



The results of the Bulgarian pension reform, which was introduced nearly a decade ago, show that the three-pillar system now needs to shift from the stage of its establishment and stabilisation to a new qualitative stage of sustainable development.

Among the key conditions and factors that will ensure the Bulgarian pension system's further sustainable development are:

- (i) Perfecting the legal and regulatory framework of all three pillars of the pension system design;
- (ii) Improving the operations of the retirement provision institutions – the National Social Security Institute (NSSI) administering the first pillar and the retirement provision companies administering the second and third pillars (II and III pillars) – by offering new pension products;
- (iii) Perfecting and enhancing the investment efficiency of supplementary retirement provision funds;
- (iv) Creating new incentives for employers and workers for informed and motivated compliance with their public social security obligations (I pillar) and stimulating them to go out of the shadow economy and invest additionally in their future by participating in the fully-funded mandatory and voluntary funds (II and III pillar).

Recently, certain experts have been trying to promote the radical idea that it would be best to have a full privatisation of the Bulgarian retirement provision system, thus providing a solution to the low benefits rate issue. Many are of the opinion, however, that full privatisation is dangerous for the pension system and society as a whole. This is a fact not only because the Bulgarian pension

The Bulgarian pension system

Nikola Abadjiev explains why the Bulgarian pension system is moving from a period of stability to sustainable development

model has proved to be efficient, but also because this idea is not in line with the current international trends. Another proof of the latter comes from some phenomena and their consequences in certain countries that have liquidated /privatised their public retirement provision systems, such as Chile, Kazakhstan, etc. The impact of this privatisation has already made them reconsider their pension reforms and start restoring, to one extent or another, their solidarity pension systems.

The Bulgarian pension reform's philosophy is based on introducing a multi-pillar social protection system, taking into consideration the national traditions and specifics. This was the basis for preserving the active leading role of the solidarity pension system, while significantly amending its parameters. We could not afford to underestimate traditions, since the Bulgarian solidarity system has more than 100 years of history. Neither the pay-as-you-go, nor the fully-funded components take prevalence in the design of the Bulgarian pension system, which is one of its major positive characteristics and a key stabilising factor of the system as a whole. It is through the parallel and adequate

development and management of all three pillars that we will be able to ensure the target replacement rate of 70-80 per cent of the preretirement income, 40 per cent of which will come from the first pillar – public retirement provision, and the remaining 35-40 per cent will be the aggregate share provided by the second and third pillars of the system.

Another important condition and key factor for the system's sustainable development is the increase of the contribution rate for supplementary retirement provision in the second pillar universal pension funds (participation in these funds is mandatory for all workers born after 31 December 1959).

The recent concrete proposals for reducing the total social security burden are justifiable to a certain extent in light of ensuring the overall economic growth. The author is of the opinion that the aggregate social security burden should not be reduced; rather there should be an effort to optimise the rates and ratio of the contributions for the first and second pillars of the pension system.

2007 saw the introduction of the five per cent contribution rate for the universal supplementary



mandatory pension funds provided for in the Social Security Code (SSC), and by law it is not expected to grow any further in the future. Meanwhile, all analysts, experts and even some political parties are of the opinion that this rate is too low and insufficient. The experience of other countries reforming their pension systems brings about the same conclusion.

Based on this, there have been proposals for increasing this contribution rate to 7-7.5 per cent and even ten per cent. Experts believe that only such a rate could possibly produce a good and adequate pension benefit from the second pillar of the retirement provision system.

The increase of the second pillar contribution rate against a decrease of that for the first pillar will bring about yet another benefit – namely the fact that the resources accumulated from these contributions will in effect stay in the retirement provision system, and together with this their allocation to the second pillar will start working for the pension fund members bringing them additional income.

On the other hand, these significant financial resources will be invested in the country's economy through the pension funds. Third, this will become an incentive for the businesses to go out of the grey sector of the economy and will restrict evasion of pension contributions.

The establishment of favourable conditions for further sustainable development of the pension system will require new political and legislative decisions and we are happy to report that they have become a fact.

Recently the governing political coalition in Bulgaria announced a plan for new changes in the country's social security system, the

following being key among them:

- Increasing the aggregate pension contribution rate to 30 per cent of the insured income, the current rate being 22 per cent;
- Introducing the following allocation/structure of the pension contribution: 12 per cent to be covered by the state, ten per cent by employers and eight per cent by workers; currently the state contribution is zero – i.e. the state is not an insurer, the employer's contribution is 13.2 percentage points and the worker's contribution is 8.8 per cent;
- Setting up a "Silver Fund".

The proposal to increase the pension contribution rate to 30 per cent will provide a solution to two of the most serious retirement provision problems – contribution rates will be increased by eight per cent, while not only will the social security burden of workers and employers not grow, but in effect it will be reduced.

With regards to the so-called "Silver Fund" we should keep in mind that its purpose, similar to the funds introduced in many countries, is to ensure greater long-term sustainability of the public retirement provision system. This fund will be filled up out of 50 per cent of the generated surplus from the implementation of the State per cent of the privatisation revenues and part of the revenues from state concessions. Expectations are that by the end of 2008 accumulations will reach over 500 million EUR.

Current trends in the development of the fully-funded second and third pillars of the system

The summarised results for 2007 bring about the conclusion that this segment of the pension system continues to develop at a good sustainable rate. Compared to 2006

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the growth in net assets managed by pension funds was 52.79 per cent and their aggregate value exceeded 1,183,873 thousand EUR. For comparison purposes we may point out that the growth in net assets managed by the same funds in 2006 compared to 2005 was 36.4 per cent. It is also positive that the number of pension fund participants has been growing at a satisfactory rate. Through the end of 2007 the total number of 2nd and 3rd pillar pension fund participants reached 3,440,814 which constitutes a growth by 7.5 per cent compared to 2006, i.e. an increase of 239,488 people.

The financial results of the retirement provision companies also speak for themselves. At the end of 2007 the aggregate financial result was positive and amounted to 17,746 thousand EUR. It should be noted that the companies' financial out-turn was negative up until 2006. This fact and out-turn have never had a negative impact over the workers' individual account balances. Ever since the funds were launched workers have always received their share of the investment return, and it has always been higher than the interest rate charged by the banks. In 2007 the average arithmetic rate of return of the universal funds was 17.19 per cent, the rate of return of the occupational funds was 17.94, and that of the voluntary funds 20.27, which was a much better outcome



compared to 2005 and 2006. The positive trends in the present development of the sector form the basis for outlining some other necessary changes in the system and the regulatory framework.

Further liberalisation and greater flexibility of the investment regime for pension companies and pension funds

At present the investment regime is liberal enough. However, it has already played its part and from now on will increasingly turn into a roadblock for the companies' operations. The market is very dynamic, the funds have accumulated a lot of assets and the legislative framework currently, in effect, hampers the pro-active investment management, and hence the effective pension funds management. Therefore, the time has come for liberalisation of the investment regime. The table below provides an overview of the investments structure of the Bulgarian pension funds.

Introducing multifunds as of 2008

It should be noted that the draft amendment to the legislative framework providing for the introduction of multifunds is almost ready. It is now sure that multifunds will be launched in the third pillar – supplementary voluntary retirement provision – as of 1 January 2009. Multifunds are expected to make investment activities more dynamic and enable riskier investments, such as infrastructure. In addition, this will generate a more active demand for pension funds' resources. But most importantly, multifunds will change the face of retirement provision operations, since the workers will be able to choose their own investment portfolios depending on their risk profile.

Introducing economic incentives and regulating tax preferences

The ideas and proposals here are aimed at increasing the size of tax preferences for voluntary funds' contributors up to 15-20 per cent

from ten per cent of the taxable base for personal income tax. Regarding the tax incentives for employers paying contributions for their workers in voluntary pension funds, their current level of around 30 EUR a month may be assessed as satisfactory, however changes of this legal provision will be needed in the coming years.

To conclude, there is clearly an urgent need for making the development of voluntary retirement provision a priority in the coming years. The key factor will continue to be the actual growth of income, which should be coupled with new tax incentives and increasing the retirement provision awareness of the Bulgarians.

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Supplementary Retirement Provision Funds							
Investment portfolio through 31.12.2007							
No	Investment instruments	Universal PF		Occupational PF		Voluntary PF	
		EUR thousand	%	EUR thousand	%	EUR thousand	%
I.	Aggregate investments, incl.:	608389	100	204210	100	324726	100
1.	Securities issued or guaranteed by the state	112459	18,48	37601	18,41	32271	9,94
2.	Equities and shares	171889	28,25	63455	31,07	104269	32,11
3.	Corporate bonds	80874	13,29	27195	13,32	29586	9,11
4.	Municipal bonds	865	0,14	592	0,29	610	0,19
5.	Bank deposits	98774	16,24	30017	14,7	56190	17,3
6.	Mortgage bonds	17788	2,92	7415	3,63	12978	4
7.	Derivatives	0	0	0	0	0	0
8.	Real estate	13393	2,2	5273	2,58	21020	6,47
9.	Investments abroad	112346	18,47	32662	15,99	67802	20,88

Source: Financial Supervision Commission and calculations by the author based on the official exchange rate of the Bulgarian Central Bank
: 1 EUR = 1.95583 BGN



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