

Improving Ukrainians Options for Financing their Retirement

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Currently Ukraine's non state pension funds (NPF) are managing 552,1 million UAH in assets entrusted to them by 456 900 participants. It is not surprising that this is only a small part of the adult population and labor force. Ukrainian workers mistrust financial institutions, including banks, and NPFs are far less known and far less understood than banks. In addition, most Ukrainians have little discretionary income. They need almost all their money for the immediate needs of themselves and their families. Little is left to save for a rainy day and almost none to save for retirement.

Throughout the developed world participating in a voluntary pension (an NPF) usually makes the difference between a comfortable retirement or one that allows few extra pleasures. In the future, this should be no less true for Ukrainians than for Americans, 50% of whom participate in an NPF. For now, however, the skepticism of Ukrainian workers about NPFs is justified. Although they have been operating for 5 years, NPFs are not fully developed financial institutions.

Part of the legal underpinnings for trustworthy NPFs is still missing. Of seminal importance is the responsibility of those governing NPFs, most notably Boards of Directors. In other countries, those who occupy such high positions of trust, are personally expected to exercise diligent oversight over those they hire to administer the NPF and manage the assets of its participants. When negligent in performing their duties, directors are personally liable. This is not true in Ukraine.

Even worse, it is often difficult to even determine negligence. NPFs and their service providers are required to disclose the identity of their beneficial owners and ultimate controllers. For example, under law, the assets of a pension fund are entrusted to an independent custodian. However, since the independence of the custodian need not be demonstrated, "independent" custodian can be controlled by the founders, administrator, or asset manager of the NPF.

Weaknesses in the law translate directly into weak regulation and increased risk of manipulation, fraud and financial losses for participants. Regulators need

the power to regulate, sufficient expertise to use their power effectively, and the standards of integrity that command the respect of those they regulate.

Neither the securities regulator nor the financial service regulator is politically independent or financially autonomous—an absolute requirement within the EU and most developed world. In the pension area, regulators are young and inexperienced, receiving low salaries. The best of them leave for better jobs in less than 5 years.

Regulatory integrity is often compromised. The regulator often does not treat NPFs equally and regulations are perceived as being issued with an eye to extracting extra fees from NPF service providers. Credentials can sometimes be won more easily through personal relations rather than with knowledge and proper testing. And the NPF industry resists even the most basic and widespread international standards preferring instead to manipulate the value of participant accounts.

Not all of the current weaknesses are the fault of the gaps in the legal framework, lack of a strong tradition of regulator integrity, or the greed of those that establish and service NPFs. It can be legitimately difficult to value assets at current market prices and proper asset diversification can be difficult for NPFs to achieve. Financial markets need to be brought up to international standards and made transparent to improve their liquidity and allow for the development of a wider range of financial instruments.

Correcting the most obvious of the gaps in development of NPFs would not be difficult. The remedies are well known from international experience. However, in Ukraine it is not the regulator, or the Rada, or the government that will make NPFs a viable means of saving for retirement. It is the NPFs themselves and those that can responsibly profit from their success as financial institutions. The changes will happen if the NPFs and the entities that profit from them take responsibility.

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