

Giving the Public the Information It Needs on NPFs

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On January 1, 2004 the Law of Ukraine ‘On Non-State Pension Provision’ took effect. At the time there were already 47 voluntary pension schemes in Ukraine. However, all but 5 terminated rather than reorganize under the new law.

During 2004 the FSR processed applications and promulgated critical regulations for implementing the new law, and by early 2005 NPFs as we know them today began to emerge. Nine new funds were active at the end of the 1st first quarter in mid-2007, 27 months later, there were 85 pension funds. Fifty of them were actively engaged in pension provision.

As the number of funds increased so did participation. Between the first and last quarters of 2005 the number of pension fund participants grew from 35,000 to 88,000. By the end of 2006, there were 193,000 and by mid-2007 participation stood at 245,000. This is a 7 fold increase in only 27 months.

Assets also increased rapidly. NPFs held only UAH 13.4 million at the end of 1st quarter 2005. By mid-2007, they has shot up to UAH 199.9 million—a 15 fold increase.

The growth in the number of NPFs, the number of people participating and size of asset holdings is impressive over a period of barely more than 2 years. Nonetheless, the system is still very small. In a country with over 16 million workers, 250,000 adults with a private pension account is not impressive. What if anything can be done to transform NPFs from fledgling financial institutions to the powerful engine that feeds capital markets in North America and much of Europe?

Transforming NPFs into Powerful Financial Institutions

Many factors will determine if NPFs will become the strong financial institutions they have become elsewhere. Many economists believe that higher wages are the essential ingredient that will fuel NPF growth. Surely this must be partly true. However, in Ukraine attitudes may be at least as important as wages and perhaps much more important.

The past is prologue, and in the past the experience of Ukrainians with financial institutions has not been good. In fact, it has been terrible. Ukrainians are justifiably skeptical that NPFs will deliver on their promises, even the most basic promise of protecting their saving and returning it to them.

The best way to encourage the growth of any financial institution is to build confidence among those who can choose to use it. In the case of NPFs, it is workers and employers that must be convinced. They must believe that Non-State Pension Funds can deliver on their promise to provide a better retirement. The time-tested best method of building confidence is information. Workers and their employers must know how NPFs are performing right now, and they must continue to be informed on a regular basis. Trust can only be restored and strengthened with repeated demonstrations of success.

FSR has taken the lead in developing the technology to produce the information workers and employers so desperately need to gain confidence in the voluntary pension system.

Over the past year, FSR has put in place a system of electronic financial reporting for all NPFs. Each quarter NPFs final extensive financial reports by completing forms posted on a secure website. The reports are entered directly into the FSR NPF data base. They are checked to ensure that critical items are completed and that financial statements add up and balance. If the reports of an NPF do not pass the checks, they are electronically returned to the NPF for correction. The electronic database is an invaluable source of financial information and the main pillar supporting regulatory oversight of the voluntary pension system.

The first and highest priority use of the database is to help FSR specialist ensure that pension funds have properly implemented the detailed rules specified in law and regulation and are operating within all guidelines. Many of the procedures to accomplish this are in place and several new procedures under development with input from Ukrainian and international experts and domestic market participants. Enforcement work is always ongoing. Over time FSR will apply more sophisticated analysis techniques, incorporate new tools developed in Ukraine and elsewhere, and meet higher and higher regulatory and enforcement standards.

With enforcement analysis well underway, the FSR is now embarking on the next major task—providing information to the public.

Extracting, reformatting and making additional computations on the financial reports of NPFs is not a simple task. To be useful information must be presented clearly, be easy to understand, and be completely accurate. The FSR has solicited the assistance of international pension and regulatory experts to assist in

designing and implementing the pension disclosure system. Resident experts from the USAID Capital Markets Project (CMP) will provide assistance along with additional domestic and international experts as needed. Market participants will also be consulted. Plans are being discussed for involving the ordinary NPF participants as evaluators of the usefulness of the information presented, other information that would be of interest, and the effectiveness of formats and methods of presentation.

Work on the new system of public disclosure has already begun, although many decisions will not be finalized pending input from stakeholders. CMP experts have reviewed and evaluated disclosure systems in other countries. Based on this review, disclosure in Ukraine will include a series of reports that will progress from the simplest and most basic information about each pension fund to more detailed and complex information. The reports under discussion are:

- Report 1: Basic Information on Each NPF
- Report 2: Comparisons of Major Performance Indicators
- Report 3: Summary Charts of Basic Elements of Fund Activity and Operation for Each Fund
- Report 4: Summary of Financial Statements for each NPF
- Report 5: Detail Financial Reports

Basic Information. Report 1 will be designed for participants of pension funds and those considering participation. Information will be provided on the founders of the fund, the type of participants served (individuals, corporate employee groups, occupational groups), number of participants, and value of assets at end of most recent quarter. Information at this level might also include the name of the pension fund administrator and the asset manager.

Performance Indicators. At the second level of detail (Report 2), information will be provided on recent rates of return of each pension fund and expense ratios. This information will be displayed in a single listing of all funds so that users can easily see the range of difference among funds and compare funds. Over time historical rates of return will be added for each fund. This type of display is common practice in other countries. It will help the public judge the level and consistency of the performance of each fund.

Data on Individual Funds. Users interested in a particular fund can examine its performance in more detail. Report 3 is expected to provide a table of returns and expenses for the fund that will show its entire quarterly history to date. Rates of return will be shown in graphic form and a pie chart may be provided of the allocation of assets among different types (stock market equities, corporate bonds, government debt securities, etc.). Other information being considered is history of growth in net assets, participation, and contributions.

Detailed Comparison of Any Two Funds. A potentially useful tool for those considering joining a fund or transferring their account to another fund would be the ability to compare the history of returns and other performance indicators between any two selected funds. The IT team is considering the cost and feasibility of providing easily accessible comparisons. A tool for limited comparative analysis is being contemplated as an adjunct to Report 3.

Financial Statements. This would be the most detailed financial information provided. Two reports (4 and 5) are being considered. Each would disclose a different level of detail. Report 4 would include a summary of the income and balance sheet. Here there would be a separate report for each pension fund. Report 5 would provide even more detailed financial information. This final level of detail might even include the full detailed financial reports for each pension fund. In most countries, the detailed financial reports are available, although in the past obtaining these reports have often required that the user pay a fee. Modern technology can overcome that barrier to public information.

Data can be presented in many formats and financial indicators can be computed using different methodologies. Although the process of selecting and organizing financial information for public disclosure is well underway, it is far from over. Undoubtedly, many other points of view and suggestions will be considered before the first reports are released to the public.

Who can get this information and where can they find it?

The pension disclosure system will be web based. The information will appear as an expansion of the current FSR website or as a separate website devoted on to pension disclosure and other important information on non-state pension funds. Other information could include instructions for contacting pension funds, making application for participation, and the range of contribution and pension options available. The CMP has conducted roundtables on NPFs in major cities around the country. Much of the information presented at these roundtables and answers to frequently asked questions could be included as separate pages on the website.

All of the financial disclosure and other information will be available free of charge to any one with internet access at home, at work, or at an internet café.

When will the data be publicly available?

The system is scheduled for a full scale test in late fall of 2008. The goal is to make the information publicly available by the end of the first quarter of 2009. However, meeting this goal will depend upon more than completing development of the website and derive the information from the quarterly financial reports NPFs file with the regulator. Information can not be made publicly

available until its accuracy can be totally assured. This will not be an issue for most of the information, but for some critical items it may be.

Currently, there is no method for valuing certain types of securities consistently across pension funds. This is particularly true for equities of joint stock companies. Until it is certain that all NPFs are using the same value for the same equity on the day pension assets are valued, rates of return may not be fully comparable from one NPF to the next. It would be irresponsible to publish rates of return that were computed using the same value of the same security on the day of the valuation.

These and other problems will need to be resolved before all information can be made available to the public. Both FSR and SSMSC are working on methods to ensure strict consistency in valuation of assets. New and revised regulations are expected to be issued in 2008, although some of these will depend upon changes in the laws themselves.

Conclusion

There is still a great deal of work to be done. However, Ukraine is close to having a second pillar that is second to none in security and reliability. Stronger enforcement of NPF rules and valuation methods that give consistent results across NPFs should soon be in place. Then, the missing ingredient in the formula for a successful voluntary pension system will be stronger, more disciplined capital markets and an increase in the volume of high quality investment grade securities. Enactment of a strong Joint Stock Company law and regulations that accommodate strong private capital market institutions will be essential to these developments.