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“Pension Reform in Ukraine: what to do about the Mandatory Accumulation System in Ukraine”.
Kyiv, April 28-29, 2010

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EDITOR'S NOTE:

This issue coincides with a conference on Pillar II, “PENSION REFORM IN UKRAINE: WHAT TO DO ABOUT THE MANDATORY ACCUMULATION SYSTEM IN UKRAINE”, organized in Kyiv, April 28-29, 2010.

The conference, held under the patronage of the Ministry of Labor and Social Policy of Ukraine, with support from the USAID Capital Markets Project, brings to Kyiv top pension reform experts from all over the world. At the conference, they will share and discuss experience of their country's administrative models for pillar II with leading Ukrainian government and public policy leaders.

- private pension funds' involvement will be highlighted through the presentation of the Polish and Hungarian models of administration;
- the administration of pillar II funds exclusively through public institutions is illustrated by the Chinese and Singapore examples;
- and the model whereby a person participates in the public system unless they opt for a private fund will be presented by speakers from Sweden and Russia.

Other topics addressed during the conference will include communicating pension reform to the public, record-keeping, and special groups. Certain key policy issues will receive particular attention: regulatory issues, fiduciary responsibility towards participants, and investment options.

This issue of IPN will pay special attention to issues directly or indirectly relevant to the planning, implementation and administration of a mandatory contribution scheme.

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INTERNATIONAL TREND: SOCIALY RESPONSIBLE INVESTMENT

Poland: Government Debates Pillar II Contributions

The Polish Government appears split over what to do with pillar II contributions. Some experts believe that pillar II contributions are too high, diverting too much money away from the financially vulnerable solidarity scheme, and have been lobbying for a cut in pillar II contributions to the benefit of pillar I, like in Latvia and Romania.

The Polish Prime Minister Donald Tusk blocked such a move earlier this year. "The government has major difficulties with closing this year's budget gap, and I suppose that some of the proposed changes in the system could originate from the very same source," Warsaw-based Open Finance consultancy analyst, Bernard Waszczyk told Globalpensions.com. "Cashing in from the funds may be tempting for the government in the short term, but it may lead to long-term troubles. If OFEs are left with administering a mere 4% of the wages, future payments will hardly boost an insured's pension", he added. The country's private pension funds which administer the contributions as well as worker representatives also oppose transfers of contributions from the mandatory scheme to the solidarity scheme, afraid that could ultimately compromise the future of pillar. (IPE.com, Globalpensions.com)

Latvia: Government Rejects Return to Higher Pillar II Contributions

The Latvian Government back-tracked on its plan to increase pillar II contributions. Before the financial crisis, mandatory contributions to pillar II stood at 8%. However, due to the crisis, the government decided last year to redirect part of the contributions to the solidarity scheme. Contributions to pillar II were brought down from 8 to 2% and the difference diverted to pillar I. They will remain at this level for another year, going up to 4% and reaching 6% in 2012. "We made a mistake in aiming to increase the contribution rate to 10%," Jana Muizniece of the Latvian Ministry of Social Affairs said. "The financial crisis shows that it is not possible to give such a large part of social contributions to the second pillar."

Under the Latvian system, the system is not mandatory for all categories until the transition period ends in 2034. It now covers about 28% of the working population, according to IPE.com (IPE.com)

Slovakia: Experts Debate Pillar II Contribution Level

Like other countries in the region, the issue of contribution rates in the mandatory scheme is being debated in Slovakia. The pillar II scheme needs contributions to ensure future pensions, but at the same time, the solidarity scheme is suffering from a serious deficit that could be contained by increased transfers away from pillar II. The Slovak Academy of Science has argued that pillar II contributions should be reduced. At present, a worker who has joined the mandatory contribution scheme may transfer up to half of his social contributions to pillar II. Some of the debates also focused on the role of private financial institutions in the pillar II systems, and on the role of public institutions, as well as the place of

employer-employee decision making in corporate funded schemes. (IPE.com)

GOVERNMENT POLICIES: RETIREMENT AGE REFORM GAINS MOMENTUM

Increasing retirement age is an important issue because it is one of the factors allowing for the long-term financial stability of the solidarity scheme (pillar I) ahead of pillar II implementation. A mandatory accumulation scheme cannot be set up independently of pillar I concerns: if the solidarity scheme is unsustainable due to too short contribution periods or unrealistically costly special pension privileges, this will also affect the sustainability of pillar II.

Increasing retirement age is hardly ever a popular decision...as the experiences of France and Greece show, but governments throughout the world are coming to the conclusion that it is necessary.

Estonia: Parliament Passes Retirement Age Increase despite Protests

The Estonian parliament approved an increase in retirement age for both men and women to 65 by 2026 through an amendment to the "State Pension Insurance Act". The bill pushed through by the Government coalition was approved under heavy criticism by a 10 vote margin while opponents picketed outside. In defense of the bill, the Minister of Social Affairs Hanno Pevkur explained that the alternatives to increasing retirement age would be to reduce pensions, to increase taxes, or increase the number of migrant workers in the country. Increasing retirement age is a way of addressing the consequences of an ageing population: more pensioners, and a higher burden on the budget. Currently, the statutory retirement age for men stands at 63 for men, and 60 for women. It will be equalized by 2016 at 63 for both, then, increased gradually by three months every year until 2026. The (The Baltic Times, the Baltic Course, Baltic Reports)

France: A Majority of French Hostile to Working Longer

80% of the French population recognizes a reform of the current pension system to be "necessary". 43% are ready to contribute for a longer period – and in effect working longer to retain full benefits- a recent poll commissioned by RTL radio revealed. More than half – 56%- said that are not ready to contribute longer. 60% are opposed to increasing the minimal retirement age of 60, 39% say that retirement age should be put off. 18% say that no reform of the pension system is needed and 1% is unsure. One reform that appears to gain general support is the harmonization of pension systems of the public and private sector. 82% believe that one system should serve private and public sector workers, in effect supporting a reform to end the privileged status given to public sector employees on retirement. In 2009 the pension branch of the French social security funds reached a deficit of 7 bn euros and is expected to go over 10 bn in 2010. Last December, the French Prime minister Francois Fillon warned that at the present rate in 2050 the state would need 100 bn euros to finance pensions. (leparisien.fr, AFP)



U.S.A.: Illinois Increases Retirement Age for State Employees

The legislature of the state of Illinois has adopted an increase of retirement age without prior public debates, hearings, or warning. Retirement age of employees for state pensions was raised from 65 to 67. The bill also caps the income on which pension calculations are based. Both measures will apply to newly hired state employees but not to active state workers. (nytimes.com)

Global: Selected Countries' Recent Plans to Increase Retirement Age in 2009-2010

TABLE 1 Selected Countries' Plans to Increase Retirement Age in 2009-2010						
	France	U.K.	Greece	Estonia	Spain	Bulgaria
Statutory pension age	60 but a recent reform set 65 as the legal age, 60 as the minimum age for private sector employees, and 70 the maximum age.	65 60	65 60	63 60	65	63 60
Reform Plans	Wanted by Government	Agreement - increase the age to 68	Currently debated	Just adopted	wanted by Government	Various plans currently debated
-Increase in contributions	Yes, possibly.		n.a	n.a	n.a	Yes- one proposal to extend the contribution period from 34 to 37 for women and 37 to 40 years for men
-Retirement Age Increase	Yes, possibly 65 years	Yes- Retirement age for women is rising from 60 to 65 by 2020. Discussions on age 68 retirement n 2046 for both men and women	Yes, possibly to attain an average exit age of 63 instead of current 61	Gradual increase to 65 in 2026	Gradual increase beginning in 2013 from 65 to 67	Yes- currently debated 63 years for men and women w. 40 years of contribution; other proposal is 65 w. 37 years of contribution

(Sources: OECD, Reuters, AFP, Bloomberg, sofiaecho.com, novinite.com)

SECOND PILLAR PENSIONS COST TOO MUCH:

Polish Administration Costs Need To Come down

The Polish Social Ministry believes the current second pillar pensions regime is still too expensive, but officials are still struggling to reach a consensus on how to cut these costs. The Polish prime minister halted plans in February to transfer money out of the second pillar system and back into the first pillar, but the in-fighting is continuing as the latest round of talks showed the social ministry still thinks it is a good idea. "As the second pillar funds invest up to 60% or 80% assets in bonds, government bills and other securities issued by the State Treasury or the National Bank of Poland, the system has become an expensive duplication of the PAYG system," officials at the Social Ministry told IPE. (ipe.com)

UK Second Pillar Too Expensive?

The UK Government recently announced the charges that will apply to its new compulsory second pillar pension scheme (NEST) which is due to start operating on 1 January 2012. The expected charging structure for the National Employment Savings Trust (NEST) will be a combined charge of a 0.3% annual management charge (AMC) and an admin contribution charge of 2% that may fall away once the set-up costs of the scheme have been recovered. Angela Eagle, the UK Minister of State for Pensions and the Ageing Society, said: "This is a fair

and sensible funding package which delivers the Pensions Commission's vision of a low cost scheme in an affordable way. It balances the needs of members, taxpayers and the interest of the broader pensions industry." (ipe.com)

However these charges were immediately criticized by the UK's National Association of Pension Funds – the self-regulatory organization for occupational pension plans in the UK. The NAPF's Director of Policy, Nigel Peaple, - said the "We are concerned that a 2% charge on contributions means charges will be relatively high - higher than in an existing scheme".

(Editor's – the only debate is over the contribution charged proposed by the Government of 2% of contributions. Nobody is disputing the proposed asset management charge of 0.3%).

CONFERENCE MATERIALS: DIFFERENT MODELS OF MANDATORY PILLAR 2 PENSION SYSTEM IMPLEMENTATION

Both Private and Government Involvement In Mandatory Pillar II Operation (Mixed Model): Experience Of Sweden And Russia

The Russian Pension Model

Starting from January 1, 2010, the old-age labor pension benefit is calculated as the sum of two components: insurance and accumulation. The insurance component of the old-age labor pension comprises a basic flat-rate benefit according to different categories of beneficiaries plus a benefit based on the notional account. The accumulation benefit is based on the value of the individual account (contributions plus interest). The individual account operates for those born on or after 1 January 1967. The current contribution rate is 20% of salaries and will increase to 26% from 1 January 2011. Salary is capped at RUB 415,000. Contributions for participants born on or after 1967 are divided in the following way: 8% of their wage is paid into the insurance component of labor pension, and 6% goes to the accumulation component. For those under 40 insurance contributions are paid to the Pension Fund of the Russian Federation unless they have chosen one of 113 NPFs or one 55 Asset management companies which were licensed to accept contributions to mandatory Pillar II accumulation component of labor pensions. Employers pay 6% of wages as mandatory contributions to the accumulation component of labor pensions. Individuals can pay voluntary additional contributions to the accumulation component at their own expense. Employers, too, may take a voluntary decision to pay additional contributions to the accumulation system on behalf of their employees. The State should pay additional contributions in cases where an individual paid at least RUR 2000 as additional insurance contributions to the accumulation component of labor pension in the previous year.

Since January 1, 2009, the State Asset Management Company has been offering two investment portfolios for pension savings: (1) an extended portfolio which invests the assets of individuals who have decided in favor of a certain investment portfolio, and individuals who have not chosen an AMC or a NPF and (2) an investment portfolio for government securities with assets of individuals who have chosen this investment strategy of the State Asset Management Company .



The State guarantees that every accounted ruble of the contributions paid to the accumulation component of the labor pension and reported at the moment of pension allocation will return to the beneficiary as pension.

The Swedish Pension System

A new public pension system was introduced in Sweden in 1994 and implemented in stages during 1995-2003. Under this system, Swedes receive retirement benefits from a unified social insurance with individual mandatory notional (NDC) and financial accounts (FDC), financed by a combination of employer and employee contributions. The new system also includes a minimum guarantee and non-contributory rights, such as child care credits in conjunction with child birth, financed from general revenues. The NDC component is financed by contributions of 16% and the FDC component of contributions of 2.5 % of wages. All workers and the self-employed are mandatory participants in both schemes. In the mandatory FDC scheme individuals can choose to invest their individual accounts in up to five of any of approximately 800 funds (about 90 fund managers) registered to operate in the system. In spite of the large number of funds, the seven largest fund managers manage the majority of accounts. The accounts of non-choosers are administered by a public fund designated for this purpose.

The Private Pension Funds Involvement In Mandatory Pillar II Operation: Experience Of Poland And Hungary

The Polish Pension System

A new mixed insurance system began on 1 April 1999. The system is compulsory for those born on or after 1 January 1969 and voluntary for those born after 1 January 1949. Employees contribute to Pillar II 7.3% of wages to one of 14 private pension funds chosen by them plus a further 1.5% for death and disability benefits. If an employee does not make his/her choice of a pension fund this choice is made for him/her by the Social Insurance Institution (ZUS) which also acts as a collector of mandatory contributions. Employers pay 9.76% to the first pillar old age pension and a further 6.5% to fund death and disability benefits. The pillar I benefit is equal to 24% of national average earnings, plus 1.3% of the insured's earnings times the number of contribution years, and 0.7% of the insured's earning times the number of noncontributory years (for example, for years spent rearing children). Noncontributory years must not exceed 1/3 of contributory years. In addition an annuity is payable from the second pillar.

The Hungarian Pension Model

The new system started on 1 January 1998. It is a mixed defined benefit and defined contribution system (DB- defined benefit + DC- defined contribution schemes). The mandatory accumulation system is aimed at those who are under 42 on a certain date. The employees from 42 to 50 could choose either the solidarity or the mixed benefit system (DB+DC). Current pension insurance contribution rates are 21% on behalf of an employer and 8.5% on behalf of an employee. For the participants of the mixed system, the accrual rate is 1.22% per each year of service. As of today, the moneys of the accumulation pension system are accumulated by 19 private funds of the DC schemes selected by the participants. Initially 6, then 7 and now 8% of wages are paid into the mandatory accumulation system.

The Public Model Of Mandatory Pillar II Operation: Experience Of China And Singapore

The Singaporean Pension System

The system of the Central Provident Fund of Singapore (CPF, the Central Savings Fund) is structured as a fully-funded, defined-contribution scheme where each member saves during his working life for his or her own retirement. As a mandatory, fully-funded scheme of individual savings accounts, CPF is effectively a "second pillar" within the World Bank's Multi-pillar Pension Taxonomy. The Government supports retirement income by providing guaranteed minimum returns on CPF savings. At the same time, CPF also allows for voluntary contributions (the "third pillar") and reflects informal or intergenerational family support (the "fourth pillar") through its various schemes. Since its inception in 1955, the CPF system has evolved into a comprehensive social security savings scheme, which not only takes care of a member's retirement, healthcare and housing needs, but also provides financial protection to the CPF members and their families and dependents – upon disability or death – through its insurance schemes. The Central Provident Fund Board of Singapore (CPF Board), represented by fifteen members, is the trustee of the Central Provident Fund and is a statutory authority under the Ministry of Manpower. The CPF Board consists of 2 representatives recommended by the government, 2 – by employers, 2 – by trade unions, and the rest – other representatives which shall include 1 representative of the private investment company and a representative of the Toronto-Centre Company (the centre for the financial surveillance leading bodies). The Central Pension Fund is responsible for administering the system (collecting the contributions and performance of the pension payments inclusive). Investment of pension assets is conducted by the three state investment companies specialized as follows: 1- general investments, 2- real estate investments; 3- investments into special instruments.

The Chinese Pension System

Because of its size China centralized its social security system on the province (oblast) level since some provinces equal or exceed some countries by population. For instance, the province of Guangdong (with a population of more than 95 million people) is equal to Mexico, the province of Henan (the population of higher than 94, 3 million people), as well as Ethiopia and Guatemala considered together, Shandong (with the population of 94, 1 million people) as Vietnam and Sierra Leone, Sichuan (81, 4 million people), as Germany, etc. And whilst there exists a national policy established by the Central government, there are still slight variations from one province to another. However, the pension insurance in each province operates under both DB and DC schemes. Depending on the province, employers pay from 13% up to 20% of wages to the Council for Social Security depending on the province. Employees pay up to 8% to the mandatory DC scheme. Initially the employer's contribution made 3% of wages to the mandatory accumulation system. But since 2006 the 3% employer contribution is no longer being paid. Administering pension schemes by provinces is centralized and coordinated by the Council for Social Security. On the national level,



investment of pension moneys is performed by the state agency – via the National Social Insurance Fund. Some provinces follow the NDC model. According to the law, funds in the individual accounts can only be invested in government bonds and special savings bank accounts, although some provinces would use them before for other investment purposes. The National Council for Social Security manages the funds from the central government, the major part of which comes from share sales of state enterprises. The Council has started to sub-contract investment management to the private sector. There are issues with farmers and migrant workers which are treated slightly differently in different provinces. Civil servants are in a separate scheme.

The Proposed Armenian Pension System

The new system is planned to start on 1 January 2011. Such a system will provide for a Basic Pension to be paid from the state budget at 100% of the minimum consumption basket (MCB). Those who don't have 10 years of social tax payments will receive a Social pension (Zero Pillar), set at 100% of the Basic Pension from 2011-2020 and 80% of the Basic Pension from 2021. From 2011 income tax and social contribution will be unified at the rate 26% of a worker's wage; employers will not pay any labor/social tax. There will be a PAYG labor pension for those born before 1970 with automatic indexation of the zero and 1st Pillar pensions. Those born after 31/12/1969 will become participants of a mandatory accumulation fund of Pillar II. The total amount of a contribution to the accumulation fund will be equal to 10% – 5% paid by workers and 5% from the state budget, up to a ceiling. NASDAQ-OMX, a private company, that is the largest stock exchange in the world and whose technologies support operations of 70 exchanges in 50 countries of the world will transfer the contributions received from the Tax Service of Armenia to private asset managers chosen by participants. NASDAQ-OMX is also an operator of the Central Depository of Armenia where moneys of the mandatory accumulation fund will be kept. Thus, NASDAQ-OMX will keep records of assets on individual pension accounts and also keep records of individual data.

RETROSPECTIVE ON PILLAR II SYSTEMS:

Analysis: Public/Private Participation In The Management Of Pillar II Systems [Excerpt From IPN#10]

Table 2 below shows that when it comes to the management of Pillar II funds, the involvement of the state and private sectors can vary to a significant degree. The cooperation between public (State) and private sector ranges from one where the State limits its role to providing only the legal framework and supervision, while collection, management and record-keeping is transferred to the private sector (in the person of non-state pension funds and asset management companies), and, to another where the State or state institution performs all the abovementioned functions necessary for Pillar II on its own. Almost all countries with Pillar II schemes involve the private sector in asset management. However, contribution collection and record keeping are two functions predominantly entrusted to public institutions, as the table 2 shows.

Sometimes the public institution managing part of the Pillar II scheme also manages the Pillar I system (e.g. in Poland, Russia).

Some countries, like Latvia, stipulated a transfer period during which the Pillar II system was fully ran by the state. Only after that period private parties were allowed to participate. In other countries, like the Russian Federation, the individual participates in the State system unless the opted to participate in the private system. In Russia less than 10% of the population has chosen a private fund.

Editor's note: The main rationale for the involvement of private asset managers is that the public sector (the State) is prone to making sub-optimal, politically motivated, investment decisions. However, there is evidence that the advantage of the private sector in this respect can be negated by high costs of collection, administration and asset management. Some years ago The World Bank did a study, comparing the results of management by the State (including asset management) versus management by the private sector. The conclusion was that the losses by the State due to sub-optimal, politicized, decision making in asset management were more or less of the same magnitude as the losses of the private sector caused by high administration and transaction charges.

Table 2: Public/Private Participation in the Management of Pillar II Systems¹

Country	Collecting institution	Management of assets	Record-keeping
Latin America			
Argentina ²	Public, Federal Administration of Public Income	Private until 2008 (when the state nationalized pension funds)	Private, pension funds until 2008
Bolivia	Private, Pension funds	Private, Pension funds	Private, pension funds
Colombia ³	Private, pension funds	Private, pension funds	Private, pension funds
Chile	Private, Pension Funds	Private, pension funds	Private, pension funds
Costa Rica	Public, Social Security Institution (CCSS)	Public	Public, Social Security Institution (CCSS)
El Salvador	Private, Pension Funds	Private, Pension Funds	Private, pension funds
Mexico	Public, Mexican Social Security Institute ⁴	Private, Pension Funds	Private, pension Funds
Peru	Private, pension funds	Private, pension funds	Private, pension funds
Uruguay	Public, Social Security bank (BPS)	Private, pension funds	Private, pension funds
Central/Eastern Europe/Central Asia			
Bulgaria	Public, National Revenue Agency	Private, pension funds	Private, pension funds
Estonia	Public, Tax and Customs Board of Estonia	Private, pension funds	Central Register for Securities, private institution ⁵ which performs the contractual work of Pillar II administration



Country	Collecting institution	Management of assets	Record-keeping
Latvia ⁶	Public, State Social Insurance Agency (SSIA)	Public during transition period, then private: the State Treasury managed investments for the first 18 months after introducing pillar II. After that it handed gradually management over to private institutions	Public, then private after transition period expires
Kosovo ⁷	Public, Kosovo pension Savings Trust	Public, Kosovo pension Savings Trust	Public, Kosovo pension Savings Trust
Croatia ⁸	Public, Tax Administration of Croatia	Private, Pension funds	Public, Central Registry For Insured Persons (REGOS)
Hungary	Public, Tax Administration	Private, pension funds	Private, pension funds
Kazakhstan	Public, State Pension Payment Center (SPPC)	Private, pension funds	Public, State Pension Payment Center (SPPC)
Russian Federation	Public, Pension Fund of Russia (PFR)	Public unless participant chooses private fund the fund (less than 10% chose a private one)	Private pension funds or Pension Fund of Russian Federation according to chosen fund.
Romania ⁹	Public, National House of Pensions (CNPAS)	Private, pension funds	Private, pensions funds
Poland	Public, Social Security Institution	Private, pension funds	Private, pension funds
Slovakia	Public, Socialna Poistovna, the Social Insurance Agency ¹⁰	Private, pension funds	Private, pension funds
Macedonia ¹¹	Public, Public Revenue Office (PRO)	Private, pension funds	Public, Pension and Disability Insurance Fund of Macedonia (PDIF)
Kyrgyzstan ¹²	Planned reform from 2010: Public	Planned reform: first public during a transition period of two years, then private through pension funds after 2012	No data available
Other			
Australia	Private, pension funds	Private, pension funds	Private, pension funds
Sweden	Public, Tax Administration of Sweden	Public unless participant chooses private fund	Public, Premium Pension Authority (PPM)

¹ Unless mentioned otherwise, source is Tapia, W. and Yermo J.(2008), “Fees in Individual Account Pension Systems: A Cross-Country Comparison”, OECD Working Pers on Insurance and private Pensions, No 27, OECD Publishing

² No info on current re-nationalized design

³ See World bank working paper on Colombia’s reform at WB website web.worldbank.org

⁴ See U.S. Social Security Administration documents, <http://www.ssa.gov/policy/docs/progdesc/ssptw/2006-2007/americas/mexico.html> and Mexican agency website <http://www.imss.gob.mx/>

⁵ See Estonian pension administration website <http://www.pensionikeskus.ee/?id=1791>

⁶ See Allianz country report <http://publications.allianzgi.com/en/PensionResearch/CountryDatabase/Documents/CEE/Latvia2007.pdf>

⁷ See trust website <http://www.trusti.org/trusti/Home/tabid/36/language/en-US/Default.aspx>

⁸ REGOS website <http://www.regos.hr/default.aspx?id=209>

⁹ Law on mandatory pensions at <http://www.privatepensions.ro/Mandatory-Pensions-Law-2nd-pillar-article-1-4.htm>

¹⁰ <http://www.socpoist.sk/?lang=en>

¹¹ Law on mandatory fully funded pension insurance, 2006. see website of the national regulator <http://www.mapas.gov.mk/>

¹² See Concept of the reform dated September 2008 on official social Fund website <http://www.sf.kg/law13.aspx>

Analysis: Licensing Requirements For Funds Managers In Six Countries [Excerpt From IPN #5, May 2009]

Editor’s Note: This month we examine how 6 countries--Poland, Croatia, Latvia, Estonia, Bulgaria, Chile – attempt to protect Pillar II funds through requirements for fund managers. All of these countries have funded accumulation accounts as their Pillar II and III schemes. These are the types of schemes already existing (Non-State Pension Funds – NPFs) and proposed for Pillar II in Ukraine. International experience in this area is relevant when resolving issues related to improving the way NPFs operate and to implementing Pillar II in Ukraine.

The institutional frameworks of pillar II schemes vary from country to country. But for every country, the actual introduction of mandatory individual contributions schemes is fraught with key institutional and regulatory issues that must be resolved before going forward. The central issue is how to protect these assets – the pension savings of future generations – which raises a number of critical questions: how can the state, as guarantor of this system, make sure that these savings are safe? Who should be allowed to manage these funds? Should the accumulation account scheme be managed by a single accumulation fund or by private funds? Investment risks

aside, how then to protect these funds against mismanagement? The following examples below show the diversity of choices made by transition countries – from South America, Central Europe, and the new EU member states. The rules these countries impose on those managing pillar II funds have a number of points in common.

First of all, whoever wishes to manage second pillar pension funds is required to produce documents proving their competence as managers and investors (business plans, detailed portfolio plans etc.), the reputation and qualifications of their managers, and information on possible sources of conflicts of interest (shareholders’ other investments, family ties, other appointments, etc.). Also, the assets of the pension fund and those of the management company are strictly separated.

Then, in many countries asset managers need to fulfill additional conditions to be allowed to touch pension assets. Finally, the management companies are held personally responsible for losses and lost profit(through reserves made up of their own funds, and by risking bankruptcy if they do not fulfill their obligations.)



Poland

Mandatory individual accounts are set up in Open Pensions Funds (OPF). OPFs are specialized pension fund companies. OPFs are independent legal entities created and managed by a joint-stock company called a pension fund society. The assets of the OPF are separate from the assets of the pension fund society that manages them. The OPF management board manages the investments of the fund assets. The assets are kept by a custodian.

Licensing is in two steps:

1. Creating a pension fund society: Authorization is from the Insurance and Pension Funds Supervisory Commission (KNUiFE). The candidate applying to become a pension fund society must submit a number of documents describing its financial plans, describing the founders (and their relationships), and proving that the interests of future members are sufficiently protected.

The pension fund society must have share capital of at least EUR 5 million which cannot be from a loan or credit at its establishment, and the share capital must be at least 2,5 million at all times. The KNUiFE must reject the application if any of the shareholders of the future pension fund society has a tax arrears. The pension fund society has two boards, a management and a supervisory board whose members need to fulfill certain conditions – for instance, education, experience, not interested parties of brokerage firms etc...

2. Creating an Open Pension Fund: Each pension fund society is allowed to run two open funds (one conservative, one more heavily invested in equities). The pension fund society has to apply for a separate authorization to create an OPF and MAY NOT undertake ANY other business than that of managing the funds.

3. Guarantees: The pension fund society creates a reserve account for the OPF from its own resources - about 0.3% or 0.4% of the funds net assets. This reserve account is used to offset eventual deficits (returns below the mandatory minimal return). If the reserve can not cover a deficit, then the pension fund society must cover it with other resources of its own; if the pension fund society can not cover the deficit, it is declared bankrupt. Then a national guarantee fund jumps in (the resources of which may not exceed 0.1% of the cumulative NAV of all OPFs). If the guarantee fund can not cover deficits, then the deficits that are not covered by the guarantee fund are offset by the Polish treasury.

Croatia

Mandatory pension funds are created and managed by Pension Fund Management Companies (PFMCs) that are joint-stock companies or limited liability companies. A PFMC may only create and manage one fund. The fund itself is not an independent legal entity.

Licensing is in two steps:

1. Establishing the PFMC through a license by the Croatian Financial Services Supervisory Agency (HANFA). Minimum paid in capital of HRK 40 million (\$US 7.5 million) (higher if more than 10 000 members) is required. There is a guarantee deposit that is kept in a separate account in a custodian bank. Documents to be submitted to HANFA include audited

financial statements of the founders for the last 3 years and a business plan, along with other information. The PFMC then registers with the Commercial court.

2. Operating license to operate a mandatory pension fund is also from HANFA. The PFMC must submit a management board with details of the members' professional qualifications, non-interested parties, and they must hold a special HANFA license.

The PFMC is responsible for the capital accumulation phase.

Then a pension insurance company pays annuities. The pension insurance companies run a single purpose business – providing pension annuities. The insurance company also needs a license from HANFA and must meet a minimum capital requirement.

Within 2 years of their establishment, a mandatory pension fund must have 50,000 members or it will be liquidated.

Editor's Note: There is a trend toward specifying a minimum number of members for the pension fund to remain in operation. Slovakia has a much higher requirement.

Latvia

The mandatory second pillar was introduced in 2001 but for the first 18 months, only the State Treasury was allowed to manage second pillar assets. From 2001 to 2007, private asset managers were gradually allowed into the system. As private institutions could increasingly be entrusted with pension assets, the state pulled out of the pension asset management activity.

The Latvian regulator, the Finance and Capital Market Commission, is in charge of supervising the performance of the private providers (whereas the Latvian Treasury was supervised by the Ministry of Finance).

Licensing: An investment management company needs to receive a special license from the regulator allowing it to manage second pillar assets. The conditions to receive this special permit are particularly stringent for asset managers who have not managed pension assets in the past. Assets are held independently of the resources of the management companies in a holding bank that it is also submitted to close supervision by the regulator. The Fund manager has the obligation to reimburse in full scheme participants for all losses caused by himself, his employees or officials violating the provisions of the contract.

Estonia

As is standard and best international practice, the participants of a pension scheme actually own the assets of the fund that are pooled and invested collectively by the respective pension assets management companies.

Pension management companies must have a minimum share capital of EUR3 million.

Assets are held independently of the resources of the management companies.

Conditions for pension management companies to manage mandatory pension funds include receiving a special operating license from the regulator, the Financial Supervisory Authority (FSA). The pension management company may establish several funds if the investment policies of the funds differ significantly. A least one needs to be a conservative investment



portfolio. The appointment of a fund manager (who must prove a certain number of years experience and hold a Ministry of Finance certificate) is subject to approval by FSA.

Protection of assets: the assets of a mandatory fund must be kept separate. Each pension management company must by means of its OWN funds establish a reserve of 2% of the value of the funds under management. This reserve is used for compensation for loss of assets due to violations of legal requirements, to fraud, and to mismanagement. If the reserve fund is not sufficient, the management company has to use its other own resources. If that is still insufficient, then they are compensated by the Guarantee Fund whose funds are composed of contributions by funds. It also guarantees assets of deposits and investment institutions. Compensation covers 90% of losses of over 10,000 Euros equivalent (up to 10,000 of losses are compensated in full).

Chile

Pension Fund administrators (AFP) must be established as public companies with the exclusive aim of managing open pension funds. Each AFP must establish four funds and may optionally a fifth.

Licensing:

To establish an AFP, an authorization must be received from the Superintendence of Pension Fund Administrators (SAFP). Among other conditions the management needs a minimum capital that is calculated in special accounting units (units with constant purchasing power realigned daily with the Consumer Price Index).

Management:

An AFP can manage the funds themselves or contract the management to an asset management company that is established for the sole purpose of managing pension fund

assets. The asset management company must be authorized by the regulator and comply with minimal capital requirements. 90% of assets of each fund need to be held by a custodian.

Protection:

Pension fund administrators (AFPs) must establish two types of reserves in order to compensate for low investment returns: (i) A return fluctuation reserve for each fund that is funded by returns on investment exceeding certain limits and (ii) a general reserve that is funded with the AFPs OWN assets and must be equal to 1% of value of assets under management.

If both funds are not sufficient, the government covers the remaining deficit, which the AFP has to pay back. If it cannot pay back the State within a certain time period, the AFP is closed down.

Bulgaria

Pillar II is managed by Universal Pension Funds which are independent legal entities created and managed by a licensed joint stock company called a pension insurance company. The same company can manage three funds (one occupational, one universal, and one voluntary).

Licensing: For a license the pension insurance company must apply to the regulator, the Financial Supervision Commission and obtain permission to manage a universal fund (also to manage an occupational fund). After receiving permission it must file an application with the responsible district court for registration of the pension fund.

(Sources: ISSA/IOPS “Complementary Pensions throughout the World”, 2008. Allianz Global website; Latvian Finance and Capital Market Commission).

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