



Global Employee Benefits Conference – Break-out session

Can pension and long-term savings plans succeed in Russia?

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TOWERS WATSON 

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Current Russian pensions market

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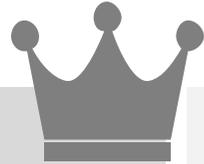
Looking to the future.....

Q&A

Introduction: Russian benefits environment

Cash is king –

Russian employees have a strong preference for immediate cash rewards over deferred pay arrangements, such as pension plans;



There is an unfortunate **mistrust** of financial organisations driven by past financial crises and therefore a hesitancy by employees to set aside savings for long periods;



Financial **awareness and education** on financial issues, particularly longer term ones is poor across the general population in Russia;

Design issues affecting pension solutions: e.g. complex local regulations, limited (but improving) tax effectiveness, investment restrictions, inadequate administration and member communication services from pension Providers;



There is **no history** of pension or long term savings in Russia and the current supplementary system has only been around for approximately 25 years;

Demographics – lower replacement ratio than under Soviet times, people living and working for longer periods, ageing demographics;



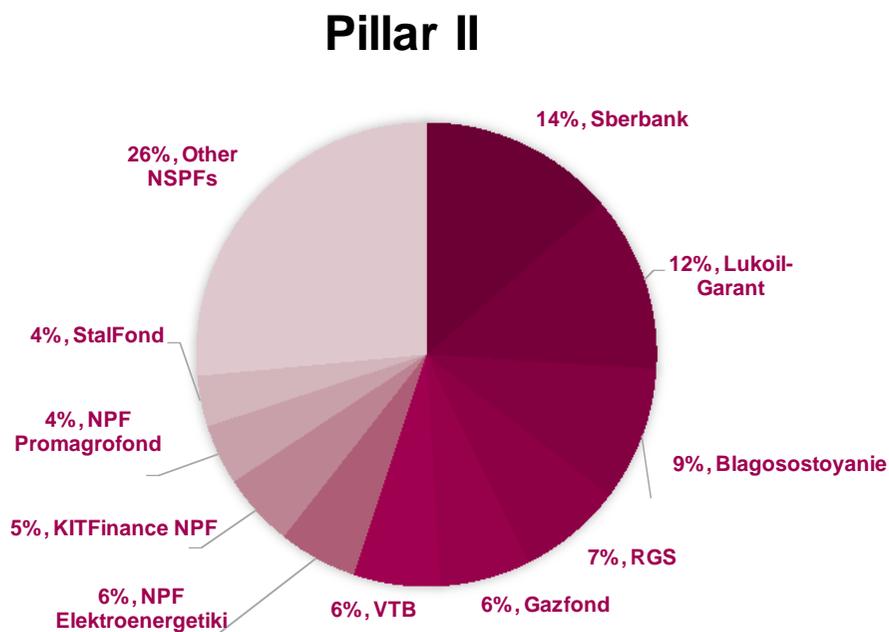
State pensions (from a full career) remain low and there is a clear need for longer-term savings to be accumulated to support old age and relieve the burden to the State system. Average State pension is currently around RUB 12,900 per month (USD 240).



For comparison, the average rent in Moscow for a one-bedroom, i.e. two room, apartment is around RUB 40,000 per month and the “shopping basket”, which mainly consists of basic food products necessary to survive, is around RUB 9,000 per month.

Russian Pensions market

- Supplementary pension provision remains minority practice in Russia with below 20% prevalence amongst multinational companies (Source: Towers Watson Russia Country Surveys 2014);
- According to a recent report by Goldman Sachs, 'The rise of Russian pension funds', private pension assets are currently \$64bn and anticipated to increase to \$200bn by 2020;
- There is continued consolidation of the Non-State Pension Funds towards a dominant group. Top 10 NSPFs have around 74% market share of Pillar II accumulations.
- Meanwhile, Pillar III market is dominated by Gazfond and Blagosostoyanie (63% of total market share). Top 5 NSPFs have 78% of Pillar III pension reserves.



Pillar III

NSPF Name	Asset (RUB millions)	% Market Share
Gazfond	335,310	35%
Blagosostoyanie	271,754	28%
NPF Transneft	62,169	6%
NPF Elektroenergetiki	39,895	4%
NPF Neftegarant	36,807	4%
Other NSPFs	195,777	22%

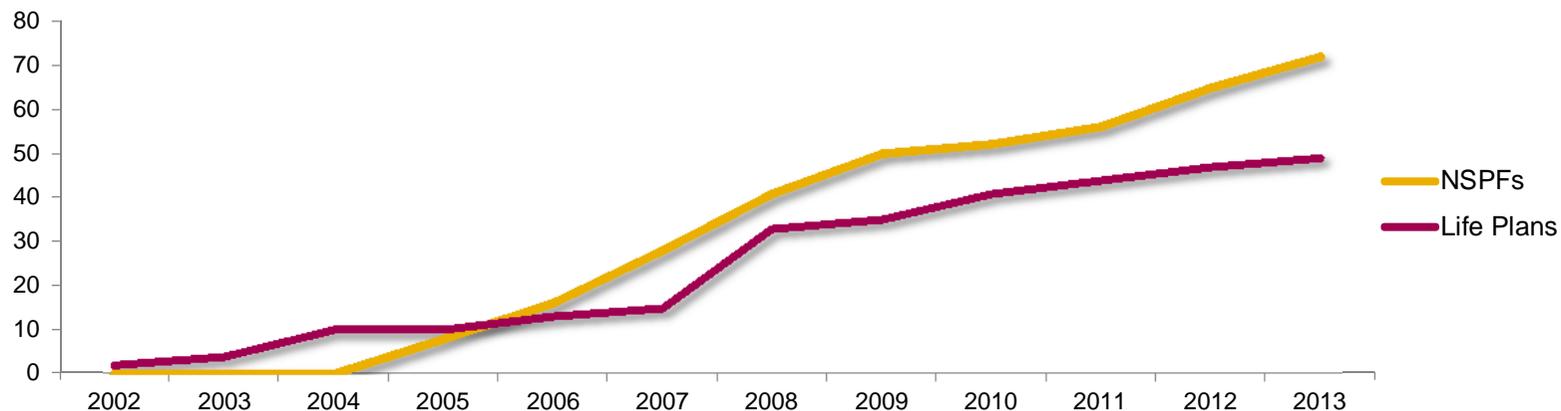
Source: www.ra-national.ru

Russian Pensions market (continued)

- The majority of local Russian employees have insufficient retirement savings arrangements and continue working after their State retirement age or rely on family support;
- Many companies in Russia have termination indemnity practices in place to support / encourage employee retirement, either as a formal or an informal arrangement – these are defined benefit obligations with volatile costs;
 - Russian labour code enables employees to work after normal retirement age.
- We are aware of some employers making one-off payments of 12 to 24 months' salary in termination indemnities to incentivise retirement. However this causes:
 - Irregular and heavy cashflow demand on business, one-off large payments need to be made to retirees;
 - Not tax effective;
 - Employees are typically worse off in the long term versus a longer-term savings plan, especially after the termination indemnity lump sum runs out.

Towers Watson Russian Pension Plan Study 2014

- Two vehicles commonly used in the local Russian market:
 - Non-State Pension Fund (NSPF) and Life Assurance Plans (LAP).
- NSPFs are more common than Life Assurance Plans;
- Chart below shows relative numbers of NSPF and LAPs since their inception:



- The LAP has been regarded as being marginally less tax-effective than the NSPF solution, though there are some tax code changes that may bring it in line, if approved.
- Legislative arrangements, reporting and the governance requirements around pension solutions are much more onerous than in basic insurance products.

Source: Towers Watson Russia Pension Plan Study (2014)

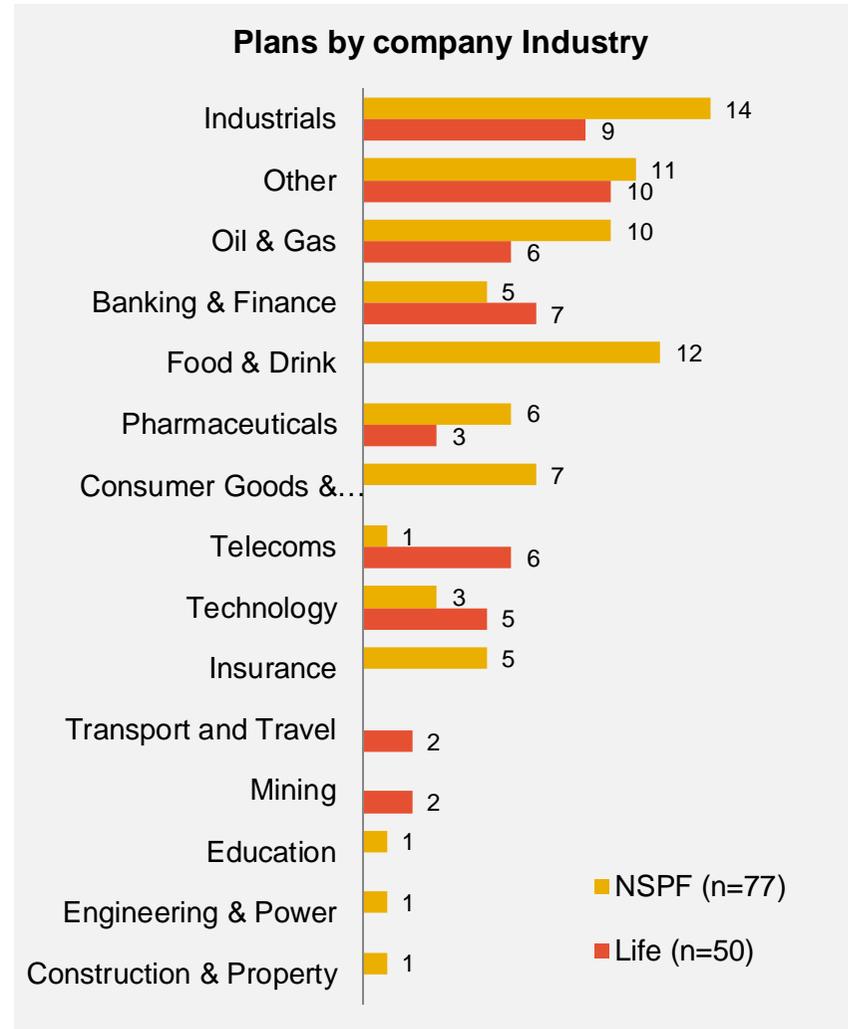
TW Russian Pension Plan Study 2014

Company HQ Region			
Options	NSPF (n=20*)	Life (n=41*)	Total (n=61*)
North America	20%	37%	31%
EMEA	55%	51%	52%
Russia / CIS	10%	10%	10%
Other	15%	2%	7%
Total	100%	100%	100%

*One provider was not able to confirm HQ regions

- The survey included 127 plans, including 77 NSPFs and 50 LAPs, from three Providers.
- Plans in Russia tend to focus locally only, and do not typically provide employee coverage to the neighboring CIS states.

Source: Towers Watson Russian Pension Plan Study (2014)



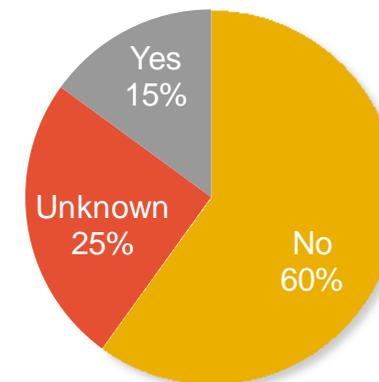
TW Russian Pension Plan Study 2014 (continued)

Employee Eligibility to join plan			
Options	NSPF (n=77)	Life (n=50)	Total (n=127)
All Local employees	74%	72%	73%
Grade-based eligibility	6%	0%	4%
Executives only	9%	18%	13%
Seniority-based: only after certain years of service	10%	4%	8%
Other	0%	6%	2%
Total	100%	100%	100%

Is there a waiting period for new hires before joining the plan?			
Options	NSPF (n=77)	Life (n=50)	Total (n=127)
No waiting period	18%	22%	20%
3 months	62%	64%	63%
1 year	13%	10%	12%
Other (include description in cell)	5%	4%	5%
Unknown	1%	0%	1%
Total	100%	100%	100%

- Plan eligibility appears to be extended to most local employees in around 75% of cases.
- Typical waiting period is 3 months.
- In LAPs surveyed, membership does not stop upon reaching retirement age.
- Some NSPF appear to differentiate by employee retirement age, as shown in the chart on the right.

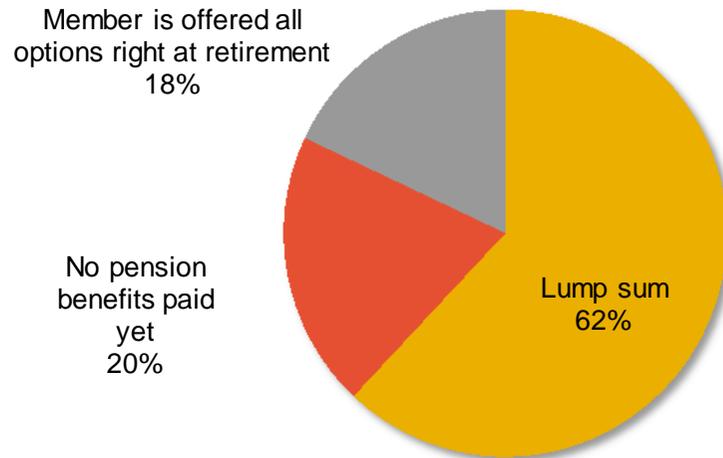
Does employee membership stop upon reaching retirement age? (NSPF)



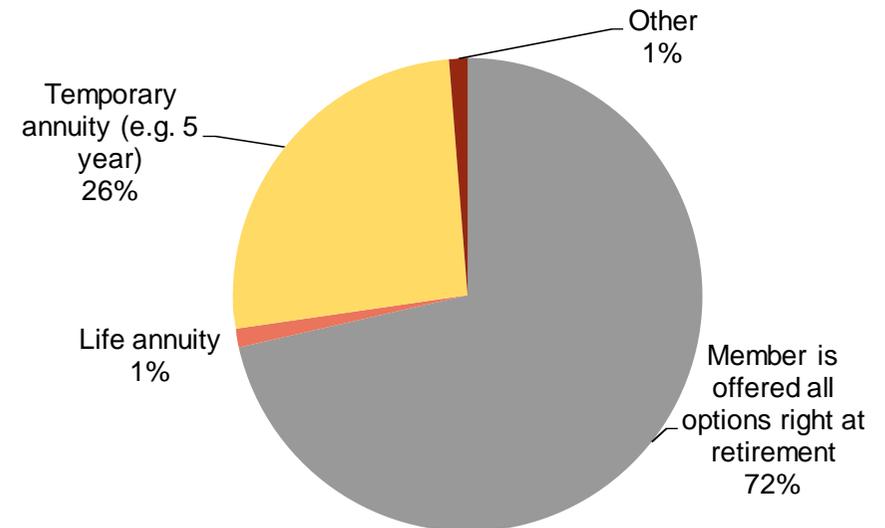
Source: Towers Watson Russian Pension Plan Study (2014)

TW Russian Pension Plan Study 2014 (continued)

Pension payment options typically taken- Life (n=50)



Pension payment options typically taken- NSPF (n=77)



- The payment options taken in plans vary significantly depending on the type of plan.
- Majority of LAPs provide a Lump sum, though a number are not yet mature enough to comment on member distribution choices.
- NSPF are likely to offer the full range of options at retirement. Temporary annuity option appears to be most popular as the single option offered to the member. The 72% of NSPFs that offer all options are typically split between Lump sums and temporary annuities.

Source: Towers Watson Russian Pension Plan Study (2014)

TW Russian Pension Plan Study 2014 (continued)

Employer Core Contribution			
Options	NSPF (n=77)	Life (n=50)	Total (n=127)
0%	48%	8%	32%
0.5%-1%	0%	8%	3%
2%	7%	16%	10%
2.5%	1%	0%	1%
3%	10%	4%	8%
4%	7%	0%	4%
5%	17%	14%	16%
6%	3%	6%	4%
7%	0%	6%	2%
8%	1%	2%	2%
9%	1%	0%	1%
10% or more	0%	2%	1%
Unknown	0%	2%	1%
Variable	0%	12%	5%
Fixed Amount	0%	20%	8%
Other	5%	0%	3%

Employer Matching Level			
Options	NSPF (n=77)	Life (n=50)	Total (n=127)
2:1	3%	0%	2%
1:1	33%	35%	33%
1:2	9%	2%	6%
1:3	3%	2%	2%
3:5	5%	0%	3%
Hybrid - different matching at different salary thresholds	3%	0%	2%
Hybrid - different matching at different year of service	0%	2%	1%
Unknown	14%	4%	10%
Other	17%	6%	13%
No matching	14%	49%	28%

- Around half of the NSPF offer a 0% core employer contribution.
- All NSPF employer core contributions are capped at around 10%. 5% core employer contributions appears to be the most popular.
- Some LAPs feature fixed contribution amounts (as opposed to % of salary).
- 1:1 employer matching level is the most prevalent design, though around half of LAPs do not offer any matching at all.

TW Russian Pension Plan Study 2014 (continued)

Total pension plan assets under management			
Options	NSPF (n=20*)	Life (n=41*)	Total (n=61*)
Under US\$1 million	75%	61%	65%
Between US\$1 million - US\$5 million	15%	34%	28%
Between US\$5 million - US\$10 million	5%	5%	5%
More than US\$50 million	5%	0%	2%
Total	100%	100%	100%

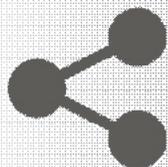
Investment Fund Options: Internal / External			
Options	NSPF (n=77)	Life (n=50)	Total (n=127)
Internal	0%	100%	39%
External	100%	0%	61%
N/A	0%	0%	0%
Total	100%	100%	100%

*One Provider was unable to disclose HQ regions

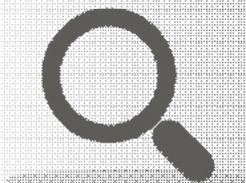
- Most plans are less than US\$1 million in size.
- There is a clear difference between investment fund options offered: all NSPF offer external investment funds, whereas all LAPs offer internal investment only. This difference is driven by different legislation imposed on NSPFs and Life plans.

Source: Towers Watson Russian Pension Plan Study (2014)

Recent developments affecting Russian pensions



Market consolidation. A recent trend of foreign insurance companies and pension Providers exiting the Russian market (eg, Allianz, AVIVA and Raiffeissen) and Russian companies rapidly consolidating, eg BIN Bank has acquired 5 NSPFs in recent times.

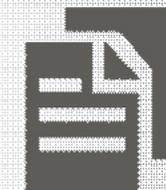


Importance of Provider reputation. The recent example of Motylev Group suggests that the owner's transparency and intentions are of crucial importance.

- 90,000 participants' savings allocated to 5 NSPFs are in question.
- The Regulator will compensate Pillar 2 contributions, but there is a question mark about Pillar 3 contributions (though these NPSFs are understood not to have had many Corporate plans).



Life Assurance Plan tax changes. The LAP solution could be aligned to the NSPF in terms of tax-effectiveness in 2016, subject to legislative changes going ahead. This will make LAPs more attractive.



Changes to pension system in 2015:

- The former mandatory second-pillar retirement plans were made voluntary as of January 1, 2015;
- From January 1, 2015, a new points based system has been introduced. New earnings-related pension is intended to encourage workers to remain in the labour force longer in order to increase their coverage period and earn a bigger pension.

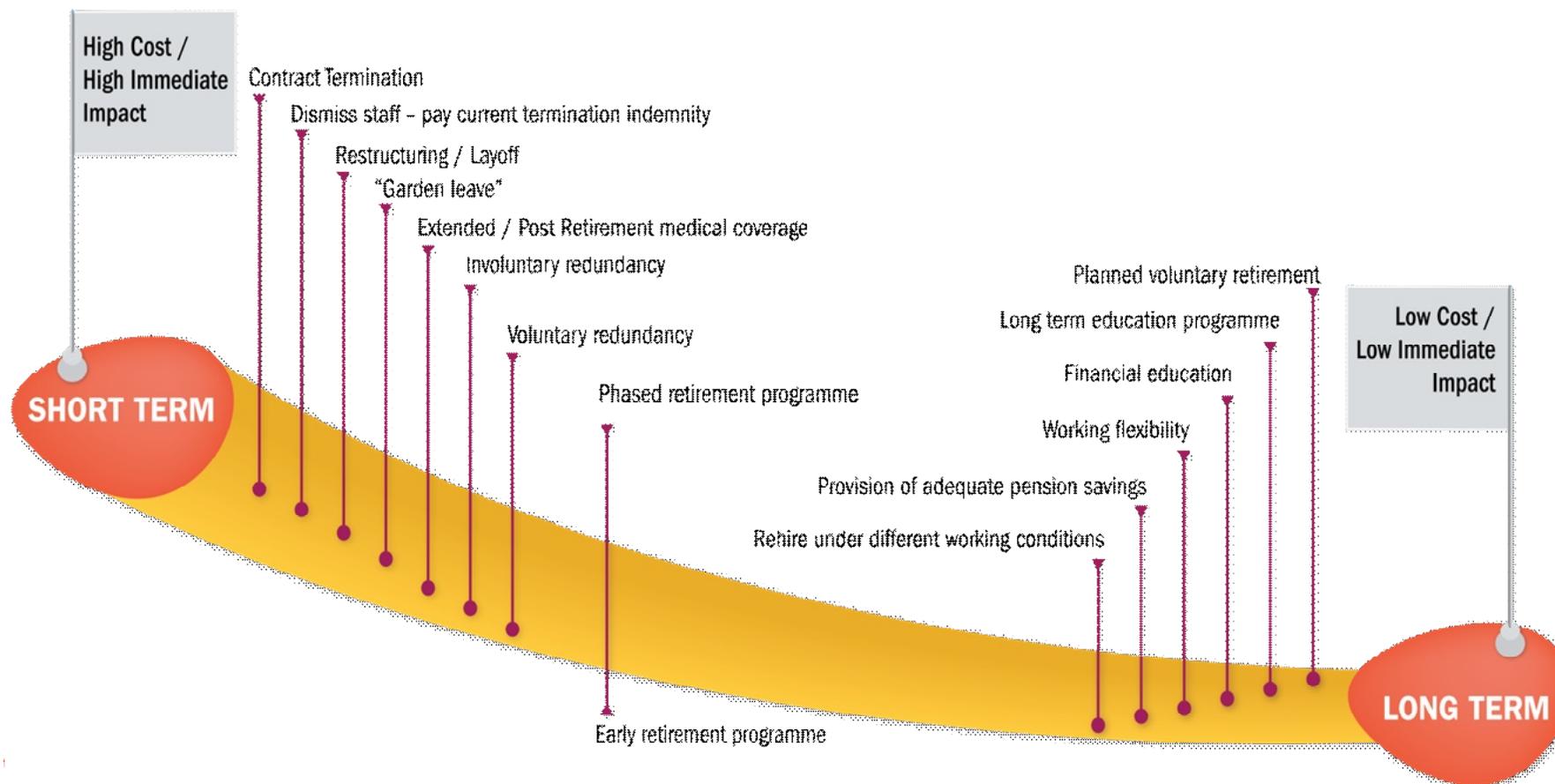
Why establish a Russian Pension Plan?

- Russian employers are facing ageing workforces that are unable or unwilling to retire.
- Given Russia’s relatively low life expectancy (compared to global averages), smaller family sizes due to a lower birth rate, increases in break ups of the family unit and other demographic challenges, this may mean “work till you drop” reality for many employees.
- Although not a “golden bullet” solution, pension plans can have the following positive impact on challenges faced by companies:

Lower Costs	Productivity	Skills Availability/ Transfer	Employability	Career advancement of the youngest	Conflicts	Changes in benefit demands
medium/long-term savings structures like NSPF/LAPs can be more cost-effective and place less cashflow stress on the business;	well funded NSPF/LAPs allow employees to retire and not work on leading to greater turnover, increased employee motivation and a younger more productive workforce;	an employee culture with clear retirement expectations and practices helps in skills and work planning, as well as knowledge transfer;	strengthening of the benefits package can make the employer more attractive to potential employees compared to alternatives without an NSPF/LAP;	orderly and planned retirement helps headcount and career path planning;	NSPF/LAP is ultimately for the employees’ benefit and likely to foster / improve relationship with employees;	with longer life expectancy and a rapidly ageing population, more employee interest is given to post-retirement income and healthcare.

Can pension plans deliver cost savings?

- To answer this question, the term of the pension plan solution must be considered.
- The chart below visually represents the spectrum of options available to a company from high cost to low cost (these typically correlate with short term and long term solutions, respectively).
- Move to longer term solutions is likely to deliver savings versus short term approaches.

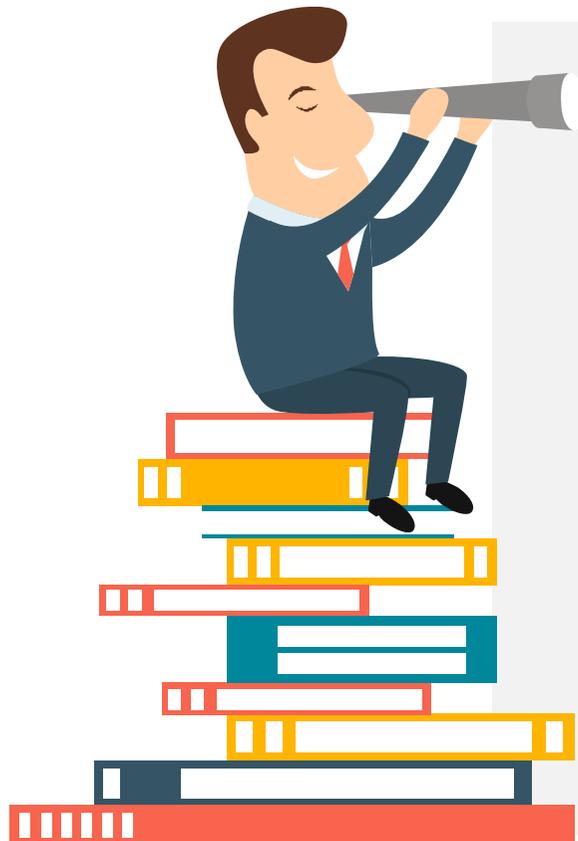


Looking forward.....



- There have been many changes to the Russian pensions framework and regulation in recent years (eg, change in legal status of NSPFs, change in Regulator to Central Bank, freezing then resumption of transfers to private pension funds). A period of calm and clarity on legislative arrangements is needed for the market to develop.
- It is anticipated that, with time, more local and multinational companies will look to introduce supplementary pensions and savings arrangements to support staff in their old age (Source TW Russia Data Surveys). As the Russian benefits market matures and levels of understanding and appreciation increase, pensions are likely to become a more significant issue for employees, and a Comp & Ben package differentiator for employers.
- Russian pension plan designs may become more sophisticated or evolve in design. One client in the FMCG industry has achieved a 40% employee participation level in their Russian pension plan using 0% core contribution and employer matching contributions only.

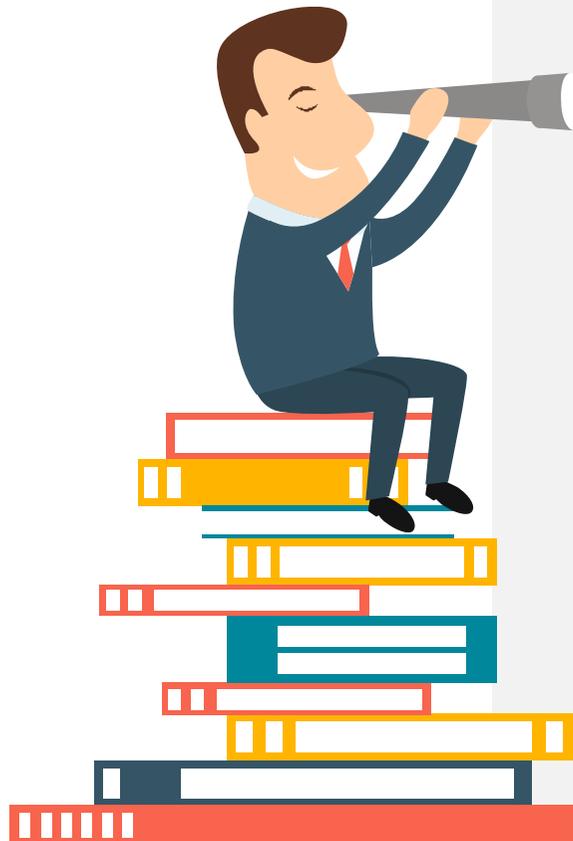
Looking forward.....



- An increase in private pension assets will support the growth and development of capital markets in Russia. This should result in a greater diversification in pension assets from bonds and cash to more equities, assuming a period of low interest rates and supportive regulation. Greater exposure to equities supports the development of the Russian exchanges and delivers capital into infrastructure projects creating jobs and wealth.
- Goldman Sachs projects an increase from \$6bn to \$60bn in private pension equity (local equities) investment holdings between now and 2020 (with Russian funds projected to own up to 55% of total estimated free float).
- The same Goldman Sachs report projects overall private pension assets to increase from \$64bn to \$200bn by 2020.

“The rise of Russian Pensions” by Goldman Sachs 2015.

Looking forward..... (continued)



- Most long term savings in Russia are held in the two prevalent vehicles, NSPF and LAPs, but experience from other developed markets suggests other savings solutions should develop, eg:
 - Deferred compensation plans
 - Long-term (cash-based) incentive plans
 - Cross-border retirement solutions, eg International Pension Plans.
- Towers Watson has seen interest from clients in the use of International Pension Plans being offered to local Russian employees. Potential advantages include:
 - Greater investment freedom (e.g. access to foreign equities);
 - Simpler regulation than is currently governing NSPFs (in Offshore centres);
 - Savings shielded from local economic issues and denominated in strong currencies such as USD and EUR;
 - Such a cross border solution could be expanded to include employees from other countries, say in the CIS or even other regions.
- Potential challenges to offering an IPP in Russia include:
 - Few precedents - this solution is being offered by the trailblazer first movers and so is not yet widely implemented in the market yet;
 - Treated differently from contributions to NSPFs from tax perspective, that is, there are no tax advantages to contributions going into IPP. The advantages are investment related.

