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# **ROLE OF INSURANCE COMPANIES IN THE NON-STATE PENSION PROVISION SYSTEM**

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## Policy Recommendation

In 2003 the Ukrainian Verhovna Rada adopted the Law “On Non-State Pension Provision,” effective January 1, 2004, as a part of national pension reform. The Law makes it clear that insurance companies can participate in the payout phase by offering annuities as well as offering supplemental products such as death and/or disability insurance during the accumulation phase. However, the provisions of the Law regarding insurance company participation in the non-State pension accumulation phase are not as clear. This ambiguity has led to a debate as to the right of insurance companies to participate in the voluntary pension system (Pillar 3) during the accumulation phase. The insurance industry is anxious to participate in both the accumulation and payout stages. They believe that open competition among multiple types of financial service providers will foster greater competition and reduce provider fees.

The Ukrainian national pension reform is based on the current best international practices. Ukrainian policymakers elected to establish a **defined contributions** scheme for Non-state Pension Funds’ operations. Under a defined contribution scheme participants, at retirement, are to receive a pension based on their contributions plus investment income less service provider cost. International practice is moving away from **defined benefit** schemes, which are viewed as risky because the long-term funding for these programs is a challenge. A defined benefit plan provides that the employer, as the pension provider, guarantees a retirement payout to each participant, related to his final or average wage.

International practice has shown that defined benefit schemes are not only more costly for employers to maintain, employers’ contributions often do not vest immediately, and employers could not or did not fund the cost of these pension programs. When employees reached retirement age, too often employers had not funded properly, investments did not meet the required pension payout and the employee did not receive the promised pension.

Placing the protection of the interests of future pensioners as the top priority the Law “On Non-State Pension Provision” provides for several safeguards including, but not limited to, the following:

- Separation of pension fund assets from assets of employers, founders, fund administrators, asset managers and insurance companies;
- Personified record keeping of NPF participants, their contributions and future pensions;
- Requirement for NPF to use a licensed fund administrator, asset manager and bank-custodian;
- NPF participant’s immediate and full property right for contributions to his account;
- Dependence of the future pension on the amount of money on the individual pension account of a participant, consisting of contributions and investment returns, less service provider cost;
- Diversification and limitations on investments of pension assets; and
- State control and supervision over private pension providers.

To ensure optimal participation in the system of non-state pension provisions and protection of money for future payments of pensions to non-state pension participants, it is necessary to create a level playing field for all entities participating in the sector, including non-state pension funds, insurance companies and banks. To achieve this objective, the following is recommended:

1. Amend the Law “On Non-State Pension Provision” to clearly state that insurance companies can participate in the non-state pension accumulation phase only by creating and registering a separate entity-- a non-state pension fund—and comply fully with this Law by involving an administrator, asset management company and bank-custodian as well as conducting its operations in accordance with the Law “On Non-State Pension Provision.”
2. Amend the law “On Insurance” to provide that life insurance companies can provide non-state pensions in accordance with the provisions of the law “On Non-State Pension Provision”.