

Income for Old Age

The reformed solidarity system (pillar 1) and voluntary pension accumulation through non-state pension funds (pillar III) have been in effect since January 1, 2004. The non-state pension provision system is based on the voluntary participation of citizens, employers and their unions who are making pension contributions with the purpose of creating additional pension benefits for citizens ensuring a satisfactory or higher level of income in their old age.

During its 4.5 years existence, the voluntary non-state pension provision system won almost half a million participants (482 511) of which 2.3% (or almost 11 000 persons) are receiving payments from this scheme, and total asset value of NPFs was 612.2 mln. hryvnas at the end of last year.

Qualified experts answer 'Uryadovyi Courier's questions about non-state pension provision.

Contributions into NPFs

Valentyna Kudin: in charge of solidarity and voluntary pension provision issues of Pension Provision Department at the Ministry of Labor and Social Policy. She answered questions relating to how to become a NPF participant, what a pension contract means, whether it's allowed to become a participant of several NPFs, what the minimal NPF contribution and is what currency the contributions are made in.

Advantages and Risks

Natalya Goryuk, Senior Pension lawyer with the USAID Capital Markets Project

How beneficial is it for employees to participate in the system of non-state pension provision?

Funds accumulated in NPFs are invested and earn investment return. The earned investment return except for its part which is according to the legislation deducted to cover administrative expenses is reinvested. Thus, pension funds are constantly growing.

When can a participant start using non-state pension provision savings?

NPF participants have a right to receive the following pension payments: defined-term pension benefits, one-time pension benefits, annuity.

Having accumulated money in non-state pension funds, people would be able to receive it in the form of pension benefits upon reaching the retirement age that they would determine themselves. The law provides for NPF participant to choose the age upon reaching which he or she will be receiving pension benefits from the fund. However, this age can be 10 years higher or lower than the statutory retirement age. This means that a male participant can start withdrawing his pension benefits from non-state pension fund at 50 and a woman participant at 45 years old should they wish so.

Is it somehow connected with the official pension?

Such pension benefits are paid irrespectively of benefits from the PFU or from other sources.

Funds accumulated by a participant in NPF are owned by this participant. The same refers to employer's funds transferred in behalf of NPF participant to NPF. The employer under no circumstances would be able to return the money that he contributed to NPF in favour of his employee.

Are there any risks for NPF participants?

It should be noted that the period of accumulation in non-state pension funds is long. During this period there might be temporary declines on the financial markets that are followed by recovery without fail. The account balances of fund participants will raise and fall accordingly; however, in the long-term prospective the periods of temporary decline are compensated by periods of significant growth.

And what about the impact of the financial crisis?

There is always risk that the period of retirement will coincide with the period of financial turmoil when the value of pension assets falls due to the downturn on the financial markets. Therefore, a fund participant is always at risk to receive lower pension benefits than he expected. In this case it would be reasonable to defer the retirement for the later date and wait for the time of economic recovery when the value of pension assets would grow and the account balances would increase accordingly.

Is a fair distribution of payments between NPF participants guaranteed?

Currently there is a risk of incorrect distribution of investment return between fund participants. Since the regulation on the unified standards for calculation of the net pension contribution unit value, the total number of units in the fund and the individual account balances has not been yet approved, fund participants are at risk to receive in the result of such distribution a much lower investment return on their contributions than they had to.

Who should regulate this issue?

Both of our regulators of the pension market: the State Commission for Regulation of the Financial Services Market in Ukraine and the Securities and Stock Market State Commission should accelerate the resolution of this issue. In my opinion, the adoption of the Law of Ukraine On Non-State Pension Provision will contribute to its resolution (the draft law is been prepared for the second reading).

In general the non-state pension system has been designed in such a way so that to protect NPF participants from losing their savings. NPF cannot be declared bankrupt and liquidated. NPF pension funds should be separated from funds of entities providing services to the NPF.

Are there any exceptions or special circumstances when benefits can be paid out without being subjected to the usual age restrictions?

In case of being qualified disabled and eligible for disability pension according to the Law of Ukraine On Mandatory State Pension Insurance the NPF participant may start receiving his/her pension benefits from the fund regardless of any age restrictions. This means that after onset of disability NPF participant may start receiving his pension benefits from any age he determines. In this case the retirement age for male participants can be lower than 50 years old.

NPF participant may receive a lump sum pension benefit. Such pension benefit is paid in case of a critical state of fund participant's health (cancer, stroke, etc.) that has been confirmed by medical certificates; in case of participant's moving to another country for permanent residence, or in case the amount of accumulated pension funds as of the day of reaching the retirement age determined by a fund participant is below the minimum amount of pension savings set by the State Commission for Regulation of the Financial Services Markets in Ukraine. This amount is set on the level to ensure during 10 years monthly benefits of 50% of officially set minimum subsistence for incapable-of-work individuals.

Thus, if in the year of 2009 the amount accumulated by a fund participant as of the date of his reaching the retirement age is not sufficient to ensure monthly benefits in the amount of at least UAH 249 (the minimum subsistence for incapable-of-work individuals for 2009 is UAH 498) for the period of 10 years, it can be paid to the fund participant as a lump sum.

Can a fund participant's savings be inherited?

In case of death of a fund participant his savings are inherited according to the civil legislation of Ukraine. The inherited pension money is paid to the heir(s) as a lump sum.

At fund participant's discretion upon reaching the retirement age determined by him his NPF pension accumulations can be transferred to an insurance company to purchase a life annuity contract. The insurance company will make actuarial calculation of the amount of his life annuity pension based on the information certified by the fund administrator on the individual account balance of the fund participant.

What happens to the savings of a participant that leaves a job?

When a NPF participant terminates labor relations with a founder-employer or an employer that pays contributions to a corporate pension fund, such participant must enter into a new pension contract with any NPF administrator. In cases, where a NPF participant terminates labor relations with a founder-employer or an employer, that pays contributions to a corporate pension fund, and enters into labor relations with another employer that is a founder of this same NPF or that pays contributions to this corporate pension fund, such participant may stay with the NPF if the terms of the pension contract provide for it.

For an employee that participates in an open-end pension fund the termination of his or her employment with a certain company does not mean that the savings accumulated at such fund must be transferred elsewhere. When switching jobs, the

employee may continue paying pension contributions to this fund. Pension assets the participant has already accumulated at this fund stay there until the employee wishes to transfer his/her funds to another open NPF. Any fund participant is entitled to such option.

And How Do They Do It?

David Bardsley, Senior Regulatory Adviser with the USAID Capital Markets Project

Readers are interested to learn about international best practices of private pension fund operations. Would you brief us on this issue?

Pension Funds exist in a majority of developed market economies as a way for workers to supplement their state pensions. Pension funds throughout the world should adhere to a number of common principles: for a small fee they manage the assets of pension fund participants, investing them mainly in deposits, equity and bonds at home or abroad in such a way as to maintain these savings, keep them as safe as possible from inflation-linked and other risks, and, if possible make them grow. The funds are obliged to disclose and report on their activities and are overseen by a regulator. When the contributor reaches retirement age he then receives his pension capital, in the form of contributions that have been transferred into his account at the fund for a certain period of time.

Where is money invested?

The rules for pension assets investment areas and volumes differ from country to country: **in Slovakia** for instance, they can be invested into three kinds of funds: growth funds (1), balanced funds (2), and conservative funds (3). Each fund has its own depository (as a rule, it is a bank or a branch of a foreign bank). NPFs in Slovakia can invest 70% of assets abroad.

In Poland, open pension funds are subject to the following maximum investment limits: no more than 40% for equities from the regulated stock exchange market; 40% each for mortgage bonds, municipal and corporate bonds; 20% for bank deposits and bank securities; 10% for equities in the regulated non-exchange market; 10% for certificates of closed-end investment funds; and 5% in foreign securities. There are no limits on investments in State-issued bonds.

In Bulgaria, the limit for investing in foreign securities is set at 15% of the mandatory pension system assets and 20% for Pillar III pension assets.

What is most important part of a Pension Fund's activities?

As a rule, the vital condition of pension fund operations in different countries is the responsibility of pension fund managers, primarily members of pension fund boards. Individuals occupying such key positions are held personally responsible for the performance of the administrators of pension funds and that of asset management companies of these funds.