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INTERNATIONAL TRENDS: GOVERNMENTS REACT IN ANTICIPATION OF DEMOGRAPHIC CHANGE

EU: Population Aging Report Analyses Age-Related Expenditures

For the third time since 2001 the European Commission published a report on economic and budgetary projections to assess the impact of ageing population on public finances*. The actual strain on the working population will increase significantly, the report says. For instance the effective economic old age dependency ratio (meaning the correlation between the number of non-working pensioners to the number of effectively employed population) is expected to rise from 37% in 2007 to 72% in 2060, meaning that ten workers support four elderly non workers today but will be supporting 7 pensioners in 2060. In some countries like Romania and Poland, Bulgaria, Lithuania, Hungary, Malta, Slovakia there will be as many workers (or almost as many) as pensioners in 2060. Projection results for public spending on pensions find that EU countries can expect an increase of 2.4% of GDP over 2007-2060. Policies in EU countries aimed at making pension programs more sustainable include: reducing the generosity of public pension schemes, increasing the statutory retirement age, restricting access to early retirement by strengthening the incentives to prolong working lives.

*2009 EU Aging Report: economic and budgetary projections for the EU27 (2008-2060).http://ec.europa.eu/economy_finance/publications/publication14992_en.pdf

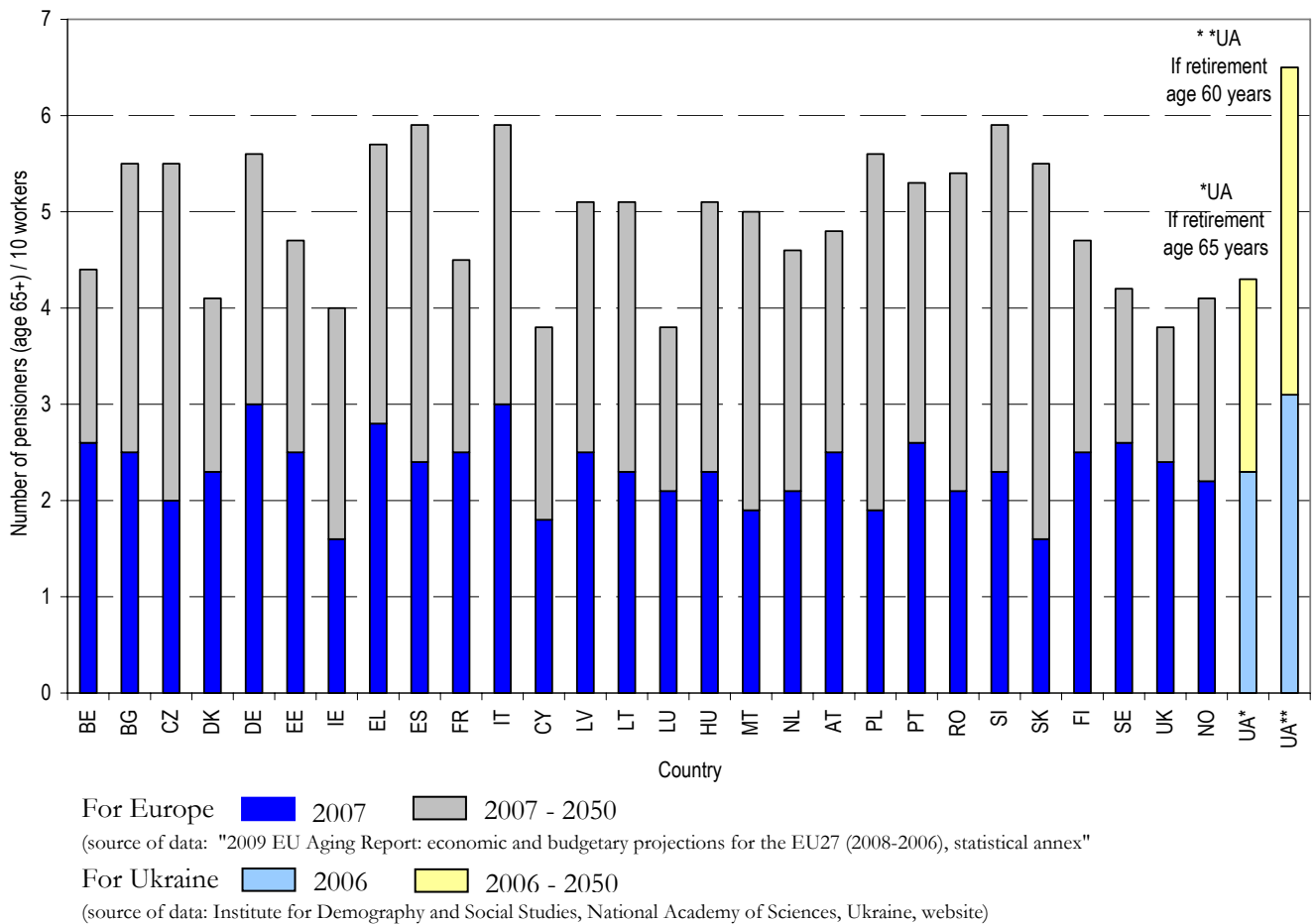
Graph: Old Age Dependency Ratios in Europe

The graph below describing the variations of old-age dependency ratios until 2050 illustrates how the strain on the working age population of a country increases when its population ages. It shows the traditional old age dependency ratio – the correlation between the non-working retirement age population and the population of working age (15-64 years old): a ratio of 6 would mean there are 6 persons of retirement age for 10 active people.

For Europe, the 15-64 age group is considered to be the working population, with retirement starting at 65+. For Ukraine we give two prognoses - one based on 65+ like in EU countries, and another at 60+ - reflecting the actual retirement age for men at the moment in Ukraine.



OLD-AGE DEPENDENCY RATIOS in Europe (pop. 65+ / working age pop. 15-64) and Ukraine (60+ / 15-59)



Editor's Note: The impact that retirement age has on the dependency ratio in Ukraine depending on whether workers work until they are 60 or 65 years old strikingly illustrates how important the issue of retirement age is for pension reform. As the graph shows, putting off retirement by 5 years to 65 years in Ukraine would significantly reduce the pressure on the working population. From about 65% the ratio would go down to 43%, meaning that 10 workers would support 4 non-workers instead of 6 non-workers.

Australia: Pension Age Raised to Defuse “Demographic Time Bomb”

For the first time in 100 years, Australia raised its retirement eligibility age from 65 to 67 by 2023. Like in most developed countries an aging population and longer life-expectancy have strained the solidarity system. “We have to put in place an essential reform to face this demographic time bomb”, Finance Minister Wayne Swan said, adding that a reform, though unpopular, is important to build a sustainable pension and retirement income system. The reform also slashed pension tax benefits for high-earners, and put an end to the practice of matching contributions for low and middle income contributors. These savings will allow the government to increase pension payments by the equivalent of about US99 dollars per month. (Bloomberg.com)

Denmark: 1 in 4 Danes to Work Beyond Retirement Age

Research by the Danish Insurance Association (DIA), revealed that almost 50% of Danish workers intend to take early retirement before the age of 65. A majority intends to retire between 60 and 65. Over a quarter plan to remain in active work beyond the age of 65. Extra years of employment could mean thousands crowns in extra pension income each month, says Anne Seiersen, associate director at the DIA. She warns

that increased life expectancy could have an impact on the workers’ future pension income. Taking into account that life expectancy of a Dane increased by about two years between 1991 and 2007, thirty-year-olds today can expect to live until 85 for men, and 87 for women. Increased life expectancy means that the pension needs to be spread over a larger number of years than before. This means that a 10-year annuity will be used up years before a pensioner’s death. For example, if a woman retires at age 62, she will have used up her pension capital by 72, and would have to “live on just social security pensions and public pension fund resources for the last 15 years of her life”. (IPE.com, Watson Wyatt) *Editor's note: Changes in life expectancies often do not occur gradually over time. In the case of Denmark an increase in life expectancy of 2 years occurred in only 16 years. Pension costs are sensitive to changes in life expectancies, and a change in life expectancy of 2 years is large. Since 1987 Ukraine has had worsening life expectancies, especially for men. However, this could turn around very quickly and cause substantial increases in the cost of solidarity pensions.*

UK: Opposition to Mandatory Retirement Age Wins Support in Parliament

British Parliamentarians of the Committee on Work and Pensions have recommended abolishing a Regulation



permitting companies to impose a mandatory retirement age of 65 years, thereby contradicting the Government's position on this issue. The British government is trying to defend the mandatory retirement age regulation in a legal action to be heard before the UK High court, following a decision by the European Court of Justice (ECJ). The British MPs representing the Committee on Work and pensions argue against their government that the "regulation contradicts the government's wider social policy and labor market objectives to raise the average retirement age and allow people to continue to work and save for their retirement". The ECJ has ruled that a national retirement age may be lawful if justified by legitimate social policy objectives, such as those related to employment policy, the labor market or vocational training (see IPN#4). However, it is still for the national courts to decide whether any of these conditions are fulfilled. Advocacy groups Help the Aged and Age Concern, the two groups that engaged the European legal process, argue that forcing people to retire at 65 constitutes "unjustifiable discrimination" and therefore a violation of the EU Equal Treatment Framework Directive. The case is now before the UK High Court. (IPE.com, FT.com, BBC.com)

Europe: EU Parliamentarians to Work Longer

The Bureau of the European Parliament announced a series of reforms to the voluntary pension scheme for Members of the European Parliament (MEPs) including an increase in retirement age from 60 to 63; abolishing early retirement at a reduced pension; and abolishing the ability to take a 25% tax-free cash lump sum. The supplementary pension scheme needs reform because of a deficit that grew from 30m euros at the end of 2007 to a stunning 120m a year later. The aim of the reform is to avoid the EU Parliament having to allocate extra resources to finance its own pension fund. The Budgetary Control committee voted in March 2009 that Parliament should "under no circumstances provide extra money out of the budget to cover the fund's deficit, warning that the pension fund "should be able to honor its commitments until well into the 2020s". (IPE.com. Globalpensions.com)

Malta: Increasing Retirement Age – Reducing Liabilities

A survey carried out as part of an EU pilot project on computing the accrued-to-date pension liabilities for Malta showed that by raising the statutory pension age from 61 to 65 (in the period 2014 to 2023), Maltese pension liabilities accumulated at the end of 2006 have reduced by about €1.6 billion (or 7.0% of GDP). Accrued-to-date pension liabilities represent the current value of pensions to be paid in the future, on the basis of pension rights. It does not take into consideration future contributions of current workers, or the accrual of new pension rights in the future. This concept is considered to be the most appropriate for eventual inclusion in the national accounts of a country. (IPE.com)

Netherlands: Longer Life Expectancy Affects Pension Prognosis

The professional association of actuaries in the Netherlands, the Actuariel Genootschap (AG), has suggested that life expectancy in the Netherlands has increased much more than initially forecasted based on figures from Statistics Netherlands (CBS). As a result, in its most recent prognosis, the CBS has

raised the expected age for men who are born today from 81.5 years to 83.2 years and women's average age from 84.2 to 85.5 years. The AG said this forecast is a reason to review the life expectancies that are being used by many Dutch pension funds for calculating their liabilities. (IPE.com)

Finland: Data Points towards Working Longer

By 2015, three working Finns will be supporting every pensioner, down from about four now, according to the United Nations. This would be the fastest shift in worker-to-retiree dependency in Europe. In February 2009, Prime Minister Matti Vanhanen announced a plan to gradually increase the retirement age to 65 years from the present 63 years of age. In light of the widespread criticisms from trade unions that had not, in their opinion, been sufficiently consulted, the government withdrew its earlier plans to gradually increase the retirement age from 63 to 65 years from 2011 onwards (see IPN#4). Still convinced that in the long term it will be necessary to increase the country's retirement age, Vanhanen's government now has agreed with trade unions to work out voluntary measures that will encourage people to work longer. The country has already taken some steps to adapt benefits to expanding life spans. Starting next year, people born in 1948 will get 98% of a full pension, while those born in 1968 will get 88%, as specified by a 2005 pension law to which the unions agreed. (www.bof.fi)

POLICY: GOVERNMENT POLICIES REFLECT CONCERN ABOUT CRISIS

United Kingdom: Industry In Favor of Tax Relief on Pension Savings

Pension industry experts say that a Government plan to eliminate tax breaks for pension contributions would reduce incentives to save and "undermine confidence in pensions, reduce the value of pensions and penalize those who are taking responsibility for their retirement", the National Association of Pension Funds (NAPF) warned. Other experts argue that the benefits for the state budget are not even clear, as some contributors may start saving in other ways to avoid paying the extra tax. (IPE.com)

Germany: Private Pensions Should Bear More Retirement Burden

Private pension consultant Bernd Rürup told IPE.com what the split between private and state pensions should be in Germany. The share of private pensions in Germany should be increased to 40%, leaving a 60% share for the state pension. At the same time he also commended the pension reforms that were pushed through over the past few years, saying they had led to a "sustainable financial position". Increasing retirement age to 67 contributed to the stability of the system. (IPE.com)

Austria: Pension Reform a Priority on Government Agenda

After causing the collapse of a government coalition last year, the future of retirement provisions remains high on the political agenda, with a special government commission set up to discuss possible changes to the Pensionskassen (pension



fund) system. The commission consists of representatives from retiree organizations, the pensionskassen, and insurance industries and the finance ministry. The issues include larger buffer funds and the restoration of minimum return guarantees. Austria has a three pillar system, with a first PAYG pillar, a mandatory second pillar represented by different schemes (DB, DC, and hybrid schemes) administered by Pensionskassen, and voluntary third pillar pensions. (IPE.com)

STRATEGY: FUNDS SEEK NEW COMMUNICATION STRATEGIES

Netherlands: Dutch Regulator Increases Supervision of Funds' Communication

The Dutch regulator (AFM) announced it would increase its supervision of how funds communicate to their participants. The decision followed a survey of the 25 schemes with the worst performance in 2007. For instance, two out of three funds belonging to this group had still not set up their uniform pension statement. These statements had become mandatory in January 2008. The uniform statements were mandated to eliminate differences in reporting and make comparative evaluations between funds easier for participants. AFM, the Dutch national bank, the Ministry of Social Affairs and Employment and the pension umbrella organizations are consulting on the best way pension funds and pension insurers can inform stakeholders about the effects of the crisis on their future pensions. Pension funds and insurers are expected to inform their scheme members individually by letter of the effects of the financial crisis on their pension. The AFM said on its website: "There is plenty of general information available, but the consequences for individual scheme members have not yet been made clear. It is important that scheme members, former members and pensioners are informed as to the specific situation at their own pension fund. It is therefore essential that communication with stakeholders is transparent and pro-active. This will increase confidence in the pension funds and the Dutch pension system. Participants need to be informed about "recovery plans, indexation, contributions, and retention of rights". (www.afm.nl, IPE.com)

General: Participants Need Reassurance, Disclosure

Hyman Robertson's pension communication consultancy says Employers and trustees will need to allay scheme members' fears by communicating clearly on the financial crisis, Helen McArthur, Hyman Robertson's senior communications consultant explains. "It is better to tell members what you do and what you do not know. When money gets tight people look at ways of reducing [expenses], and often insurance and savings (particularly pensions) are seen as easy payments to stop, with the intention of recommencing payments when belts slacken in the future. "The key messages are of long-term planning – that today's events do not necessarily affect the payment of pensions in the future. "Informed choice" requires clear, concise information. To help get these messages across, communication should use simple, everyday language, target and tailor communications for different groups, and let employees know where they can get more information." (www.hymans.co.uk)

Ireland: Officials Demand Clear Communication on Risks, Fees

Paul Kenny, Pensions Ombudsman told the Irish Association of Pension Funds (IAPF) Annual Defined Contribution Conference that providers should step up the quality of information offered to pension scheme members, especially those in Defined Contribution schemes "since they take all the risk". Mr. Kenny suggested using professional pension fund titles instead of calling portfolios 'evergreen and such', he underlined the importance of informing DC members about ways in which their money is invested and called for greater transparency. He believes that poor communication caused a number of problems. Officials should draw on the effect of the crisis by encouraging pension funds to take necessary precautions and improve their information campaigns to increase people's awareness on the issue of pension savings and convince them to continue saving money. Chief Executive of the Pensions Board Brendan Kennedy expressed his opinion that trustees should not offer too many funds to members as this makes their choice more difficult. He said: "...in recent years, adding more funds too often meant adding greater risk. This increased the likelihood that members would end up bearing more investment risk than they should have." (IAPF)

Hungary: Regulator Sets Communication Requirements

The Hungarian Financial Supervisory Authority (HFSA) said pension fund members need more and better information. It issued a list of requirements that private pension funds should fulfill to ensure that they provide information to their members factually, taking into consideration an individual member's age, life status and future plans. It should provide very detailed information revealing such issues as the investment policies of the portfolio, its risks and future policies, net yield rates, portfolio switching costs, process of portfolio switching, meaning of the individual yield indicators, investment policies and strategy of the fund and many other factors. The HFSA website even allows one to compare different portfolios. (HFSA website - pszaf.hu)

UK: Calls for Nationwide Campaign to Boost Confidence

The National Association of Pension Funds (NAPF) says that despite a rise in pensions confidence – from its all time low of 1% in December 2008 to 7% today- a national campaign boosting pension confidence should be launched by the Government. The current economic environment makes confidence in future pensions quite fragile, NAPF chief executive Joanne Segars pointed out. "No matter how long and deep the recession, we still need to provide for old age, Segars remarked. The survey found that employees still consider pension schemes to be the most attractive benefit that an employer can offer on top of the base salary, growing from 30 to 34% of respondents. By comparison with survey from early 2008, flexible working hours and year end bonuses had lost in popularity to employer pension contributions. For the first time, women rated a workplace pension as a more important perk than flexible work hours. A consistent position over the past year is the fact that almost half of employees who do not have access to a workplace pension said they would feel more loyal towards their employer if they did offer that. (www.napf.co.uk)



MARKETS: FUNDS POST CAREFUL OPTIMISM

Turkey: Army Pension Fund Plans Investments in Europe

Turkey's largest pension fund Ordu Yardimlasma Kurumu (OYAK) with over 241,000 members, mainly former and current military personnel, and over US\$8bn in assets, is seeking to invest over US\$100 million in Europe and the U.S., its CEO Coskun Ulusoy told journalists. He said that it was a good year for such investments as asset prices were low. OYAK runs a unique investment strategy. Instead of the passive investment strategy adopted by most pension funds investing in "safe" minority equity shares and bonds, the Turkish fund favors "a strategy of taking majority interest in firms, joining the management and actually running them" as the Turkish newspaper Hurriyet described it. Such an entrepreneurial strategy breaks with the generally accepted risk-hedging strategy for pension funds of limiting investments to minority shares. The fund's first such investment was made in the 1960s when it became a partner in the Turkish Renault automobile production plant. It then expanded into steel, energy and cement. According to Hurriyet, the fund's assets have gone from just over US\$1bn in 2000 to 8.2 bn in 2008 and the fund's beneficiaries have seen their benefits "quadruple over the same time frame." Its 50-odd companies dominant in basic industries turned a profit of \$2 billion last year and Ulusoy claims the group will again be profitable this year despite the harsh economic environment. (Bloomberg, Hurriyet)

Poland: Funds post 5.7% Increase

Polish pension fund assets increased by 5.7% on average in April, according market researcher Analizy Online. It was the second consecutive month of positive results since the financial crisis hit last autumn. Since the end of March, the funds' total value increased to PLN145bn (US\$44.5bn). Analizy online attributed the increase to the improvement performance of the Warsaw Stock Exchange whose index (WIGG20) grew 19% monthly. For April, Polsat pension fund boasted a return of 7.1%, ING returned 6.2% and Generali 6.1%. (Globalpensions.com)

Croatia: Funds Boast Positive Return

Funds' assets returned 1.4% in April and 0.5% for this year so far according to the Croatian regulator Hanfa, thereby slipping back into positive territory. Last year, Croatian funds posted a negative return of -12.5% in 2008. At the same time allocation has barely changed: this year 95% of assets were invested domestically, split 69-10 between bonds and equities while in 2008 placements in equity were slightly higher with 15% against 64% in bonds (and 94% invested domestically). In Croatia only 15% of assets may be invested overseas. (www.neurope.eu)

Netherlands: Pension Funds Back Into Buying Stocks

After being a net seller of stocks in the fourth quarter of 2008, pension funds are back buying stocks at the end of the first quarter of 2009. Purchases totaled 4.5 bn euros. Dutch pension funds are watched closely because they are some of the largest in the world managing a total of 697 billion in assets at the end

of 2008. Dutch ABP is the third largest state fund worldwide after the Japanese state fund and the Norwegian one. However, Dutch funds have changed their asset allocation to a lower risk one, increasing the allocation to state bonds from 16% of gross asset purchases last year to 21% this year. Purchases include German, French, Italian and Spanish state bonds considered to be carrying a low default risk (Reuters through guardian.co.uk).

THIS MONTH'S ANALYSIS: PAYING PENSIONS ABROAD

Editor's Note: The international position on whether pensioners should receive their solidarity benefits if they reside outside their "native" country varies from country to country. There have been many arguments on this issue. There appears to be a trend among Western countries that pensions are paid out on an employment basis and not a nationality basis. The state owes you a pension not because you hold its passport but because you paid into the system through your employee contributions. In short: what matters is where the worker earned his pension and not where he resides or what nationality he has.

So in many countries these payments are made independently of the place of residence during retirement, but with conditions. The developed western countries lead that trend though there is not yet one definite international practice on continuation of pension payments if a person leaves the home country and lives abroad permanently.

The arguments against paying out pensions abroad from a government's point of view usually center around the fact of having funds leave the country. The counter-argument is that a pensioner living abroad while collecting a pension is not costing the government for health care, other services and subsidies that would normally be provided if the pensioner were living in the country where he earned his retirement benefits. Another argument is that since these amounts have been earned and credited to the individual as a result of the individual's labors, the government's promise to pay retirement benefits should be honored regardless of residence.

European Union and European Economic Area

The European Parliament and the Council of Europe have endorsed several regulations on social security rights within the EU. The latest regulation, No 883/2004, should go into force at the end of 2009.

According to these regulations, all EU Member States in which a person has been insured must pay an old-age pension when the insured person reaches the age of retirement. The competent institution must take into consideration all the contribution periods completed in the legislation of all other Member States, both in the case of general systems and special systems. The Regulation also contains rules concerning the way in which the competent institutions calculate benefits and establishes rules to prevent overlapping. A person receiving benefits under the legislations of different Member States whose amount is less than the minimum provided for in the legislation of the Member State of residence is entitled to a supplementary pension from the institution of the Member State of residence. Most of these rules also apply to members of the European Economic Area (a free trade agreement between European Free Trade Association (EFTA) countries, the European Community (EC), and all member states of the European Union (EU)*. The EEA is based on the same principles of freedom of movement as the EU, allowing goods



and persons to move around freely between states. Though less binding than the agreements within EU/EEA, the Council of Europe adopted a “European Interim Agreement on Social Security Schemes Relating to Old Age, Invalidity and Survivors” in 1953 which determined the basic principles of pensioners to receive old age benefits in any one of the countries which are Contracting Parties to the Agreement. Contracting Parties to the agreement include all present EU countries plus Norway, Iceland, and Turkey. A 1977 Convention on Social Security and its Protocol extends these principles to include non-nationals.

*The contracting parties to the EEA Agreement are three of the four EFTA states – Iceland, Liechtenstein and Norway – and the 27 EU Member States along with the European Community. Switzerland is linked to the European Union by the Swiss–EU bilateral agreements, with a different content from that of the EEA agreement.

If the pensioner is moving to a Non-EEA country (or Switzerland):

In this case pension rights are largely dependent on bilateral agreements, often based on reciprocity. However, this agreement still allows significant variations from EEA member to member.

Some EEA countries have bilateral agreements with a number of countries. Full pension payments are, nevertheless, often compromised (see the system in United Kingdom described below for an example).

United Kingdom

In the United Kingdom, the Pension Service, which is the government authority paying pensions, has different provisions for paying pensions depending upon how long the pensioner is absent from the country. If a pensioner is leaving for longer than 12 months the pension can be paid directly into an overseas bank account in the country where the pensioner is living, for those who are leaving for less than 12 months the only effective option is to have the money paid into a UK bank account. Otherwise it can be paid in a lump sum but only upon the pensioner’s arrival back in the UK. There is no reduction. In the UK, pensions are calculated on all contributory service within the European Union. If a person entitled to a UK pension moves outside the EEA trade agreement zone, his rights to receiving pensions are less secure; some third countries have social security agreements with the UK regulating these rights on a case by case basis. They include Australia, Israel, Japan, New Zealand, Philippines, Republics of the former Yugoslavia, Turkey, USA. The actual pension rights can be reduced – for example, by not including regular inflation adjustments.

Non EU/EEA Countries

Countries outside of the EU EEA zone, manage the pension rights individually. Some of them work out bilateral agreements.

United States

U.S. citizens may receive their solidarity payments (called Social Security payments) as pensioners living outside the U.S. with some exceptions. Social Security restrictions prohibit sending payments to individuals in Cambodia, Vietnam, Cuba, North

Korea or areas that were in the former Soviet Union (other than Armenia, Estonia, Latvia, Lithuania and Russia). There is no reduction. There are some exceptions that can be made to the above restrictions, and if granted, require the pensioner to appear at the US Embassy each month to receive their payment.

Canada

Canada Pension Plan (CPP), Quebec Pension Plan (QPP) and Old Age Security (OAS) benefits can be paid when a pensioner is living outside the country, subject to certain conditions. CPP/QPP benefits are paid outside Canada as long as all conditions of eligibility continue to be met. OAS is paid outside Canada if the pensioner lived in Canada for at least 20 years after age 18. Guaranteed Income Supplement (GIS) and Spouse's Allowance (SPA) benefits are paid for six months plus the month of departure. Canada's OAS system is intended to guarantee a minimum income to retirees, and benefits are subject to an income test. A pensioner can receive OAS benefits outside Canada, but generally must file an annual return reporting worldwide income.

Central Europe

Albania

Albanian law does not provide for payment of pension funds outside of Albania.

Macedonia

Macedonian law provides that payments be delivered to a person living abroad only if there is an international or bilateral treaty. Any pensioner living in a country with which Macedonia does not have an agreement does not receive payments. If a person living in a country with which Macedonia does not have an agreement and who has not been receiving payments while living outside of Macedonia returns to Macedonia, the pension payments are resumed, but there is no payment for the time the pensioner did not live in Macedonia. The law does provide for payments abroad when an individual can justify the move.

Serbia

Serbian law provides for payments outside of Serbia if there is a reciprocal agreement with the country of residence of the pensioner.

Newly Independent States (CIS)

The “Agreement of Guarantee of Rights of State Members of the Commonwealth of Independent States in the Sphere of Pension Provision” provides that if a pensioner moves from his native country to the country of another signatory, the pensioner will receive payments according to the laws of the country to which he has moved and is residing.

Russia

Russian law holds that payments “may” be received by pensioners who are resident outside of Russia. This applies for labor pensions but not for social pensions. A pre-payment of six months is paid before the person leaves the country.

Payment to certain categories (war related individuals or victims) are mandatory to pensioners outside Russia and not subject to discretion. (also see CIS below).



In March 1992, this Agreement was signed by Armenia, Belarus, Kazakhstan, Kyrgyzstan, Russia, Tajikistan, Turkmenistan, Uzbekistan and Ukraine. Azerbaijan and Moldova have not signed. As a result, Moldova does not provide for the payment of pension funds outside of Moldova.

(Sources: various institutional sources on country by country basis. On EU, see <http://ec.europa.eu>)

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The USAID Capital Markets Project (CMP) was launched in October 2005, and is a five-year program designed to assist the country in developing a vibrant and effective financial sector. This effort will promote sustained economic growth and reduce the costs and risks to a sound pension system. You can find out more on the CMP website www.capitalmarkets.kiev.ua or on the website about pension reform in Ukraine: www.pension.kiev.ua

USAID's assistance focuses on the following areas: Economic Growth, Democracy and Governance, Health and Social Sector. Since 1992, USAID has provided \$1.6 billion worth of technical and humanitarian assistance to Ukraine to further the processes of democratic development, economic restructuring and social sector reform in the region. For additional information about this and other USAID programs in Ukraine, please call USAID's Development Outreach and Communication Office, tel. (044) 492-7101 or visit the USAID website at: <http://ukraine.usaid.gov>.