

To Implement an Accumulation Pension System Pillar I and III Must Coordinate

Interview with Mr. Gary Hendricks, USAID Capital Markets Project Expert

1. Mr. Hendricks, what requirements, in your opinion, should be set to private retirement provision entities, in particular to non-state pension funds (hereinafter, NPFs) that are going to participate in the accumulation system of mandatory state pension insurance (translator's note – hereinafter, MAS)?

Partially such requirements are laid down in Article 20¹ proposed in the Draft Law of Ukraine On Implementing MAS (passed in the first reading) as an amendment to the Law of Ukraine On Non-State Pension Provision.

In the light of the currently discussed proposal for NPFs to participate in Pillar II from the very start of the system we need to make sure NPFs are ready for this. The Law of Ukraine On Mandatory State Pension Insurance provides for the possibility to accumulate Pillar II pension funds in NPFs in 11 years after the MAS launch. However, at the moment it is proposed that beginning from January 1, 2011 Pillar II will be implemented at once through NPFs. And since it is proposed to expedite the process additional requirements should be set.

At the current stage for NPFs it is important to prepare for Pillar II. NPFs' accounting and personified record-keeping systems should be tested. For this purpose there should be established an expert group consisting of Ukrainian as well as foreign specialists who would do this work.

There are some legislative moments connected with custodians' activity that should be regulated before Pillar II launch. There is a long list of issues that I would like to be resolved before Pillar II implementation.

2. What cut-off age should be for Pillar II?

This question is rather many-sided and requires detailed research. On the one hand low cut-off age would allow the regulators and the market to get better prepared for a full-fledged system development. On the other hand there are major drawbacks connected with this approach. With a low cut-off age of the participants the system would be filled in very slowly. In this case the cost of transition to MAS may be treated as a disadvantage.

The purpose of Pillar II introduction is to relieve the burden on PAYG system. However, there is no guarantee that we shall hit the target if the cut-off age is low.

I should say that this issue is being studied and I cannot say anything concrete at the moment.

3. What strategic issues of Pillar II in your opinion should be resolved?

Here the state responsibility plays an important role. I am concerned by the fact that today there are more than 100 NPFs in Ukraine. Currently there is a proposal to allow all NPFs to operate in MAS. Talking about other countries' experience not more than 15 NPFs would participate in such pension system.

In Slovakia all private pension funds were allowed to Pillar II, however, they were required to increase the number of their participants up to 250 000 within 18 months. If this requirement was not met by NPF, the NPF had to leave Pillar II.

In Ukraine requirements should also be set to the NPFs willing to participate in Pillar II. NPFs should be ready to such work. The requirements to NPFs can be set either in the law or determined by the State Commission for Regulation of the Financial Services Markets in Ukraine.

4. What requirements should be set to investment of Pillar II pension assets?

Such requirements are set in the Law of Ukraine On Mandatory State Pension Insurance, however, it is possible that they may be reviewed and made similar to those set in the Law of Ukraine On Non-State Pension Provision.

5. How control functions should be split up in MAS?

Proposals that currently exist are not concrete; therefore it is difficult to give a definite answer. Based on the international experience one can say that in most countries all control functions over pension funds, including supervision over compliance with asset valuation regulations and pension assets diversification requirements is exercised by a single pension regulator. For instance, in Estonia Pillar II is controlled by a single institution and I should say it's one of the most efficient systems in the Eastern Europe.

6. What key issues should be resolved for Pillar II implementation?

To begin with it is necessary to decide clearly whether the system is going to work through a single Accumulation pension fund or through NPFs and depending upon the choice amend the legislation framework accordingly. In any case NPFs should meet international standards.

Ukraine should make a final choice in this issue. However, there are pros and cons in both approaches. Minus in implementing Pillar II through a single Accumulation Fund is that most pension funds may be invested in government securities, while their yield in Ukraine is very low. Besides, there is a risk of inactivity and political influence in managing this institution. If we implement the system through NPFs, there is a risk of mismanagement.

7. Which countries' experience Ukraine could use when implementing Pillar II?

Each country is unique and has its own specifics that should be taken into account when implementing reforms of any kind. One of the problems in Ukraine is that the cost of solidarity system remains unstable: political situation changes in the country which causes the change in rules and benefits. In addition the high inflation presses. In Ukraine it is important to stabilize the solidarity system of pension insurance before implementing Pillar II. In particular, the World Bank made a number of recommendations for such stabilization. So that Pillar II became strong from the very beginning we need a streamlined work of both pillars - Pillar I and Pillar III.

8. Based on other countries' experience: what mistakes could we avoid in Ukraine when

implementing Pillar II of mandatory state pension insurance?

One of the major mistakes typical for other countries when they implement MAS is overlapping in time of Pillar I unsteadiness and Pillar II implementation.

The second mistake is insufficiency of investment objects inside the country and creation of barriers for overseas investments.

Ukrainian companies managing assets of non-state pension funds as a rule prefer to invest inside the country. However, as soon as good investment opportunities appear in the country, the money will return to Ukraine immediately.

9. Taking into account the political situation in the country and the global financial crisis may be it is worth deferring Pillar II implementation in Ukraine for a couple of more years?

On the one hand, of course, it is not the best period. On the other hand, the political situation is never stable and the economy suffers downcycles from time to time.

Here everything depends upon the readiness of infrastructure and legislation.