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- **Pension system transformation will hinder the collective investments market in Russia.** In 2014–2017, pension savings, comprising 59% of the total collective investments in Russia, generated two thirds of the market growth. In ACRA opinion, pension assets will continue to form the most substantial share of the market. The growth rate of such share will begin to slide after the individual pension capital (IPC) scheme is introduced.
- **Asset management market still undergoes consolidation.** Since 2014, the number of asset management companies has shrunk from 401 to 286, and the trend will remain in the next three years.
- **Growing risk appetite will be another driver for the collective investments market.** Open-end mutual investment funds (OMIFs) and personal asset management services are currently the most fast growing segments of the collective investments market. Although current rates exceed the inflation and protect against it (for the first time ever in the Russian financial market history), a possibility of their decline forces investors to turn to riskier assets. Population's perception of the inflation depends on the variations in deposit rates; and a turning point may come not earlier than 2021.
- **Possible extension, until 2020, of the moratorium on the cumulative component of pensions and its subsequent cancellation** are considered by ACRA as the most probable events. In terms of economic essence, individual pension capital is similar to pension reserves. The current concept assumes that individuals will make voluntary contributions to form their individual pension capitals. It is expected that the Bank of Russia's requirements to such contributions will be similar to the requirements to pension savings.
- **The ability to independently select a management company for their pension savings and make an informed choice in favor of a non-state pension fund (NSPF) is the main argument for bringing future participants of the IPC system to NSPFs.** If an individual fails to select an NSPF, leaving his pension savings within the Pension Fund of the Russian Federation (PFR), the selection will be carried out randomly among licensed NSPFs and the cumulative component of the pension will be transferred to a fund so selected.

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Russian law contains the following definitions of terms "pension savings" and "pension reserves":

Pension savings mean funds credited by the state to accounts of insureds;

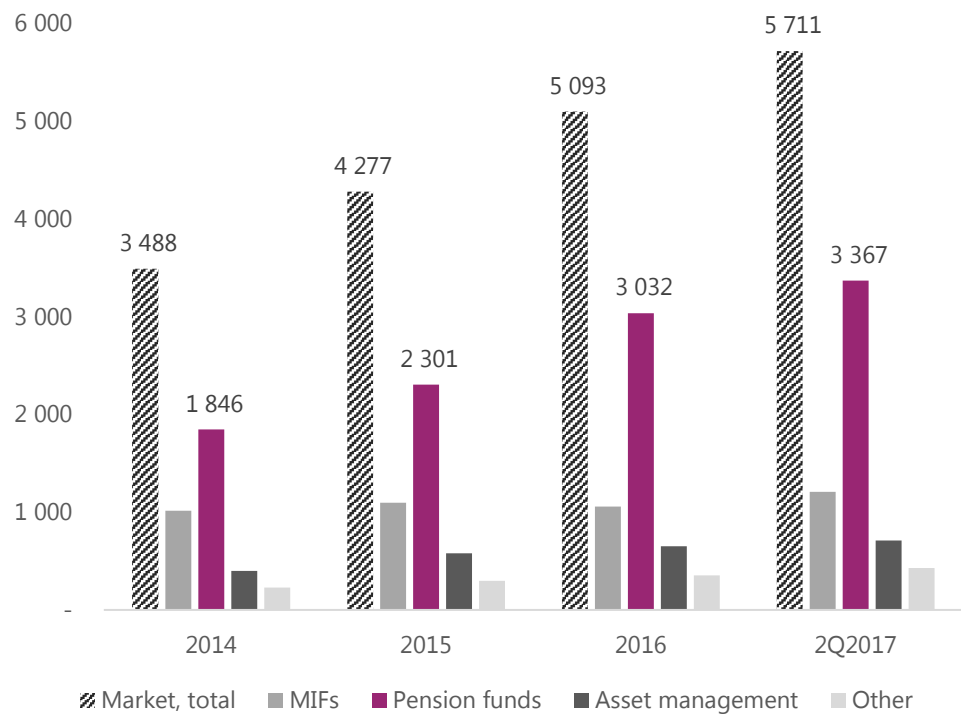
Pension reserves mean funds owned by individuals who voluntarily placed such funds under management of a non-state pension fund (NSPF).

Asset management means both corporate and individual management of funds. Other assets include military mortgage, assets of endowment funds, assets of self-regulated funds, and reserves of insurance companies.

Russian collective investments market: growing importance of pension assets and continuing consolidation

The Russian collective investments market (asset management companies, except the state-owned asset management company VEB) demonstrate a steady growth trend. In ACRA's opinion, the main source of this growth are pension assets that include pension savings and pension reserves.

Figure 1. Russian collective investments market profile, RUB mln



Source: CBR, ACRA estimates

Among mutual investment funds (MIFs), open-end funds (OMIFs) and interval funds (IMIFs) showed an increased dynamics and, unlike the closed-end funds, they demonstrated an average annual increase from 4% to about 24% in 2014–1H2017.

The number of collective investments market participants is decreasing: from 2014 to 2H2017, the number of management companies and non-state pension funds decreased from 401 to 286 and from 120 to 69, respectively.

The consolidation of the asset management market is facilitated, in particular, by the need of management companies for sufficient own funds, reduction in the number of large investors, the need to establish a qualified risk management service and make significant IT investments to streamline business processes.

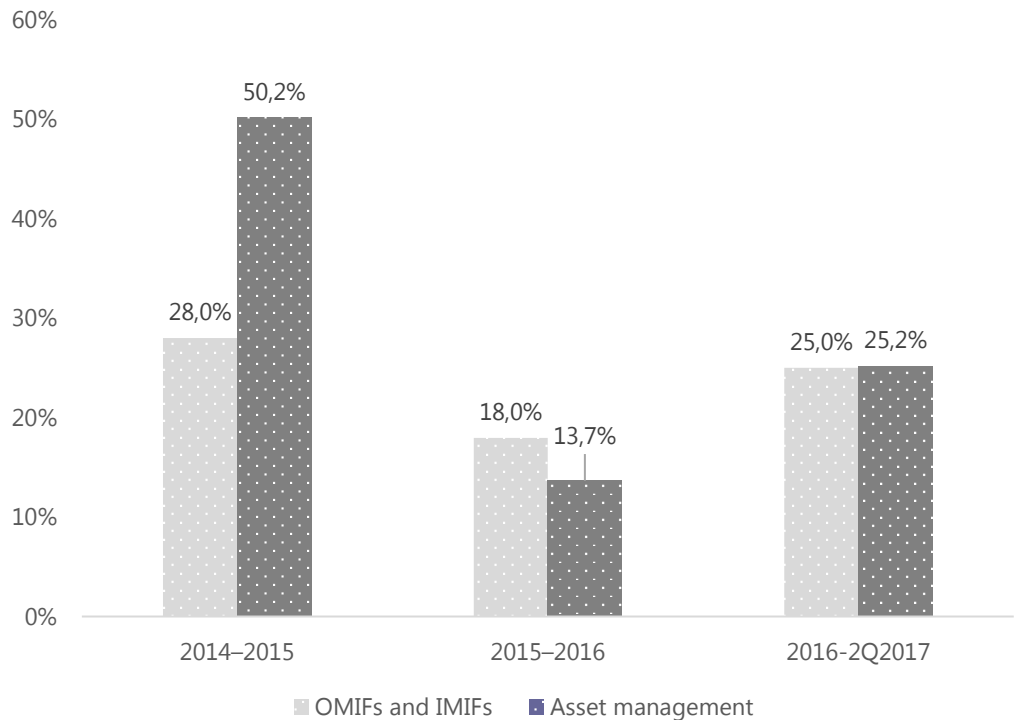
In 2017, deposit rates exceeded the inflation by 3.2 percentage points—for the first time in the history of the Russian financial market, bank deposits protect investments from inflation. However, inflation expectations and perceptions of inflation are still 5-6 percentage points higher than the official consumer price index. The perception of inflation by the population depends on how deposit rates change. A turning point may come in this trend not earlier than 2021. See ACRA survey [Positive ruble interest rates to raise propensity to save in Russia](#) published on March 15, 2017.

See ACRA outlook [Low inflation in Russia to force the government and businesses to seek new forms of flexibility](#) published on October 9, 2017.

Individuals take a closer look at stock markets amid sliding deposit interest rates

ACRA notes that the number of investors and the amount of their investments in the stock market have been growing recently; such investors include individuals investing through MIFs and/or asset management companies.

Figure 2. Most dynamic sectors of the Russian collective investments market



Source: CBR, ACRA estimates

The growing interest of individuals in stock market instruments can be explained by the current and forecasted decrease in the rates of interest paid on bank deposits, as well as by the emergence of individual investment accounts (IIS) and tax incentives within the framework of IIS.

Among the mutual funds, the most successful in attracting funds are bond OMIFs, which allows us to conclude that, in the current economic situation, individuals are not ready to make high-risk investments (in stocks or other instruments with increased profitability and risk), but they are also discontented with the deposit rates offered by banks.

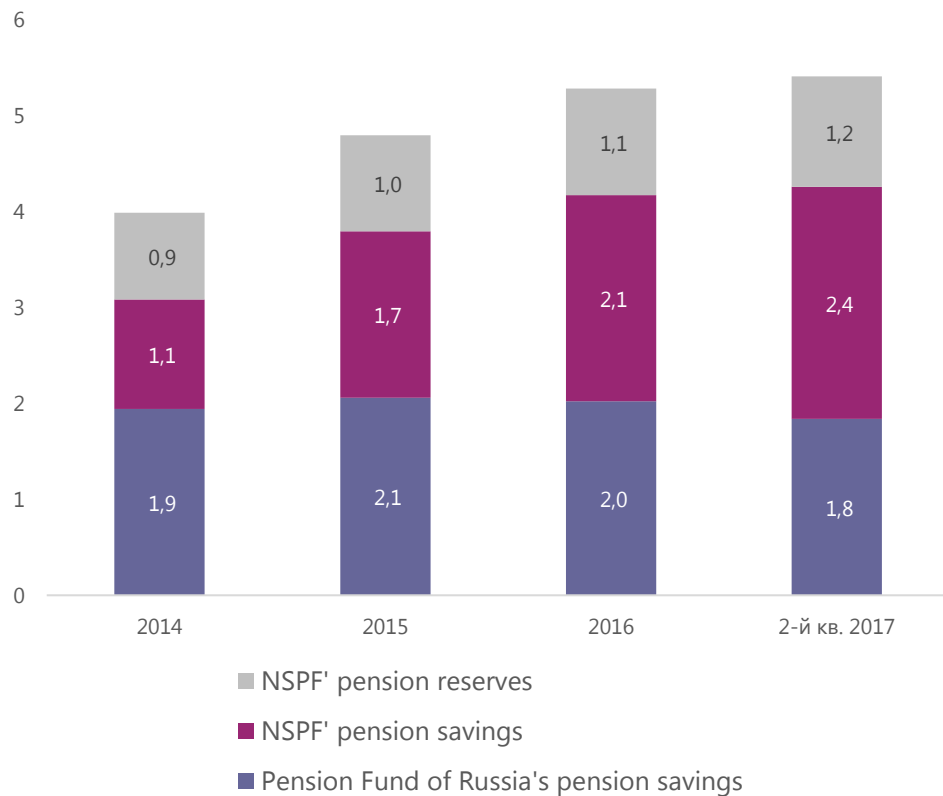
Asset management services are mainly popular among high net worth individuals: according to ACRA estimates, the initial amount of investment is approximately RUB 5 million, and the average account is estimated at RUB 50 million.

The new budget rule implies lower state spending, which will limit the possibilities to increase funding for the PFR deficit. The transfer of pension insurance functions from the state to financial institutions will generate demand for a more developed domestic bond market. See ACRA research [Russian government to become a net borrower and Kazakhstan government to remain a net creditor in 2018](#) published on July 27, 2017.

Individual pension capital: a new driver for the pension system and the collective investments market

Pension assets increased the volume of the collective investments market. The main growth driver is pension savings managed by NSPFs for the pension moratorium period of 2014–2019.

Figure 3. Pension assets under management in the Russian collective investments market, RUB bln



Source: CBR, ACRA estimates

In 2014–2Q2017, the share of NSPF pension savings in the collective investments market has grown from 56.7% to 71.6%, and the share of voluntary pension insurance (pension reserves) has declined from 41.3% to 27.2%.

Possible extension (until 2020) of the moratorium on the cumulative component of pensions and its subsequent cancellation are considered by ACRA as the most probable events.

The most expected pension product is the individual pension capital (to some extent, similar to pension savings), which is expected to be launched in 2019–2020.

The current concept assumes that the IPC system will be built on the voluntary contributions made by individuals. It is expected that the requirements to such contributions will be similar to the requirements to pension savings. Therefore, in terms of economic essence, individual pension capital will be much closer to pension reserves other than pension savings.

The initial IPC shall be formed from the pension savings managed by non-state pension funds. If an individual would fail to select an NSPF, leaving his pension savings within the PFR, the selection will be carried out randomly among licensed

NSPFs and the cumulative component of the pension will be transferred to a fund so selected.

That is why, today, non-state pension funds are active in attracting potential participants in IPC, soliciting people to make an informed decision in their favor.

Recent changes in the IPC concept limit its mass application, especially at the initial stage: the replacement of the *auto-subscription* (the contribution of Russian citizens to the IPC system will be 1–2% of the salary, with possible withdrawal or “tax holidays”) with *auto-registration* (putting citizens into the pool of potential participants of the individual pension capital system).

According to the Agency’s estimates, implementation of the auto-subscription model would allow non-state pension funds to receive about RUB 30–50 billion within the first year of the IPC system. However, introduction of the auto-registration model instead of auto-subscription will significantly reduce this amount, since it will be necessary to obtain employee’s consent to participate in the IPC system, which will affect the inflow of funds to non-state pension funds and, consequently, to asset management companies and increase the advertising costs of the product.

In ACRA’s opinion, pension assets will continue to occupy the largest share in the collective investments market. Its growth rate will gradually decline after the introduction of the IPC system. In the next three years, the interest of individuals in the stock market will continue. In our opinion, the key tool that may attract mass investments to the securities market is the general increase of financial awareness in the country. Under the conditions of anti-Russian sanctions, the high-risk investments market will see no major growth drivers in the near future, except for some shares (“local stories”).

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