

## **The Pension Fund Solution by an Austrian Bank**

**Thomas Benesch**

Graz University of Technology  
Institute of Industrial Economics and Management Science  
Department of General Management and Organisation  
Kopernikusgasse 24  
8010 Graz  
Austria

Phone: ++43/316/873-7505

Fax: ++43/316/873-7506

E-Mail: [benesch@iwb.tu-graz.ac.at](mailto:benesch@iwb.tu-graz.ac.at)

*In Austria the system for old age provision, is dominated by the public pension system. Most of the pensions (about 93%), drawn by retired persons in Austria, derives from the public pension system. The average net income replacement rate, for social security pensioners in the private sector, amounts to about 72 percent of the income earned before retirement. This is, in international comparison, rather generous.*

*At present, the financial gap, particularly affects whoever earns over the upper limit income threshold, has few premium years, and who retires before the official retirement age.*

*The present financing problems, have their cause mainly in the unfavourable situation of the labour market. Weak employment growth, and the implementation of generous early retirement insurance schemes, have seriously strained the pension system. The ageing of the population, will create additional, long term, financing problems, over the next decades.*

*Important kinds of the company pension, are the pension funds and the direct provision promise. The spread of pension funds, has increased quickly, because of recent tax incentives. Here we present a internal pension fund model.*

In 1996, the BAWAG<sup>1</sup> (Bank of Employment and Economy) reacted to the trend of providing security for old-age pensions by pension funds and therefore reformed the company's old-age pension scheme in agreement with the representatives of the employees.

The essential point of this reform of the pension scheme was the introduction of contributions made by the employees and the foundation of the „BAWAG pension fund stock corporation“ as the internal pension fund of the BAWAG and its subsidiary banks.

In the course of this remodelling the former direct provision promise was supplemented with effect from January 1<sup>st</sup> 1997 by a model of pension fund which is oriented by contributions and which is supposed to replace the direct provision promise in the long run.

The decision of establishing an internal pension fund as opposed to joining one of the many external ones was made due to the following advantages:

- An internal pension fund is comparatively **cheaper** since the costs of the trustee work and the costs of the current contributions can be kept at a low level by the internal administration, a fact which is ultimately for the benefit of the entitled expectants and beneficiaries
- Existing **know-how** as far as the management of securities is concerned
- Absolute **authority to decide** as far as the investment of the capital of the pension fund is concerned

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<sup>1</sup> See BAWAG pension fund AG: Annual report 1997, Vienna 1998, p. 3-14 and BAWAG: the Bank Pension of the BAWAG, in: an Information Brochure, Vienna 1997, p. 4-10, as well as BAWAG: The Pension Fund Model of the BAWAG, in: an Information Brochure, Vienna 1997, p. 4-21.

- The pension law which has been changed by new collective agreements can be administered directly in the house, so there is only **one authority** the employees have to address in this connection and that is the staff department

## **1. Legal basis**

Proceeding from the former pension law which was regulated by a collective agreement from 1961, three new collective agreements have been signed. These are

- the collective agreement concerning the reorganization of the pension claims from 1961 in the version from 1997
- the collective agreement concerning the contributions for securing the pensions and the special account for old age provision as well as
- the pension fund (PF) collective agreement from 1997.

## 2. Establishment of the internal pension fund

Figure 1: Steps from foundation to taking up business activity

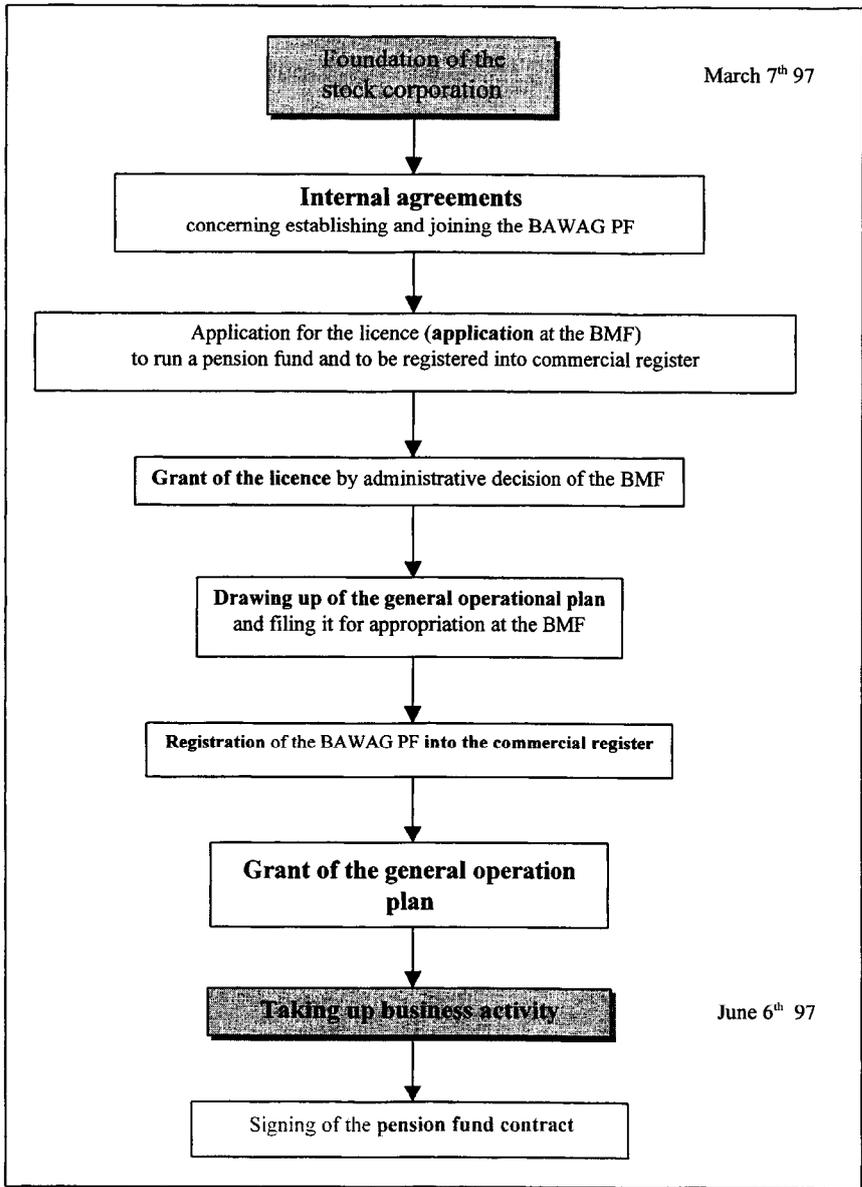


Figure by the author herself

Source: BAWAG pension fund AG: Annual report 1997, Vienna 1998, p.3.

For investing the capital of the investment and risk association the 'BAWAG Special 8 - co-ownership fund for securities' which is administered by the BAWAG Invest closed corporation, was created according to the provisions of investment of §25 PKG (pension fund law).

Due to the small volume of the fund and to short-term transactions in the segmented shares a yield of 12,2% of the invested capital was already realized in the rump business year 1997.

Difficulties at establishing the pension fund occurred only in a few cases, for example with

- considering the continuous changes of the law, here the professional association of the Austrian pension funds provided valuable support
- the arrangement of the new collective agreements, as well as
- the adaptation of the software which turned out to be quite time-consuming

Here, for instance, solutions concerning servicing and attendance as well as the automation of the data (which data can be automated with the help of the computer and which not?) have to be found.

### **3. The internal pension arrangement**

After the reorganization of the pension law three groups of employees were defined depending on the date of entering:

1. Employees who are subject to the collective agreement and who entered employment **before** 01.01.1967 (men) or 01.01.1972 (women), as well as men / women who have already attained their 50<sup>th</sup> / 45<sup>th</sup> year of life before 31.12.1996. If these employees meet the requirements for the claim (e.g. 5 continuous years of service at the BAWAG) they receive a so-called „*transition pension*“, which is

determined on basis of the period of service and the annual salary at the end of employment, as well as a payment from the pension fund.

Therefore, the entire pension consists of the:

- ASVG pension
  - payment of the bank
  - payment of the pension fund
2. Employees who meet the requirements as stated below point 1. but entered employment **after** 01.01.1967 (men) or 01.01.1972 (women). Those employees receive a so-called „*pension of vested rights*“ beside the payment of the pension fund at entering the pension. This pension of vested rights is basically calculated like the transition pension but it considers the annual salary of 1996 and a possible period of service up to the 60<sup>th</sup> year of life with men and the 55<sup>th</sup> year of life with women. Thus, the claim to a benefit of the bank which has been acquired till the 31.12.1998 is determined, recorded and valorized by the collective agreement till the actual entrance to pension.
- Contrary to the transition pension, however, the benefit of the pension fund is not considered at the calculation of the benefit of the bank.
3. All other employees receive a benefit from the pension fund if they meet the requirements for the claim.

#### **4. The pension fund model**

Each employee who is due to the internal agreements subject to the bank or part-time collective agreement automatically becomes a member (beneficiary) of the BAWAG pension fund provision at the end of the according waiting period.

In order to finance this, the employer makes a continuous contribution (12 maturities) of 2,5% of the annual basis of assessment (=14 times the monthly salary plus bonus but without the bonus for social and hazardous work) as well as a non-recurring contribution for securing the pension (for beneficiaries who entered the BAWAG before 01.01.1997) between 1,5 and 1,9% (according to salary classification) of the basis of assessment at the end of one year of service. Part-time employees receive single premium of 2,5% of the basis of assessment for each completed year of service.

A participation of the employees is basically possible for benefiting employees but only to an extent of 25, 50, 75 or 100% of the employer's contribution. It is settled by individual arrangements. If an employee decides on a participation, his contribution is made up by a financing share and an insurance tax (2,5%). The portion of administrative expense included in the premium income, however, is paid by the employer.

The continuous employer's contributions as well as the non-recurring contributions for part-time employees are vested after at most four years, whereas the employer's contributions and the contributions for securing the pensions attain this status immediately.

The scope of benefit contains

- an old-age pension (from the 60<sup>th</sup> year of life on)
- a premature old-age pension (from the 55<sup>th</sup> year of life on)
- a disability pension (including an increased risk protection up to the 50<sup>th</sup> year of life)
- a widow(er)'s pension / orphan's pension

and is paid out 14 times a year.

The amount of the benefit results from the retirement of the capital which has been accumulated till the beginning of the pension (= paid in contributions + achieved success in investment + actuarial result), at which the claim on an old-age or disability pension of widow(er)s amounts 60% and that of orphans amounts 10% (half-orphans) or 20% respectively (orphan who has lost both parents).

In order to achieve a stable value of the pension benefits, the contributions are adapted depending on the salary (adaptation of the contribution) and in the phase of benefit a valorization of the pensions (adaptation of the pension) is carried out.

With the help of the information system for entitled expectants and beneficiaries a statement of account is sent to all beneficiaries at the beginning of each year, so the employee is able to obtain a general view of the paid in contributions and the amount of pension he can expect.

## **5. Perspectives for the future**

Since the BAWAG entered into a cooperation with the ALLIANZ in 1998, it is intended to lay back the licence for the BAWAG pension fund stock corporation in 1999.

This decision has been explained on the one hand with the fact that the ALLIANZ as the partner enterprise already has got an external pension fund, the ALLIANZ pension fund AG, of its own which makes a participation economically meaningful. On the other hand, the results of the BAWAG's internal pension fund did due to the small capital (only current contributions!) not really come up to their expectations.