

The Contemporary Issues and Challenges in a Supplementary Pension System: The Slovenian Case

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Background: Impediments for the Development of Sufficient Funded Pension System

A weak financial position of many pension funds has highlighted the need to secure financial resources and improve risk management practices to meet retirement needs, triggering a variety of reform efforts. Governments should seek to encourage and influence market developments in this area, and policymakers may need to reconsider appropriate risk sharing mechanisms between the public, private and households sectors (Groome et al., 2006). Fultz (2004) argues time has been lost in the new EU member countries with miscast solutions to address national aging. The frequent proposals of various researchers of pension topics and practitioners are still only real options and will require and reward greater attention by all the EU member states. Despite coming difficulties of social security pensions - study done by the European Commission (2006) concludes that many member states are facing serious risk of fiscal imbalances in the decades to come - reform options are not yet widely grasped (Davis, 2002). Even the IORP directive¹ effective in September 2005 did not deliver unified and best solutions for the sound development of single EU financial markets (Delbecque, 2005). New member states provided additional diversity as they reformed their unsustainable systems of retirement provisions from the start of transition era (Fultz, 2004).

In Slovenia as well, current supplementary system which was introduced at the beginning of the decade, does not offer reasonable, sound, effective and competitive a possibility to save for retirement. Despite welcome first steps when funded pension system was first born, administrative barriers and obstacles, coupled with rent-seeking behavior of financial institutions that were allowed to manage assets of pension funds in an isolation of the financial system, are still predominant characteristics of the system.

In Slovenia, pension funds manage meagre 560 million EUR which represents about 2 percent of the Slovenian GDP (Financial Stability Report, 2006). On 31 December 2005 there were about one half of the total number of all employees included in the supplementary pension system – i.e. 210,775 according to mutual structures (mutual pension funds) and 179,499 according to insurance legislation like structures. There are roughly 165,000 civil servants that were included in the special close-type fund ZVPSJU (Insurance Supervision Agency, 2006 and Securities Market Agency, 2006) with one move in 2004. Annual contributions per member are low and coupled with strategically improper asset allocation can by no means fulfill expectations of the founders of the system.² Due to lack of awareness, but as well as improper saving vehicle around 98 percent of contributions are financed by employers (Insurance Supervision Agency, 2006).

Pension companies, insurance companies, banks and Kapitalska družba are allowed to set and manage a pension scheme. Structure of the pension scheme of pension companies and insurance companies are governed according to insurance legislation, but pension schemes offered by banks and Kapitalska družba by mutual funds legislation. This distinction allowed

¹ Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision.

² The motive was to provide at least replacement of the gap from the first pillar.

development of parallel financial vehicle with split and uncoordinated supervision which led to discrimination between members. Contributions into the pension scheme offering insurance-type financial vehicle are treated in a different way than contributions into the mutual fund-like pension scheme from many aspects – e.g. valuation and accounting rules, reserve provisions, reporting, treatment in case of transferring assets into other pension scheme (i.e. portability issue), etc.. Insurance-type products are for reasons of transparency, fairness and from perspective of its sole contents (insurance-like provisions), less suited for funded retirement provision in Slovenia. There is no transfer of insurance risk under such schemes and benefits are not evenly allocated among members of a single pension scheme. No such discrimination is possible under a mutual fund-like scheme. In addition, quantitative portfolio limits under the insurance legislation that follows life insurance directive³, do not support reasonable asset allocation for pension purposes.⁴ Main drawback of the system is lack of competition as only above stated institutions may offer saving products for the old age. Whatever good intention of setting up funded part of the pension system designers had had, isolating it from the logic of financial markets and institutions introduced damaging legacy that will only hardly be overcome in the near future. Boards of institutions providing pension schemes are negotiating directly with boards of sponsoring enterprises. In an environment with a lack of financial literacy it allows low transparency that offers room for personal benefits. Beneficiaries can not select pension vehicles but are told that the selected pension scheme provides best benefits. There is some competition among pension scheme providers. However, because of the mandatory minimum return (*guarantee*) that is embedded in the system, it happens in the area of costs, and not returns. Although cost efficiency is an important determinant of future beneficiaries' wealth, returns are much more important.

Minimum guarantees are keeping providers of pension schemes away from strategic asset allocations that would be reasonable for the beneficiaries. In case that provider of a pension scheme does not meet minimum return it must create provisions from its own capital. As there is only risk that return will not be met and thus that provisions will have to be created, and no additional benefit, providers do not deviate from the “benchmark portfolio” allocations which is designed with respect to domestic government bonds.⁵ Especially young members of the system are thus bearing the opportunity loss as they are forced to allocations that are not yielding otherwise achievable rate of return (Berk, Skok, 2005). For the long run, stocks compared to bonds are far more suitable vehicle for long-term saving (i.e. provide higher return) and are even less risky (Viceira, Campbell, 2002 and Siegel, 2002). As the benchmark is designed in a way that includes illiquid long-term government bonds with great extent of interest rate risk, it only requires a part of return (40 percent) to be met. Such a regulation does not even foster professional bond portfolio management and thus prolongs periods where pension providers are developing in a way parallel to the financial system and are not capable of competing with other substitute saving vehicles (Berk et al., 2006).⁶

³ Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning Life Insurance.

⁴ E.g. stocks are seriously underweighted.

⁵ Secondary legislative act (Pravilnik, 2005) determines calculation of minimum yield pension funds must meet on a monthly basis and thus implicitly provides a benchmark pension scheme providers follow.

⁶ Mutual funds can be regarded as a close substitute to pension funds. Slovenian asset management firms have made great progress in the last three years as according to UCITS Directive competition from abroad forced them to shape-up their products. If pension legislation will not be improved, even corporate sponsors might become aware that investing into the long-term products that are not competitive is far less suited for providing good prospects of their employees.

The goal of this article is to address solutions to the contemporary issues in the supplementary pension system and some challenges for design of the funded system and the pension system as a whole in the near future. One can clearly see that the development of the Slovenian supplementary pension system is missing and that there are many areas of improvement possible for the policy-makers to achieve in years to come. Without a trustworthy cornerstone solutions that are integrated into the financial system one can not expect that Slovenian pension funds will contribute to solving the unsustainability of pensions. On the contrary, they will most probably soon disappear.

Framework for the Development of Sound Funded Pension Pillars and Design Issues of the Whole Pension System

Reasonable orientation for designers of the future pension system to follow in Slovenia should be directed at strengthening the funded pillar as researchers state many arguments in favor of such a system. However, benefits do not come by themselves, but are conditioned upon the ability of the legislator and regulators to create simple and transparent environment that foster fund management with the sole goal of creating the highest possible benefits for included members. Funded system is the most suited to solve the problem of unsustainable fiscal problems of old societies in the long-run and can as well provide benefits for the financial system – institutional investors cause performance improvements of enterprises, better assert shareholder rights as they exert corporate governance pressures (Davis, 2002). Econometric analysis suggests that growth of institutional investors' share in domestic equity leads to higher productivity, dividends and lower investment than would otherwise be the case. Hence, besides enhancing shareholder value in terms of dividends, institutions improve economic efficiency via increased productivity, which may relate to pressure on company managers to maximize profits. The downward pressure on fixed investment need not be a negative aspect owing to the risk of wasteful investment on retained earnings where corporate governance is weak (Davis, 2002a). Funded pension system has benefits that spread across financial system in terms of higher stability of financial markets, creates saving and thus provides sources of finance for new investments (Daykin, 1999 and Iglesias, 2007). In Slovenia where government is committed to privatize some enterprises, demand from pension funds would well balance the supply of new stocks, if only privatization would be designed in a way of establishing diversified ownership structure. Very important implication of a developed financial system is that it provides the least distortions in labor markets which improves labor mobility, even across wider economic area (Holzmann, 2004). Besides that it strengthens asset management culture and lowers cost of capital in the economy which as a consequence results in a higher economic growth (Vittas, 2005).

Slovenian pension system as a whole should therefore evolve through achieving structural change. Traditional first pillar, which is under a serious demographic attack and is about to cause fiscal imbalances (European Commission, 2006) should be diminished. The optimal solution for Slovenia would be to erect sound framework for providing funded pensions which would besides solving the pension problem of ageing Slovenian population promote financial system and economic growth. This framework has to promote professional asset management, competition, cost efficiency, simplicity, transparency, regular reporting and has to allow flexible product design based on prudent investor principles. Assets should be exclusively valued according to market values (OECD Guidelines, 2006). Optimal financial vehicle to do this task well is mutual fund-like structure – at best with umbrella structure (i.e. umbrella fund which offers sub-funds with different investment policies suited for various desired strategic asset allocation or for various age cohorts). Pension funds should provide fair

and timely information to all beneficiaries (Directive, 2003, World Bank, 2002 and OECD Guidelines, 2005). Under a funded part of the pension system there should as well exist vehicles for most affluent members. Very appropriate to meet that goal are individual retirement accounts and managed individual pension portfolios, through which investors that possess knowledge about investing in the capital market are able to select investment vehicles from the pool of mutual funds, banking products and securities traded in the market, or are allowed to choose optimal asset allocation individually with their investment professional (banks, investment companies, asset managers and providers of pension schemes).

Very important issue under such a system relates to investment policy. It should at a minimum identify the strategic asset allocation strategy for the pension fund (the long-term asset mix over the main asset classes), the overall performance objectives for the pension fund, and the means of monitoring and, when necessary, modifying allocations and performance objectives in the light of changing market conditions. The investment policy should also include decision-making mechanism regarding the tactical asset allocation, security selection and trade execution (OECD Guidelines, 2006). Even within occupational pension system, asset allocation should be under discretion of each member and not the corporate sponsor, meaning that they have to be portable. Sponsors should only provide financing according to agreement to provide occupational pension financing for its employees and play a role of a supervisor (Berk et al., 2006). It should as well take part in educating employees regarding the long-term asset allocation.

Even though well constructed funded system can in the long run optimally solve the pension problem of Slovenian society, structural change of the system can not be achieved in the short-run (Williamson, 2004a). Namely, it is not possible to channel contributions into the funded pillars as pensions of current retirees are being financed through a *pay-as-you-go* system. There is no any possibility to meet incurred financial obligations of the traditional *pay-as-you-go* pillar without a smooth transition towards a more stable pension system structure.

For the country like Slovenia (i.e. with such a level of current and forecasted imbalances) it makes the most sense to introduce multi-pillar pension system promoted by a World Bank (2005), with a strong notional defined contribution - NDC part (Holzmann, Hinz, 2005). NDC allows long-term sustainability with high level of simplicity and transparency, high level of fairness (it rests on actuarial pension determination with low level of redistribution), provides incentives to work as it creates and reinforces the sense of ownership, exposes pension system to political risk at a lower extent and does require only limited administrative burden (Williamson 2004, Williamson, 2004a and Williamson, Williamson, 2005). NDC is also beneficial for diversification reasons. Namely, NDC is exposed to macroeconomic and to some extent still to demographic risk, but not financial risk. According to cornerstone principle of finance, because of non-perfect correlation between different drivers of risk the result is beneficial regarding the relation between required sources and outcomes. Lindbeck and Person (2003) argue that designers of the multi-pillar with the introduced actuarial fair pensions that result in Pareto improvement of the system should on the other hand take care of a minimum benefit – i.e. introduce a *zero pillar* (Daykin, 1999) that should shield very vulnerable groups of a society. Holzmann (2004) argues that NDC should represent the core of a sound pension system, with social pensions and supplementary funded pensions on its wings.

In Slovenia, social pensions should be financed through contributions (percentage of the gross payroll that is dedicated for redistribution of income in the society), general taxes and portfolio of Kapitalska druzba.⁷ The contribution rate should be only a part of the current contribution rate, which is already a burden for enterprises with respect to international competitiveness.⁸ Social pensions should be fully indexed to the growth rate of the economy.

Such a system would not burden the competitive abilities of enterprises, solve fiscal imbalances, shield Slovenian population from risk of ending in poverty and according to the fact that pension system would be exposed to diversified drivers of risk, and be better able to smooth consumption in time.

One very critical issue that must be taken care of when designing the future pension system is awareness-raising (Fultz, 2004). Namely, educational system in Slovenia does not at all cover issues of personal finance. Average person is thus rather unequipped for making financial decisions about the appropriate savings product to choose for long-term pension saving. Many are even not aware of the fact that each individual will have to save for her/his own pension, although many voices are raised in the professional press addressing that issue. Government should promote saving in the pension system and provide preliminary forecasts about the reasonable expectations under separate options available in the pension system. Precondition for such a promotion are certainly sound financial vehicles that are integrated into the financial system and that offer myriad of options to the corporate sponsors on one hand and to the individual on the other.

Tax Allowance for the Funded Pension System

Countries differ regarding the level of tax allowance. By targeting an optimal tax allowance it is reasonable to take into account desired goals of the funded pension systems, fiscal stance and capacity. Supplementary pensions should at least be able to level out the gap from the first pillar. It makes sense that countries think about substitution of saving that would otherwise be generated as well. This last view is important in considering supplementary (individual) third pillar tax allowance in a system that is extremely redistributive. Setting tax allowance at the relatively higher rate can lessen those effects as the capacity to save in the third pillar is greater in groups of employees with higher wages (that group loses the most from the first pillar).

There are two very important things to have in mind when setting the level of tax allowance – i.e. expected productivity growth of the economy and asset allocation. Productivity growth must be taken care of because in forty years (time when individual is assumed to be included in the supplementary pension system) society makes substantial progress and in order to cope with the economic reality, an individual must be generating at least that growth rate of asset value (return on assets). It is certainly not enough to match inflation – i.e. calculating real rate of return only adjusting for inflation is not enough. The future values differ substantially regarding the asset allocation decision. If one has started to save in the supplementary pension system at her 27 and until 65 stayed invested in stock, she would on average have generated 94-times of an annual pension savings expressed in real for productivity adjusted

⁷ Kapitalska druzba was established with the goal to provide funds for the pension system and still has assets at disposal to do the task.

⁸ Contribution rate is currently somewhat below 25 percent.

euros (see Table 1).⁹ If she stayed invested in bonds, the result would have been only 30 which is less than number of years of saving (39).

Table 1: Future values in real terms, adjusted for productivity growth of an annual (gross) pension savings

Age	Productivity growth = 2,5	
	Stock	Bonds
27	1,04	0,99
28	2,11	1,96
29	3,21	2,92
30	4,36	3,87
31	5,55	4,81
...
60	65,67	27,26
61	70,67	27,90
62	75,97	28,52
63	81,59	29,14
64	87,55	29,75
65	93,86	30,35

Sources: Dimson, et al. (2002); Development Report (2006); author's calculation.

Notes: Real return assumptions: stock 6% p.a., bonds 1.2%.

Let's look at the hypothetical example. If Ana who opened her pension account at the age of 27 wants to generate her pension assets at the level to be able finance her pension at the level of 700 EUR net after taxes (which is financed out of the pension account worth 217,000 EUR at her age of 65), she needs an annual tax allowance of 3,300 EUR.¹⁰ Her monthly annuity factor is .31 if she invests in stocks.¹¹ She needs far more if she invests in bonds – i.e. 7,200 EUR p. a.. If she opens her pension account at the age of 32, she needs 4,200 EUR and 8,000 EUR tax allowance respectively.

Table 2 shows that individuals that invest in stocks and are included as soon as possible fare far better than individuals that save in bonds. That conclusion conflicts with the opinion of Slovenian providers of pension schemes as they still consider bonds as an optimal vehicle for pension saving.

Stocks are in terms of standard deviation even less risky in the long-run than bonds.¹² Because of the fact that sovereigns are not prepared to bear inflation risk when issuing bonds, bond asset class always carries some probability of incur losses in terms of purchasing power. That renders bonds risky despite the fact that they are not exposed to credit risk. Stocks on the other hand are tied to real assets and thus less prone to losses.

Table 2: Monthly annuity factors expressed in terms of annual (gross) pension savings, required tax allowances for targeted (net) pension of EUR 700 for individuals with different entrance timing (at 27 years and at 32 years of age) and total pension savings at the age of 65 years

⁹ Future value is calculated in by first accounting for productivity growth and then real asset class return.

¹⁰ Calculation is done under the assumption of 1 percent real rate of return in retirement and 30 percent marginal tax rate. Ana's life expectancy of 87 years is assumed according to Whitehouse (2007).

¹¹ Monthly annuity factor is inflation and productivity growth adjusted factor in terms of an annual (gross) pension savings – e.g. Ana saves 1 EUR per annum, she can expect .31 EUR per month when she is 65.

¹² Starting as soon as after 18 years of saving (consult Siegel, 2002, Campbell and Viceira, 2002 for details).

	Productivity growth = 2,5%		Productivity growth = 2,5%	
	Stock	Bonds	Stock	Bonds
	Pension plan at 27		Pension plan at 32	
Annuity Men***	0,35	0,16	0,28	0,15
Annuity Women***	0,31	0,14	0,24	0,13

Annual Tax Allowance Women	3.279	7.165	4.164	7.975
Pension savings @ 65	217.441	217.441	217.441	217.441

Sources: author's calculation.

Notes: the average personal income tax for the payout phase assumed: 30%;

interest rate in the payout phase assumed: 1% p.a.;

*** - expected life: 82 years for men and 85 years for women.

Impact of a Strategic Asset Allocation Decisions

As already evident from above a strategic asset allocation plays an extremely important role for retirement welfare. Table 3 provides some more results expected by different asset allocation strategies. Results are stated for the case when productivity is assumed to be zero (unrealistic, but useful for comparison) and for our previous case (productivity being 2.5 percent).

The first allocation strategy is directed to stocks. An individual remains invested in stock during the whole active life and purchases monthly annuity when she/he is 65. Monthly annuity factor expressed in terms of annual gross pension savings is .50 for men and .43 for women. When one decides to shift her/his asset allocation towards bonds in the last 5 years before retirement annuity factor is .35 for men and .31 for women. If an individual chooses bonds, annuity factor amounts to .16 for men and .14 for women. In case of balanced asset mix (50 percent being invested in stocks and 50 percent in bonds and 100 percent in bonds in the last five years) the annuity factors are .23 and .20, respectively.

Table 3: Impact of a strategic asset allocation on monthly annuity factors expressed in terms of annual (gross) pension savings

Age	Productivity growth = 0				Productivity growth = 2,5			
	Stock	Stock*	Bonds	Balanced**	Stock	Stock*	Bonds	Balanced**
27	1,06	1,06	1,01	1,04	1,04	1,04	0,99	1,01
28	2,18	2,18	2,04	2,11	2,11	2,11	1,96	2,03
29	3,37	3,37	3,07	3,22	3,21	3,21	2,92	3,07
30	4,64	4,64	4,12	4,37	4,36	4,36	3,87	4,11
31	5,98	5,98	5,18	5,57	5,55	5,55	4,81	5,17
			...					
61	118,12	112,77	43,70	68,82	70,67	65,81	27,90	41,86
62	126,27	115,14	45,23	70,66	75,97	65,94	28,52	42,30
63	134,90	117,53	46,79	72,52	81,59	66,07	29,14	42,74
64	144,06	119,95	48,36	74,40	87,55	66,20	29,75	43,17
65	153,76	122,40	49,96	76,31	93,86	66,32	30,35	43,60

Annuity Men***	0,82	0,65	0,27	0,41	0,50	0,35	0,16	0,23
Annuity Women***	0,71	0,56	0,23	0,35	0,43	0,31	0,14	0,20
Variable Annuity Men****	1,20				0,74			
Variable Annuity Women****	1,10				0,67			

Sources: Dimson, et al. (2002); Development Report (2006); author's calculation.

Notes: interest rate in payout phase assumed: 1% p.a.;

* - invested 100% in bonds in the last 5 years before retirement;

** - invested 50% in stock and 50% in bonds; in the last five years 100% in bonds;

*** - expected life: 82 years for men and 85 years for women;

**** - accumulation and payout phase 6% annual yield.

If an individual chooses variable annuity (reasonable for less risk averse investors that have invested in stocks), annuity amounts to multiple of 1.2 of annual gross pension savings.

Table 4 carries the same message, but in terms of EUR amounts. An individual is assumed to save 1,000 EUR p.a. during her/his active period.

Table 4: Impact of a strategic asset allocation on (net) monthly annuity expressed in terms of annual (gross) pension savings of EUR 1,000

	Productivity growth = 0				Productivity growth = 2,5			
	Stock	Stock*	Bonds	Balanced**	Stock	Stock*	Bonds	Balanced**
(Net) Annuity Men (in EUR)	574	457	186	285	350	248	113	163
(Net) Annuity Women (in EUR)	495	394	161	246	302	214	98	140
(Net) Variable Annuity Men (in EUR)	843				515			
(Net) Variable Annuity Women (in EUR)	771				471			

Sources: author's calculation.

Notes: Calculation for an individual that entered the supplementary pension plan at her/his age of 27;

The average personal income tax for payout phase assumed: 30%.

* - Invested 100% in bonds in the last 5 years before retirement;

** - Invested 50% in stock and 50% in bonds; in the last five years 100% in bonds.

From Table 3 and Table 4 we can see that an individual is able to influence her/his pension welfare substantially and that stock are more suited to provide desired benefits for the old-age.¹³

Issues to Be Cautious About

Before concluding it makes sense to mention some potential threats in designing and implementing supplementary funded pension system. Firstly, for the above illustrated reason (impact of strategic asset allocation) there exist a possibility that under the not enough competitive and efficient second pillar (poor product design and portability, high and intransparent management fees, poor reporting and governance mechanisms, isolation from the financial market, etc.) mandatory occupational pension pillar will not bring enough satisfaction. It is highly probable that in addition to providers of pension schemes labor unions will as well foster bonds as an optimal pension asset class. Guarantees are another possible and very probable thing where things might not get into optimal settings. General public in concern which does not possess enough financial knowledge can easily be manipulated by people who pack guarantees under the cover of social security. Guarantees should be available to everyone, but be at the discretion of each individual and not everyone as an obligation. If guarantees are obligatory, especially younger generation encounter opportunity losses (Berk et al., 2006, Berk, Skok, 2005). Obligatory guarantee deters saving in the third pillar as it makes sense to save amounts that have already been taxed with individual taxes elsewhere in the financial system and can be allocated in the reasonable and desired strategic asset allocation.

Secondly, another potential threat is introduced by allowing pension funds in developing countries to invest in alternative asset classes such as hedge funds, private equity, and real estate. Alternative asset classes are beneficial in the portfolio management context as they are uncorrelated to traditional assets (stocks and bonds) and thus provide room for improvement of risk-return relationship. However, if governance mechanisms for such assets and

¹³ For illustration on risk by investing in the long run, see Siegel (2002) and Viceira and Campbell (2002).

investment products are not clearly stated there is a threat of manipulation. Therefore, there is a risk that pension provider, investment manager or provider of such products appropriate funds on the pension fund members' account. In Slovenia for example, legislation on investment funds does not specify alternative investment funds and before clear mechanism are set, it is better to exclude those products as an eligible asset/product.

Thirdly, another issue like obligatory guarantees that can deter individuals from saving in a third pillar is obligation to annuitize the accumulated savings. Many pension system researchers and professionals argue that mandatory annuitization of the accumulated retirement saving is not suggested, at least as long as NDC account allows the financing of a minimum pension (Holzmann, 2004). Namely, mandatory life-time annuity exposes an individual to risk of inflexibility. If the government (first pillar) is able to provide pensions above minimum living standards there is no need to consider pension savings as not being private property. By setting provisions for mandatory annuitization government protects insurance industry but not individuals who might be paying unfair prices for their annuities. Very importantly, mandatory annuitization can conflict with various life-time situations – e.g. consider Ana aged 64 just received her doctor's report that says she became seriously ill. If pension savings are Ana's only life-time savings, she is not able to finance expensive medical treatments she would be more than willing to finance.

Finally, very important for the supplementary pension system is proper benchmark for minimum rate of return (guarantees) – if it exists.¹⁴ Current benchmark in Slovenia is inefficient, uses yields to maturity of Slovenian sovereign long-term bonds instead of holding period returns, uses return benchmarks from previous periods (which can for reasons of monetary stance be already inappropriate), and applies arbitrarily set guarantee threshold (40 percent of the yield of previous year). Such a benchmark is inappropriate from many aspects, but above all does not send the right signal and does not foster professional asset management techniques by providers of pension schemes or their outsourced asset managers. Future benchmark should be known ex-ante, be unambiguous, marketable and liquid and easily tractable. Providers of pension schemes should meet around 95 percent of the holding period returns. Measurement periods should not be too short as they are under current system.¹⁵ Modified duration of benchmark portfolio should not exceed 3 years and should include as much as possible inflation-linked sovereign securities.

Concluding Remarks

Hotly debated pension issues are on the agenda of majority of modern societies as population ages and causes demographic problems for traditional *pay-as-you-go* pension systems erected in different socio-economic environment in the past. This article discusses contemporary issues and challenges in creating of a sound supplementary funded pension system in Slovenia. As only the introduction of such a system can not solve the problem optimally, this paper addressed reasonable possibilities of the development of sound, efficient and sustainable pension system that promotes economic growth and prosperity, offers social protection to the poor and provides appropriate incentives to save and take care of each person's pension. However, precondition for such a pension system is transparent and competitive supplementary funded pension system that offers portable and innovative products and provides sound governance mechanisms that establish sufficient trustworthiness.

¹⁴ In Slovenia there is minimum guarantee in a form of domestic sovereign bonds yield. Other forms of guarantees are also possible – see World Bank Pension Reform Primer (2002).

¹⁵ Period should be extended to about two years, but constantly monitored (World Bank Pension Primer, 2002).

Because of the fact that Slovenian supplementary funded pension system was founded in parallel to existing financial markets and that providers of pension schemes already have lobbyist powers and follow rather short-sighted strategies, such a system will not emerge overnight.

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