-Kapital</i>	377	31.01.02	N/a	N/a	Kazan	
80	NSPF <i>UGMK-Perspektiva</i>	378	08.02.02	N/a	N/a	Ekaterinburg	
81	<i>Bersil, National NSPF of Tatarstan Republic</i>	380/2	21.05.04*	N/a	N/a	Kazan	

Data as of December 2004

Notes:

* - date of license re-issuance

- ¹ – License suspended on 20.04.2001; renewed on 16.05.2002
- ² – License suspended on 19.07.2000; renewed on 20.03.2001
- ³ – License suspended on 07.12.2001; renewed on 08.02.2002
- ⁴ – License suspended on 16.02.2001; renewed on 26.04.2002
- ⁵ – License suspended on 22.04.1997; renewed on 25.02.1999

Sources:

1. Non-State Pension Funds Inspectorate, Ministry of Labor and Social Development (<http://npfinsp.mintrud.ru>)
2. National League of Management Companies (www.nlu.ru)
3. Information and Research Portal of the Pension Industry (<http://fundshub.ru>)
4. Website of the Pension Fund of the Russian Federation (www.pfrf.ru)
5. Website of the Federal Service for Financial Markets (www.fscm.ru)

ANNEX 3 Portfolio Selection Prototype Developed by Queisser and Whitehouse

Portfolio selection menu offers to pension plan participants investments with different risk / return indicators. This objective may be achieved even with the help of a simple set of base options that are not summarized in practice but may be generally described as funds with conservative investment strategy (monetary market tools, bonds, bank deposits), balanced (mixed assets, including both shares and bonds), more aggressive strategies implemented primarily through investment in various-risk stock.

Besides investment portfolio risks, Queisser and Whitehouse¹ propose to take into account participants' sophistication in terms of understanding the capital market. Hence, in each risk class of investment portfolio they propose to use different number of fund offers to the pension plan participants recognizing their positioning by the level of knowledge.

Table 1. Investment Portfolios: Three Levels of Investment Choice for Pension Plan Participants

	Base set	Advanced base set	Full set
Risk / returns	Stable cost	Monetary market tools Diversified bonds Conservative - life style	Monetary market tools Diversified bonds Conservative - life style
	Balanced	Moderate - life style Aggressive - life style	Moderate - life style Aggressive - life style
	Stock of large national companies	Stock of large national companies	Stock of large national companies
	Stock of international companies	Stock of international companies	Stock of international companies
	Stock of second echelon national companies	Stock of second echelon national companies	Stock of second echelon national companies Stock of developing markets companies Investment through own broker

Note: Portfolios are placed in the order of growing risk and returns.

Option “**Base Set**” is designed for the less experienced pension plan participants.

Fund “Stable Cost” is offered to the most conservative investors. This fund may be either a deposit or (in the USA) a guaranteed investment contract. Moving down the table, investments (based the historical experience) become more volatile though offering higher returns. Fund “Balanced”, for example, may be allocated, for example, in proportion 50 : 50 or 60 : 40 among shares and less risky tools such as government or corporate bonds. Fund “Stock of second echelon national companies” has the highest risk.

Option “**Advanced Base Set**” is for more experienced investors.

¹ Monika Queisser and Edward Whitehouse Individual Choice in Social Protection: The Case of Swiss Pensions, OECD social, employment and migration working papers 2003

Here the authors recommend a broad choice in the conservative zone: funds “Tools of monetary market” and exclusively bond portfolio (“Diversified bonds” in the table). This group also includes funds **Life Style** represented by the “Conservative - life style”, “Moderate - life style” and Aggressive - life style” in the table. This is to secure an automatic adjustment of portfolios during participant’s life cycle: from a higher risk and returns on the portfolio to more stable investment when the participant approaches the retirement age.

Option “**Full Set**” is a recommendation for those participants who believe themselves to be most experienced in investment issues.

Additional opportunities are provided here to choose the higher risk zone. They may include funds “Stock of developing market companies” and “Investment through own broker” when participants may buy shares on their own choice.

ANNEX 4 Draft Federal Law “Peculiarities of Realization of Right to Choose Investment Portfolio (asset management company) by Citizens of Pre-Retirement Age Who Intend to Continue Service After Retirement Age”

Draft

Federal Law

Federal Law “Peculiarities of Realization of Right to Choose Investment Portfolio (asset management company) by Citizens of Pre-Retirement Age Who Intend to Continue Service after Retirement Age”

Article 1. Basic Definitions and Terms Used in this Law

For the purposes of this Federal Law, the following definitions and terms shall be used:

Pre-retirement age means an age five and less years before the age when an individual becomes eligible for an old-age labor pension benefit;

Pre-retirement age individuals are the insured who have reached or reach in the current year an age five years less than the age established by Federal Law “On Labor Pensions in the Russian Federation” as age making an individual eligible for an old-age labor pension, but who have not reached the age making an individual eligible for an old-age labor pension.

Article 2. Peculiarities of Realization of Right to Choose Investment Portfolio (asset management company) by Citizens of Pre-Retirement Age

The insured who have reached an age five years less than the age making an individual eligible for an old-age labor pension may postpone transfer of pension assets set aside on their behalf from the management company chosen by them to a management company investment declaration of which meets the requirements set for the conservative investment portfolio and continue enjoying the rights established by Federal Law “On Investment of Funds for Financing Funded Part of Labor Pension in the Russian Federation”, Article 31, subparagraphs 1 and 2, if they intend to request assignment of the funded part of old-age labor pension at the age exceeding the age set by Federal Law “On Labor Pensions in the Russian Federation” as the age making an individual eligible for an old-age labor pension. This right shall be realized through submission to the RF Pension Fund of an application requesting a deferment of assignment of the funded part of the old-age labor pension (hereinafter the labor pension funded part assignment deferment application) in an order established by this Federal Law.

Article 3. Procedure of Realization of Right to Choose Investment Portfolio (asset management company) by Citizens of Pre-Retirement Age and Retirement Age

1. The RF Pension Fund shall send to all the insured who have reached an age five years less than the age making an individual eligible for an old-age labor pension one year before they reach the pre-retirement age a notice of peculiarities of realization of a right to choose an investment portfolio (asset management company). The notice shall indicate that the insured may

choose a management company with investment declaration not meeting the conservative investment portfolio requirements only if they send an application to the RF Pension fund requesting deferment of assignment of the funded part of the old-age labor pension.

2. The RF Pension Fund shall send notifications of conservative investment portfolio requirements compliance (incompliance) of the investment declaration of the management companies that shall have been chosen by the insured who realized their right to choose an investment portfolio (management company) but not sent the deferment application to the RF Pension Fund and not started transfer of pension assets to the management company through annuity reserve funds annually till the insured individual applies for assignment of the funded part of labor pension.

3. The insured who have reached or reach during the current year the pre-retirement age but who shall have not sent to the RF Pension Fund an application for deferment of assignment of the funded part of the old-age labor pension, as well as the insured who shall have not sent to the RF Pension Fund a new application for deferment of assignment of the funded part of the old-age labor pension six years before the year indicated by them in the last deferment application, in case of realization of rights set by Federal Law “On Investment of Funds for Financing Funded Part of Labor Pension in the Russian Federation”, Article 31, subparagraphs 1 and 2, may choose a management company only if its investment declaration meets the conservative investment portfolio requirements.

Upon expiration of the period of time when the insured may defer transfer of pension assets to the management company with an investment declaration meeting the conservative investment portfolio requirements, in case a new deferment application and application for transfer of pension assets are not submitted, the RF Pension Fund shall transfer pension assets set aside for such individual to the state management company if the investment declaration of the management company chosen by such individual previously does not meet the conservative investment portfolio requirements.

4. The application for deferment of assignment the funded part of the old-age labor pension shall indicate the year till which the insured intends to postpone the assignment of the funded part of the old-age labor pension.

5. Six years before the year indicated in the application of the insured for deferment of assignment of the funded part of the old-age labor pension, the RF Pension Fund shall send to the insured a notice of peculiarities of the procedure of realization of a right to choose an investment portfolio (management company). The notice shall indicate that the insured may choose a management company with investment declaration not meeting the conservative investment portfolio requirements only if he/she sends to the RF Pension Fund a new deferment application indicating a year later than in the previous application. At the same time, the RF Pension Fund shall send to all insured mentioned in paragraph 1 of this item who shall have realized the right to choose an investment portfolio (management company), a notification of conservative investment portfolio requirements compliance (incompliance) of the investment declaration of the management companies that shall have been chosen by the insured.

6. Procedure for pension assets transfer to a management company with investment declaration meeting the conservative investment portfolio requirements shall be set in accordance with the Federal Law.

Article 4. Procedure of Submission by the Insured and Review by the RF Pension Fund of Application for Deferment of Assignment of Funded Part of Labor Pension and Transfer of Pension Assets

1. The insured shall submit to the RF Pension Fund applications for deferment of assignment of the funded part of labor pension and transfer of pension assets within a timeframe for submission of a statement of choice of an investment portfolio (management company) established by Federal Law “On Investment of Funds for Financing Funded Part of Labor Pension in the Russian Federation”.

2. Application for deferment of assignment of the funded part of labor pension shall present grounds for postponing the transfer of pension assets set aside for the given insured individual to a management company with an investment declaration meeting the conservative investment portfolio requirements, if the period between the deferment application year and expected year of application for assignment of the funded part of labor pension is six years and more. In this case the insured may within a period of time five years less than the deferment period enjoy the rights established by Federal Law “On Investment of Funds for Financing Funded Part of Labor Pension in the Russian Federation”, Article 31, subparagraphs 1 and 2, and a decision to transfer pension assets set aside for the given insured to a management company with an investment declaration meeting the conservative investment portfolio requirements shall be made five years before the year indicated in the deferment application.

3. Application for deferment of assignment of the funded part of labor pension shall not represent grounds for postponing transfer of pension assets set aside for the insured to a management company with an investment declaration meeting the conservative investment portfolio requirements, if the period between the deferment application year and expected year of application for assignment of the funded part of labor pension is five years and less.

Pension assets set aside for the insured shall be transferred from the management company chosen by him/her earlier to a management company with an investment declaration meeting the conservative investment portfolio requirements, if the insured individual earlier used the right to choose an investment portfolio (management company) and the investment declaration of the management company does not meet the conservative investment portfolio requirements.

4. Forms of applications for deferment of assignment of the funded part of labor pension and on transfer of pension assets, as well as instructions on completion of these documents shall be approved by the RF Government.

5. The RF Pension Fund shall send forms of applications for deferment of assignment of the funded part of labor pension and on transfer of pension assets, as well as instructions on completion of these documents to the insured indicated in Article 4, item 1, Article 3, item 5 of this Federal Law within the timeframe established by Federal Law “On Investment of Funds for Financing of Funded Part of Labor Pension in the Russian Federation” for mailing statements on choice of an investment portfolio (management company).

6. Applications for deferment of assignment of the funded part of labor pension and transfer of pension assets shall be reviewed by the RF Pension Fund by December 1.

7. Application for deferment of assignment of the funded part of labor pension shall be disregarded if it is submitted:

- by an individual not indicated in Article 4, item 1, Article 3, item 5 of this Federal Law;
- beyond the timeframe established for submission of the deferment application;
- by an individual who shall have sent to the RF Pension Fund earlier a deferment application indicating the same or a later date of expected application for assignment of the funded part of labor pension that shall have been executed by the RF pension Fund.

8. Application for transfer of pension assets may be declined if:

1) Transfer application submitted by a due individual indicates a management company:

- with an investment declaration not meeting the conservative investment portfolio requirements;
- that by the transfer application date shall have announced suspension (termination) of acceptance of pension assets of new applicants (insured) for management;
- whose asset management agreement shall have been terminated by the time of review of the transfer application by the RF Pension Fund.

2) Transfer application submitted by a due individual is executed in a form not established by law.

Submission of the application for deferment of assignment of the funded part of labor pension shall not represent grounds for declining the application for transfer of pension assets to a management company with investment declaration not meeting the conservative investment portfolio requirements.

9. Application for transfer of pension assets shall be disregarded if it is submitted:

- by a an individual not indicated in this Federal Law, Article 4, item 1, Article 3, item 5;
- beyond the timeframe established for submission of the transfer applications.

10. Shall the application for transfer of pension assets not indicate the method of pension assets transfer (one-time or gradual), the RF Pension Fund shall transfer pension assets gradually in a manner set in this Federal Law, Article 3, item 6.

11. The RF Pension Fund shall notify the applicant in writing about declining his/her application for deferment of assignment of the funded part of labor pension and / or application or transfer of pension assets or about disregarding these applications not later than on December 31 of the current year indicating the reasons for rejection (disregard) and also respond to applicant's inquiry about the results of the review of his/her applications within three months of the inquiry date.

12. The RF Fund shall notify the applicants in a form that provides for confirmation of the notification receipt. Notification expenses shall be borne by the sender of this notification.

13. If the insured individual disagree with the decision made by the RF Pension Fund regarding the application for deferment of assignment of the funded part of labor pension and /

or transfer of pension assets, he/she may challenge such decision in court at the place of residence. An individual challenging decision of the RF Pension Fund in court under this article shall be exempt of the duty according to the RF legislation.

Article 5. Procedure for Execution by the RF Pension Fund of Decisions Made on Applications of the Insured for Deferment of Assignment of Funded Part of Labor Pension and Transfer of Pension Assets

If application on deferment of assignment of the funded part of labor pension is submitted by the insured in respect of whom the RF Pension Fund started to transfer pension assets to a management company with an investment declaration meeting the conservative investment portfolio requirements:

a) shall the insured have sent to the RF Pension Fund an investment portfolio (management company) statement in accordance with provisions of Federal Law “On Investment of Funds for Financing Funded Part of Labor Pension in the Russian Federation”, the RF Pension Fund shall cease transferring pension assets to the management company with an investment declaration meeting the conservative investment portfolio requirements. All pension assets set aside for such individual shall be transferred to the management company chosen by him/her following the procedure and timeframe established by Federal Law “On Investment of Funds for Financing Funded Part of Labor Pension in the Russian Federation” to transfer pension assets in accordance with the investment portfolio (management company) choice statement made by the insured;

b) shall the insured have not sent to the RF Pension Fund an investment portfolio (management company) statement in accordance with provisions of Federal Law “On Investment of Funds for Financing Funded Part of Labor Pension in the Russian Federation”, the RF Pension Fund shall continue transferring pension assets to the management company with an investment declaration meeting the conservative investment portfolio requirements.

Annex 5: Life Style Investment Options

The below example demonstrates the translation of the Life Style investment strategy into practice under the corporate retirement plan of a British company.

For those who want to get actively engaged into the investment strategy, this retirement plan offers two Life Style investment options. Both of them channel investment into funds selected with a view to increasing the amounts on the retirement account prior to the retirement of a participant. As a participant's retirement age is approaching, the amounts accumulated on his pension account, start to be invested into funds which can ensure the preservation of the savings in a manner considered to be most efficient by the management of the retirement plans (this process is called "switching-off").

Proposed Funds for Participants the Life Style Investment Options:

Life Style Investment Option: the Barclays Global Investors:

- Barclays Global Investors Aquila Life 60/40 Global Equity Fund.
- Barclays Global Investors Aquila Life Over 5 Years UK Index-Linked Gilt Index Fund.
- Barclays Global Investors Aquila Life Corporate Bond Over 15 Years Fund.
- Barclays Global Investors Aquila Life Cash Fund.

Life Style Investment Option: the Merrill Lynch:

- Merrill Lynch 70/30 Global Equity Fund.
- Merrill Lynch Pre-Retirement Fund.
- Merrill Lynch Cash Fund.

Guidelines for Participants:

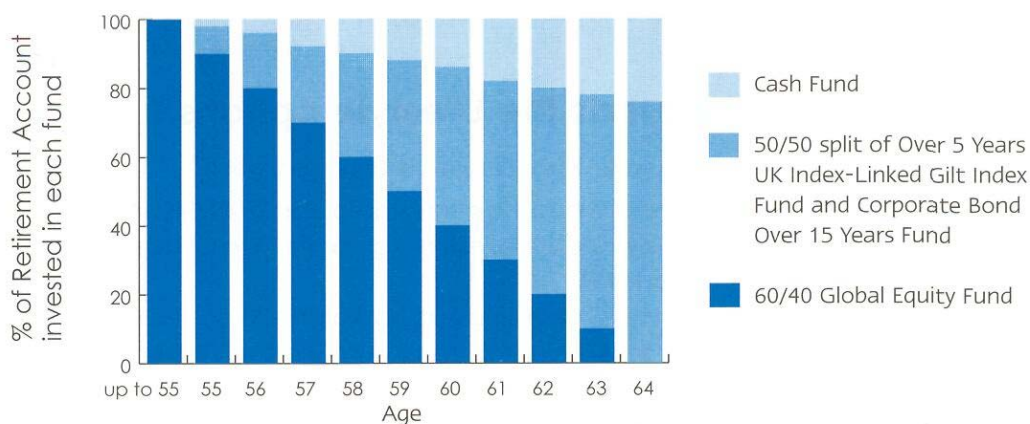
We may choose only one Life Style Investment option. We may use this plan if you want to have your past as well as future fees invested under one strategy.

You may also invest into any other available funds though some of the funds accessible for depositing accumulated amounts under the Life Style investment are also available for private deposits. Therefore, if you choose a mix of one of one Life Style investment options with one or

more private investment funds, you will have to check whether the funds are open for investment under the selected Life Style strategy. Otherwise, unintentionally, you may invest your money twice in one and the same fund.

Life Style Investment Option: the Barclays Global Investors

The diagram below shows your retirement account investment and the process of switching-off in case you select the Life Style investment option of the Barclays Global Investors.



The horizontal axis depicts ages from 55 years and older. The vertical axis shows the percentage of the retirement account invested into each of the funds.

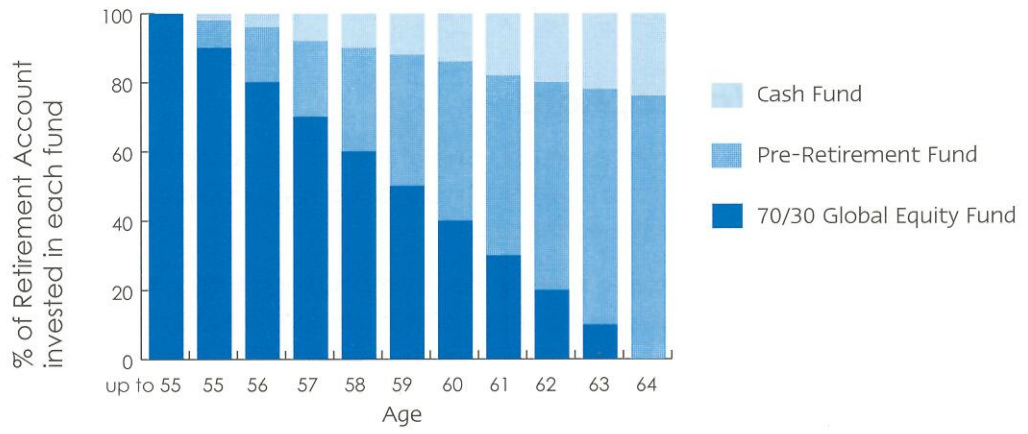
The fund (from top downward): Cash Fund; 50/50 Split of over 5 years UK Index-Linked Gilt Index Fund and Corporate Bond over 15 years Fund; and 60/40 Global Equity Fund.

Life Style Investment Option: the Merrill Lynch

The diagram shows your retirement account investment and the process of switching-off in case you select the Life Style investment option of the Merrill Lynch.

The horizontal axis depicts ages from 55 years and older. The vertical axis shows the percentage of the retirement account invested into each of the funds.

The fund (from top downward): Cash Fund; Pre-Retirement Fund; 70/30 Global Equity Fund.



ANNEX 6 Draft Federal Law on Investment Arrangements for Pension Savings Made for the Benefit of Preretirees in the Russian Federation.

Draft

FEDERAL LAW

Investment Arrangements for Pension Savings Made for the Benefit of Preretirees in the Russian Federation

Article 1. Major Concepts and Terms Used in This Federal Law

For the purposes of this Federal Law, major concepts and terms shall have the following meanings:

“A conservative investment portfolio” means an investment portfolio made up of pension savings by a management company acting under a Pension Plan Trust Agreement with the Pension Fund of the Russian Federation whose investment declaration meets the requirements to asset composition and structure set forth herein;

“The preretirement age” means an age five or less years below the age which entitles to the old-age labor pension;

“Preretirees” means insurants who, during the current year, have reached or will reach the age five years below the age which entitles to the old-age labor pension as established by the Federal Law on Labor Pensions in the Russian Federation, but are still under that age.

Article 2. Peculiarities of the Process Whereby Preretirees and Retirees Exercise Their Right to Investment Portfolio (Management Company) Selection

1. The proceeds of pension savings made for the benefit of preretirees shall be invested as established herein.

If an insurant eligible for the assignment of the fully funded part of the labor pension before the age which entitles to the old-age labor pension has not applied for the assignment of the fully funded part of the labor pension before the preretirement age, the proceeds of pension savings made for his/her benefit shall be invested as established herein starting from the year when he/she reaches the preretirement age.

2. After an insurant has reached the preretirement age, the proceeds of pension savings made for his/her benefit shall be transferred to a conservative investment portfolio as established herein.

This paragraph shall not apply to pension savings made by management companies within their conservative investment portfolios.

3. If the insurant referred to in paragraph 1 above intends to apply for the assignment of the fully funded part of the old-age labor pension at an age above the one established in the Federal Law on Labor Pensions in the Russian Federation as an age which entitles to the old-age labor pension, he/she may postpone the transfer of pension savings made for his/her benefit to a conservative investment portfolio and continue to enjoy the rights established in Articles 31.1.1 and 31.1.2 of the Federal Law on Investment of the Fully Funded Part of Labor Pension in the Russian Federation. The above right shall be exercised as established by a separate Federal Law.

4. When exercising their rights to select an investment portfolio (management company) and join the Pension Fund of the Russian Federation as specified in Articles 31.1.1 and 31.1.3 of the Federal Law on Investment of the Fully Funded Part of Labor Pension in the Russian Federation, and the second paragraph of Article 36.8.1 of the Federal Law on Nongovernmental Pension Funds, insurants may select only a conservative investment portfolio.

An insured preretiree may move to the Pension Fund of the Russian Federation only if the composition and structure of the investment portfolio managed by the nongovernmental pension fund responsible for the fully funded part of the labor pension formed for the benefit of such preretiree meet the requirements to the composition and structure of conservative investment portfolio assets set forth herein.

When exercising his/her rights established in Article 31.1.2 of the Federal Law on Investment of the Fully Funded Part of Labor Pension in the Russian Federation, the insurant who has reached or will reach the preretirement age during the current calendar year may select a nongovernmental pension fund only if the mandatory pension insurance agreement between such insurant and the selected nongovernmental pension fund provides for a lifelong annuity in respect of the fully funded part of the labor pension as established by a separate Federal Law.

5. When an insurant who has reached the preretirement age but has not applied for the assignment of the fully funded part of the labor pension exercises his/her rights established in Article 31.1.2 of the Federal Law on Investment of the Fully Funded Part of Labor Pension in the Russian Federation, he/she may select only a conservative investment portfolio in a management company operating under a Pension Plan Trust Agreement with the Pension Fund of the Russian

Federation. The above rights shall be exercised as described in Article 11 of the Federal Law on Investment of the Fully Funded Part of Labor Pension in the Russian Federation.

6. The proceeds of pension savings made for the benefit of an insurant who has not selected any investment portfolio (management company), shall be transferred to the conservative investment portfolio of the governmental management company during the year when such insurant reaches the preretirement age, and the transfer time and procedure shall be consistent with the provisions of Article 3.3 hereof.

Article 3. Implementation of Preretirees' Right to Investment Portfolio (Management Company) Selection

1. All insurants referred to in Article 2.1 hereof who earlier used their right to select an investment portfolio (management company) shall be notified by the Pension Fund of the Russian Federation of the peculiarities of the process whereby preretirees shall exercise the rights established in Article 31.1 of the Federal Law on Investment of the Fully Funded Part of Labor Pension in the Russian Federation, as described herein.

The Pension Fund of the Russian Federation shall send such notifications to the insurants within the timeframe established for the dissemination of documents relating to investment portfolio (management company) selection in the Federal Law on Investment of the Fully Funded Part of Labor Pension in the Russian Federation.

The format of the notifications shall be established by the Federal Executive Authority responsible for the regulation of pension savings formation and investment. Every year but, not later than September 30, the Federal Executive Authority for monitoring and supervision of pension savings formation and investment shall publish a list of conservative investment portfolios to which insurants who have reached or will reach the preretirement age during the current year may transfer pension savings made for their benefit.

2. If the investment declaration of the investment portfolio selected earlier by an insurant who has reached or will reach the preretirement age during the current calendar year does not meet the requirements set forth in Articles 7 and 8 hereof, the proceeds of pension savings made for the benefit of such insurant shall be transferred to the conservative investment portfolio of a management company as from the year when the insurant reaches the preretirement age, and in compliance with the procedure described herein.

Pension savings may be transferred to a conservative investment portfolio gradually or as a lump sum, at the insurant's discretion, as indicated in his/her request for pension savings transfer to the conservative investment portfolio (hereinafter "the request for pension savings

transfer”). The insurant shall send the request to the Pension Fund of the Russian Federation as specified in Article 4 hereof and within the timeframe established for the submission of request for investment portfolio (management company) selection in the Federal Law on Investment of the Fully Funded Part of Labor Pension in the Russian Federation.

The forms of the requests for pension savings transfer and instructions how to fill in the requests shall be approved by the Government of the Russian Federation.

The Pension Fund of the Russian Federation shall send the forms of the requests for pension savings transfer and instructions how to fill in the requests to insurants who have reached the age five or less years below the age which entitles to the old-age labor pension within the timeframe established for the dissemination of the forms of the requests for investment portfolio (management company) selection in the Federal Law on Investment of the Fully Funded Part of Labor Pension in the Russian Federation.

3. If an insurant did not submit the request for pension savings transfer, the Pension Fund of the Russian Federation shall transfer pension savings made for his/her benefit from the management company selected earlier by such insurant to the conservative portfolio of the governmental management company, provided the investment declaration of the investment portfolio within which the pension savings are invested does not meet the requirements set forth in Articles 7 and 8 hereof, and, in doing that, shall comply with paragraph 4 below.

Pension savings made for the benefit of an insured preretiree shall be transferred to the conservative portfolio of the governmental management company within the number of years equal to the difference between the age which entitles to the assignment of the old-age labor pension and the age reached by the insurant during the current calendar year. If the number of years so established is more than five, the pension savings shall be transferred within 5 years.

4. In case the proceeds of pension savings shall be gradually transferred to the conservative investment portfolio within 5 years, the first-year transfer shall cover 20 percent of the amount recorded in the special part of the insurant’s earmarked account within the individual pension registration system of the Pension Fund of the Russian Federation as of January 1 of the year when the request for pension savings transfer was submitted, plus the investment income generated between the date on which pension savings are reflected in the individual registration system and the date of the transfer. The Pension Fund of the Russian Federation shall transfer to the conservative investment portfolio the amount equivalent to pension insurance contributions paid for the insurant during the past year plus the net financial outcome of their temporary investment. The second-year transfer shall cover 25 percent of the amount of pension savings still held in the management company selected earlier by the insurant plus all pension insurance

contributions paid for the insurant during the past year and the net financial outcome of their temporary investment. The third-year transfer shall cover 35 percent of the amount of pension savings still held in the management company selected earlier by the insurant plus all pension insurance contributions paid for the insurant during the past year and the net financial outcome of their temporary investment. The fourth-year transfer shall cover 50 percent of the amount of pension savings still held in the management company selected earlier by the insurant plus all pension insurance contributions paid for the insurant during the past year and the net financial outcome of their temporary investment. The fifth-year transfer to the specified management company shall cover the remaining pension savings still held in the management company selected earlier by the insurant plus all pension insurance contributions paid for the insurant during the past year and the net financial outcome of their temporary investment.

In case the proceeds of pension savings shall be transferred within 4 years, the first-year transfer shall cover 25 percent of the amount recorded in the special part of the insurant's earmarked account within the individual pension registration system of the Pension Fund of the Russian Federation as of January 1 of the year when the request for pension savings transfer was submitted, plus the investment income generated between the date on which pension savings are reflected in the individual registration system and the date of the transfer. The Pension Fund of the Russian Federation shall transfer to the conservative investment portfolio the amount equivalent to pension insurance contributions paid for the insurant during the past year plus the net financial outcome of their temporary investment. The second-year transfer shall cover 35 percent of the amount of pension savings still held in the management company selected earlier by the insurant plus all pension insurance contributions paid for the insurant during the past year and the net financial outcome of their temporary investment. The third-year transfer shall cover 50 percent of the amount of pension savings still held in the management company selected earlier by the insurant plus all pension insurance contributions paid for the insurant during the past year and the net financial outcome of their temporary investment. The fourth-year transfer shall cover the remaining pension savings still held in the management company selected earlier by the insurant plus all pension insurance contributions paid for the insurant during the past year and the net financial outcome of their temporary investment.

In case the proceeds of pension savings shall be transferred within 3 years, the first-year transfer shall cover 35 percent of the amount recorded in the special part of the insurant's earmarked account within the individual pension registration system of the Pension Fund of the Russian Federation as of January 1 of the year when the request for pension savings transfer was submitted, plus the investment income generated between the date on which pension savings are

reflected in the individual registration system and the date of the transfer. The Pension Fund of the Russian Federation shall transfer to the conservative investment portfolio the amount equivalent to pension insurance contributions paid for the insurant during the past year plus the net financial outcome of their temporary investment. The second-year transfer shall cover 50 percent of the amount of pension savings still held in the management company selected earlier by the insurant plus all pension insurance contributions paid for the insurant during the past year and the net financial outcome of their temporary investment. The third-year transfer shall cover the remaining pension savings still held in the management company selected earlier by the insurant plus all pension insurance contributions paid for the insurant during the past year and the net financial outcome of their temporary investment.

In case the proceeds of pension savings shall be transferred within 2 years, the first-year transfer shall cover 50 percent of the amount recorded in the special part of the insurant's earmarked account within the individual pension registration system of the Pension Fund of the Russian Federation as of January 1 of the year when the request for pension savings transfer was submitted, plus the investment income generated between the date on which pension savings are reflected in the individual registration system and the date of the transfer. The Pension Fund of the Russian Federation shall transfer to the conservative investment portfolio the amount equivalent to pension insurance contributions paid for the insurant during the past year plus the net financial outcome of their temporary investment. The second-year transfer shall cover the remaining pension savings still held in the management company selected earlier by the insurant plus all pension insurance contributions paid for the insurant during the past year and the net financial outcome of their temporary investment.

Moneys referred to in paragraphs 1-4 above shall be transferred within the timeframe established by Article 34.1 of the Federal Law on Investment of the Fully Funded Part of Labor Pension in the Russian Federation, except the amount of pension insurance contributions paid for the insurant during the last transfer year and the net financial outcome of their temporary investment which the Pension Fund of the Russian Federation shall transfer to the management company not later than June 30 of the following year.

If the proceeds of pension savings are transferred to the conservative investment portfolio as a lump sum, the amount reflected in the special part of the earmarked account as of the transfer date adjusted for the investment income generated between the date on which pension savings are reflected in the individual registration system and the date of the transfer shall be transferred within the timeframe established Article 34.1 of the Federal Law on Investment of the Fully Funded Part of Labor Pension in the Russian Federation, and the amount of pension

insurance contributions paid for the insurant during the year preceding the transfer of pension savings to the conservative investment portfolio plus the net financial outcome of their temporary investment shall be transferred by June 30 of the year when the transfer shall be made.

For the purposes of this Article, the pension savings investment income and the net financial outcome of temporary investment of pension insurance contributions shall be defined pursuant to the Federal Law on Investment of the Fully Funded Part of Labor Pension in the Russian Federation.

5. If an insured preretiree submits a new request for investment portfolio (management company) selection after the commencement of pension savings transfer to the conservative investment portfolio, then:

1) In case the request specifies a conservative investment portfolio other than the one selected earlier by the insurant, the proceeds of pension savings already transferred to the conservative investment portfolio shall be transferred as a lump sum to the newly selected conservative investment portfolio, and the proceeds of pension savings to be transferred to the conservative investment portfolio pursuant to paragraphs 2 and 3 above shall be transferred to the newly selected conservative investment portfolio as established in paragraphs 2 and 3 above;

2) In case the request specifies an investment portfolio other than those included in the list of conservative investment portfolios published by the Federal Executive Authority for monitoring and supervision of pension savings formation and investment, the transfer to such portfolio shall include only the part of pension savings made for the benefit of the insurant in the management company selected by the insurant before the preretirement age which is not subject to the transfer to the conservative investment portfolio during the current year. If the transfer of pension savings to the conservative investment portfolio is to be completed during the current year, the Pension Fund of the Russian Federation shall not meet the request.

6. After the completion of pension savings transfer to the conservative investment portfolio, the insureds may exercise the rights established in Articles 31.1 and 31.2 of the Federal Law on Investment of the Fully Funded Part of Labor Pension in the Russian Federation, pursuant to **Article 2.5** hereof. In that case, the Pension Fund of the Russian Federation shall transfer the proceeds of pension savings between conservative investment portfolios as a lump sum, based on the insurant's request for investment portfolio (management company) selection.

Article 4. Submission of Requests for Pension Savings Transfer by Insurants and Their Review by the Pension Fund of the Russian Federation

1. An insurant may submit a pension savings transfer request to the local office of the Pension Fund of the Russian Federation at his/her place of residence either in person or in another manner. In the latter case, the check of the insurant's identity and authenticity of his/her signature shall be conducted as established for the requests for investment portfolio (management company) selection by the Federal Law on Investment of the Fully Funded Part of Labor Pension in the Russian Federation.

Requests submitted by insurants on sheets of paper other than the specified letterhead but in compliance with the fill-in instructions shall not be considered a breach of the procedure established herein. If an insurant submits more than one request for pension savings transfer within a calendar year, it is the first request that shall be reviewed.

2. A failure by an insurant to observe the procedure to submit the request for pension savings transfer shall not obligate the Pension Fund of the Russian Federation to take actions to exercise the insurant's right to a deferred assignment of the fully funded part of the labor pension.

3. A request for pension savings transfer may be rejected if:

1) The request submitted by an eligible individual specifies an investment portfolio whose investment declaration does not meet the requirements formulated in Articles 7 and 8 hereof;

2) The request submitted by an eligible individual specifies a management company:

- which does not have a conservative investment portfolio;

- which, by the time of request submission, has announced a suspension (termination) of the receipt of pension savings to be put into a trust for the benefit of new applicants (insurants); and/or

- whose Pension Plan Trust Agreement has been terminated (cancelled) by the time of the request review in the Pension Fund of the Russian Federation;

3) The request for pension savings transfer submitted by an eligible individual does not meet the fill-in instructions.

4. The request for pension savings transfer shall not be reviewed if:

- It was submitted by an individual other than those specified in Article 2.1 hereof; and/or

- The submission timing is not consistent with the one established for the submission of the request for pension savings transfer.

5. If the request for pension savings transfer does not specify how the proceeds of pension savings shall be transferred (as a lump sum or gradually), the Pension Fund of the

Russian Federation shall make the transfer gradually within 5 years as described in Article 2.4 hereof.

6. The Pension Fund of the Russian Federation shall notify the applicant in writing that his/her request for pension savings transfer has been rejected or shall not be reviewed within the timeframe established by Article 31.2 of the Federal Law on Investment of the Fully Funded Part of Labor Pension in the Russian Federation, specifying the reasons for the rejection (refusal to review), and reply to the insurant's request about the results of the review within 3 months after the receipt of the request.

7. The format of the notification sent to the applications by the Pension Fund of the Russian Federation shall allow certifying the notification issue. The relevant expenses shall be paid by the sender.

8. In the event an insurant does not agree with the decision made by the Pension Fund of the Russian Federation in respect of his/her request for pension savings transfer, he/she may contest the decision in court.

Article 5. Review by the Pension Fund of the Russian Federation of Preretirees' Requests to Join a Nongovernmental Pension Fund or the Pension Fund of the Russian Federation

1. Preretirees' requests to join a nongovernmental pension fund shall be reviewed as established in Article 36.9 of the Federal Law on Nongovernmental Pension Funds. Such requests shall not be satisfied for reasons specified in the Federal Law on Nongovernmental Pension Funds, or in case the request submitted by an eligible individual specifies a nongovernmental pension fund while the mandatory pension insurance agreement between the insurant and such nongovernmental pension fund does not provide for a lifelong annuity in respect of the fully-funded part of the labor pension.

2. Preretirees' requests to join the Pension Fund of the Russian Federation shall be reviewed as established in Article 36.10 of the Federal Law on Nongovernmental Pension Funds. A request shall not be satisfied:

- 1) For reasons specified in the Federal Law on Nongovernmental Pension Funds;
- 2) For reasons specified in Article 4.3 hereof; and
- 3) If the composition and structure of the investment portfolio managed by the nongovernmental pension fund responsible for the formation of the fully funded part of the labor pension for the benefit of the respective preretiree do not meet the requirements to the composition and structure of conservative investment portfolio assets set forth in Articles 7 and 8 hereof.

Article 6. Implementation by the Pension Fund of the Russian Federation of Decisions on Insurants' Requests for Pension Savings Transfer to and Joining the Pension Fund of the Russian Federation

1. If the Pension Fund of the Russian Federation has rejected or refused to review the request for pension savings transfer submitted by the insurant specified in Article 2.1 hereof, the proceeds of pension savings made for the benefit of such insurant shall be gradually transferred to the conservative investment portfolio of the governmental management company as established in Article 3.4 hereof.

2. While the proceeds of pension savings are being transferred to the management company whose investment declaration meets the requirements formulated in Articles 7 and 8 hereof, the investment outcome shall be recorded in the special part of the insurant's earmarked account separately for the part of the proceeds put into a trust in the management company to which pension savings are being transferred, and for the part of the proceeds which is still held in the management company selected earlier by the insurant.

3. Based on the request to join the Pension Fund of the Russian Federation made by an insured preretiree, the proceeds of his/her pension savings shall be transferred to the selected investment portfolio as a lump sum using the procedure and within the timeframe established in Article 36.12 of the Federal Law on Nongovernmental Pension Funds.

4. The proceeds of pension savings shall be transferred to the nongovernmental pension fund selected by an insured preretiree using the procedure and within the timeframe established in Article 36.12 of the Federal Law on Nongovernmental Pension Funds

5. The proceeds of pension savings made for the benefit of insured preretirees shall be transferred to conservative investment portfolios free of charge.

Article 7. Eligible Assets (Investment)

1. Proceeds comprising a conservative investment portfolio may be invested in eligible assets designed for the investment of annuity investment portfolio funds pursuant to the Federal Law on Financing the Payment of the Fully Funded Part of the Labor Pension and Peculiarities of Investing Pension Savings Made for the Benefit of Preretirees and Retirees in the Russian Federation.

2. Proceeds comprising a conservative investment portfolio may be invested in asset categories mentioned in paragraph 1 above only if they meet the requirement of the Federal Law on Investment of the Fully Funded Part of Labor Pension in the Russian Federation.

4. The Government of the Russian Federation may impose additional limitations on the investment of proceeds comprising a conservative investment portfolio.

Article 8. Requirements to the Structure of a Conservative Investment Portfolio

The structure of a conservative investment portfolio shall meet the requirements formulated in Article 9.1 of the Federal Law on Financing the Payment of the Fully Funded Part of the Labor Pension and Peculiarities of Investing Pension Savings Made for the Benefit of Preretirees and Retirees in the Russian Federation, as well as requirements of Articles 28.1.3 and 28.1.6 of the Federal Law on Investment of the Fully Funded Part of Labor Pension in the Russian Federation. Management companies in charge of conservative investment portfolios shall observe the provisions of Articles 9.2, 9.3 and 9.7 of the Federal Law on Financing the Payment of the Fully Funded Part of the Labor Pension and Peculiarities of Investing Pension Savings Made for the Benefit of Preretirees and Retirees in the Russian Federation, as well as Articles 28.5-28.9 of the Federal Law on Investment of the Fully Funded Part of Labor Pension in the Russian Federation.

Article 9. Pension Savings Transfer to Conservative Investment Portfolios When Insurants Reach the Preretirement Age

1. When insurants reach the preretirement age, the Pension Fund of the Russian Federation shall inform the respective management companies about amounts expected to be transferred from investment portfolios whose investment declarations are not consistent with the provisions of Articles 7 and 8 hereof to conservative investment portfolios, by March 15.

2. The governmental management company shall make monthly transfers from the conservative investment portfolio to the Pension Fund of the Russian Federation according to the annual transfer plan covering funds required to pay the fully funded part of the disability labor pension to eligible insurants.

3. Management companies in charge of conservative investment portfolios, including the governmental management company, shall make monthly transfers of pension savings to the Pension Fund of the Russian Federation according to the transfer plan covering pension savings

to be transferred due to the assignment of the fully funded part of the labor pension. When the functions of the governmental company and the annuity reserve management company are performed by the same entity, the transfers to be made pursuant to this paragraph shall cover the proceeds of pension savings from the conservative investment portfolio.

Article 10. Responsibilities of the Pension Fund of the Russian Federation Relating to Pension Savings Transfer to Conservative Investment Portfolios When Insurants Reach the Preretirement Age

The Pension Fund of the Russian Federation shall:

2) Prepare and deliver to management companies annual plans of pension savings transfer to the conservative investment portfolio of the governmental management company due to the assignment of the fully funded part of the timed disability labor pension;

3) Calculate and deliver to management companies, within the timeframe established herein, the expected amount of pension savings to be transferred to a conservative investment portfolio during the current year in view of the fact that an insurant has reached the preretirement age;

4) Transfer the proceeds of pension savings from the investment portfolio selected earlier by the insurant to a conservative investment portfolio in cases specified herein; and

5) In response to insurants' requests for the assignment of the fully funded part of the labor pension, transfer the proceeds of pension savings from the management companies selected by the insurants and the governmental management company to the annuity reserve management company, and when the functions of the governmental company and the annuity reserve management company are performed by the same entity, transfer the proceeds of pension savings from the conservative investment portfolio to the annuity investment portfolio.

Article 11. Public Regulation, Monitoring and Supervision of Pension Savings Transfer to Conservative Investment Portfolios When Insurants Reach the Preretirement Age

The Federal Executive Authority for monitoring and supervision of **pension savings formation and investment**, as agreed with the Federal Service for Financial Markets, shall determine, on the annual basis, whether the investment declarations of investment portfolios operated by management companies acting under Pension Plan Trust Agreements with the Pension Fund of the Russian Federation pursuant to the Federal Law on Investment of the Fully

Funded Part of Labor Pension in the Russian Federation, meet the requirements of this Federal Law, and by September 20 publish the list of conservative investment portfolios to which insureds who have reached or will reach the preretirement age during the current year may transfer pension savings made for their benefit.