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#UkrFinForum17

Day 2. Panel 4-2

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Pension reform as a precondition for capital-markets development

The discussion of pension reform, begun on the first day, was continued on this special panel. The main concern was the type of reforms parliament will approve and what the subsequent effects will be. Currently, an updated version of pension reform proposed by the government has not been voted on by parliament.

According to **Country Director for Belarus, Moldova, and Ukraine, World Bank, Satu Kahkonen**, the World Bank is concerned because this new version endangers the poorest pensioners, as it transfers an indexation of pensions to a later period. Further, panellists expressed concern that the draft does not foresee an early introduction of the second pillar of the pension system, making the consideration and adoption of amendments by MPs especially important, especially on this issue. As the main prerequisite for introducing the second pillar of pension system, we often hear the need to balance the pension fund deficit. However, the fund has been in deficit for at least 10 years, noted **Grigoriy Ovcharenko, Director, Head of Local Asset Management, ICU**, so waiting for this to be rectified does not makes sense now.

The country has been waiting for the second pillar of the pension system since 2003, and it's now time to take responsibility and correct this situation, according to **Member of Parliament Natalia Veselova**. Other panellists agreed. According to panellists, conditions have improved over the last two years, although Ukraine has not achieved all its goals. USAID defined two years ago three main concerns: macroeconomic stability, financial sector readiness, and the ability to implement reform. The macroeconomic situation has improved significantly, the economy has stabilised, and the financial sector's readiness has improved, as evidenced by greater profitability, and improved protection of savings, among other things. However, the ability to implement reform remains inadequate.

Panellists discussed the lack of instruments for investing pension savings. Ukraine's financial market effectively does not have an asset class of shares, which is why the financial community prefers to postpone the second pillar. However, there are a number of countries, including Turkey, Spain, Israel, Greece, Slovenia, Czech Republic, and Korea, where pension funds are not invested in shares, or only invest a small portion of funds under management in shares, no more than 20%.

According to the panelists' estimates, in the first years, the system will accumulate UAH10-15bn, not that great of an amount. Given that deposits of corporations are UAH300bn, and the volume of government bonds in circulation is about UAH700bn, newly accumulated funds by pension accounts can be successfully absorbed with minimal risk. Given the expected amount, there is no need to wait for the development of new instruments for investing pension funds. Likely, the availability of new funds will boast the creation of new instruments. Pension reform should be looked at in terms or dynamics, not statistics, since it is integrated in the overall economy.

Different proposals include at least 2% payments to the second pillar

Panelists discussed the conditions under which funds are accumulated, and rate for obligatory payments. The draft bill, prepared by Members of Parliament, proposes starting with workers contributing 2% of wages, with a gradual increase over five years to 7%. Some panelists proposed combining payments of both the employee and employer in the second pillar, and subsequently adding additional contributions from the state pension fund once it is no longer in deficit.

Control over the market has to improve to prevent fraud

Panelists emphasized the necessity of regulation of asset management companies and their investment of funds. Indeed, of the three main conditions identified by USAID that hasn't been met is the ability to implement reform: the problem of corruption remains unresolved. Anti-corruption reform remains one of the main issues of the agenda, as was noted on other panels of this forum. Control over the pension fund market is further complicated by the fact that during this time, the Verkhovna Rada did not adopt the amendments to the legislation allocating the functions of the National Financial Services Commission between the NSSMC and the NBU—the so-called "split"—which will reduce the risk of poor management of pension funds and asset management companies.

It is time to implement reform, and solve problems when they arise

Conclusions: The introduction of the second pillar is necessary, and should not be postponed. Accumulation of funds of individual accounts will create a pool of "long" money, which will accelerate economic growth, and the development of the stock market. It is impossible to predict all the problems and difficulties before the implementation of reform, but this should not stall implementing the second level. It is time for Ukraine to get its feet wet in terms of pension reform, and resolve difficulties when they arise.

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