

**CABINET OF MINISTERS OF UKRAINE  
ORDINANCE**

of October 14, 2009 No. 1224

Kyiv

**On Approval  
of the Concept of the Pension Reform Furtherance**

1. Approve the Concept of the pension reform furtherance (hereinafter referred to as the Concept) developed by the Pension Reform Commission which is attached.

2. The Pension Reform Commission shall:

make public presentation of the Concept with the participation of the Party of trade unions and All-Ukrainian organizations of employers and entrepreneurs that are the subjects of the General Agreement between the Cabinet of Ministers of Ukraine, All-Ukrainian associations of employers' and entrepreneurs' organizations and All-Ukrainian trade unions and trade union associations for 2008 – 2009 (hereinafter referred to as social partners).

organize a public discussion of provisions of the Concept particularly but not exclusively the implementation of the accumulation system of mandatory state pension insurance and transformation of the Pension Fund of Ukraine into a nonprofit self-governing organization, specifically by holding conferences, seminars, forums, public hearings, roundtable meetings.

based on the results of the public discussion of the Concept within 3 months work out an action plan on its implementation and also, if required, make proposals on amending the Concept.

3. The Cabinet of Ministers of Ukraine Ordinance of December 15, 2005 No. 525 On Approving the Pension System Development Strategy (The Official Visnyk of Ukraine 2005 No. 51, p.3205) shall be deemed invalid.

**Prime Minister of Ukraine**

**Yu. Tymoshenko**

APPROVED  
by Ordinance of the Cabinet of Ministers of  
Ukraine  
of October 14, 2009 No.1224-p

## **CONCEPT of the Pension Reform Furtherance**

### **General part**

Quality of the life of the population to a great extent depends on pension provision of senior citizens and confidence in the future of the persons who work.

Pension provision itself is the principal constituent of the system of social protection of the population.

The directions of reforming the pension system in Ukraine are specified in the Laws of Ukraine “On Mandatory State Pension Insurance” and “On Non-state Pension Provision”. The above laws envisage creating a three Pillar pension system: the solidarity system of mandatory state pension insurance (Pillar I); the accumulation system of mandatory state pension insurance (Pillar II); the system of non-state pension provision (Pillar III). In 2004 the solidarity system of mandatory state pension insurance and the system of non-state pension provision were introduced.

The above model corresponds to the worldwide multipillar model of the pension system. At the same time it is required to take some additional measures aimed at creating a possibility for insured individuals after their retirement to have guaranteed incomes which will ensure sustainable living standards, taking into account the results of the labor activity and the amount of the accumulated pension money of each employee when determining the rates of pension benefits.

### **Problems to be Resolved**

In 1991 Ukraine initiated a transition to the development of the pension system based on an insurance basis. Under the auspices of the Pension Fund of Ukraine a system of collection and distribution of insurance contributions of employers and individuals for payment of pension benefits was created. This became a beginning of a transition to traditional world principles of the organization of pension provision.

In the process of the implementation of this reform a number of the transformations important for the subsequent development of the pension system, specifically, in the solidarity system have been made:

granting pensions on the basis of the data of the personified record keeping system has been ensured;

the sources of financing of pension benefits between the budget of the Pension Fund of Ukraine and the state budget under different pension programs have been separated;

the extent of insurance contribution relief was reduced, specifically, in May, 2009, measures were taken regarding payment of insurance contributions to the Pension Fund of Ukraine by natural persons – business entities and by their family members, who take part in engaging in entrepreneurial activities by such business entities and are not in labor relations with them, in the amount of not lower than a minimum insurance contribution per each person;

- the systems of payment of taxes and insurance contributions have been separated by law;
- the functions of granting and payment of pensions and monetary allowances from the Ministry of Defense, the State Border Guard Service of Ukraine, the Department of State Guard of Ukraine, bodies of control of other military formations, the Security Service of Ukraine, the Service of Foreign Intelligence of

Ukraine, the Ministry of Interior, Administration of the State Service of Special Communication and Information Protection of Ukraine, the State Tax Administration, the State Department on Enforcement of Sentences, the Ministry of Emergencies, the Ministry of Transport and Communication and judicial bodies have been transferred to the Pension Fund of Ukraine;

- representatives of the parties of a social dialogue (by three representatives from trade unions and associations of employers) are attracted for managing the Pension Fund of Ukraine);
- a minimum pension benefit not lower than the subsistence wage for the persons who lost their ability to work has been fixed thus making it possible to meet provisions of Article 46 of the Constitution of Ukraine in full.

Due to an increase in the value of one year of covered service period from 1% up to 1.2% beginning from January 1, 2008 (and from October 1, 2008 up to 1.35%) and the implementation of legislative changes relating to upgrading of the salary which is taken into account when granting (recalculating) pensions (proceeding from the amount of the average wage from which insurance contributions for 2006 were paid, namely UAH 928.81) we have succeeded to renew to some extent the differentiation of pension amounts for 8 Mio pensioners and to ensure the implementation of recommendations of Convention 102 of the International Labor Organization concerning minimum standards of social security in terms of ensuring pensions in the amount of 40% of the wage in case of availability of 30 years of the covered service period.

However, an impact of one-time updating on the differentiation of the pension rate will disappear very soon, if the basic amount of pensions is not increased subsequently. It will result in the fact that in a two - three year's time the amount of pension again will become lower than the minimum amount, that is, the differentiation achieved will be neutralized.

Until now disproportions in pension provision are preserved that are conditioned by special pension programs for certain categories of citizens which establish individual terms of pension provision. In particular, this refers to the procedure of determining the wage from which pensions for employees of certain branches of the economy are calculated, adjustment of their pension amounts for inflation and a pension rise due to the wage growth.

Complete separation of the pension benefits financing sources has not been achieved yet.

Despite the measures that are taken in connection with revision of the Unified Wages Scale and the amount of minimum wage almost one third of the insured persons pay their pension contributions from the wage which does not exceed its minimum wage. This causes a decrease in the base for insurance contributions calculation and results in an undesirable decline of pension benefits in the future.

Application of the mechanism of increasing an insurance contribution rate to ensure pension benefit payment does not contribute to wage legalization and an increase in the influx of insurance contributions into the Pension Fund of Ukraine.

The financial and economic crisis influenced the stable operation of the Pension Fund of Ukraine adversely.

In addition, the main problem of the deterioration of the demographic situation of Ukraine is aging of the population which is proved by the increase of the elderly people share and the change in the generations ratio. Over the period from 1959 to 2001 according to the population census the relationship between the pension age persons and the population of the working age increased almost twice (from 22.7 up to 41.1%). According to the projections of the Institute of Demography and Social Studies of the National Academy of Sciences of Ukraine during the period of 2010-2025 this ratio will reach 50% and by the year of 2050 – 76%. Even now pensioners make up almost 30% of the total population.

The number of payers of contributions to pension insurance is equal to 15.2 million persons and the number of pensioners – 13.8 million, that is, a common contribution payer finances 90.8% of an average pension and in some regions – even more. In addition, the share of pension expenses in GDP already exceeds 15%.

To diversify the sources of acquisition of incomes in the old age and to ease the demographic factor on the financial situation with the solidarity system and to prevent further decrease in the amounts of pensions the Law of Ukraine “On Mandatory State Pension Insurance” provides for implementation of the Accumulation System of Mandatory State Pension Insurance (hereinafter referred to as the Mandatory Accumulation Pension System).

One of the preconditions of the implementation of the mandatory accumulation pension system is the experience of implementation and operation of the system of non-state pension provision.

491.1 thousand people became participants of the non-state pension provision system since its implementation. The total value of non-state pension funds assets as of July 1, 2009 amounted to Mio 732.2 UAH.

Reduction in the volumes of production of main types of industrial products and services in the period of the financial and economic crisis deteriorated considerably the conditions of investment activity, including those of NPFs that had a negative impact on the rate of return of pension assets. To-date the majority of NPFs do not provide profitability of pension assets higher than the rate of inflation. The level of investment income in the majority of funds is insufficient, and on the financial market there are no reliable types of financial instruments which would make it possible to ensure adequate diversification of NPF pension assets.

The main reasons of the slow development of the system of non-state pension provision are:

- low level of pension assets profitability;
- lack of legislative regulation of certain issues of the NPF market operation;
- low level of confidence of the population in non-state pension provision, the banking system and other financial institutions on the part of the population;
- lack of employers’ interest in financing private retirement schemes for employees;
- low level of financial ability of people to participate in the system of non-state pension provision;
- limited choice of financial instruments suitable for investment of pension funds in them resulting from the capital markets development lagging behind the needs of institutional investors;
- poor public education on the content and role of the Accumulation System of Pension Provision in the society and the lack of funds for it.

It should be noted that the capabilities of the non-state pension provision system have not been used to the full extent to resolve the retirement provision problems of people.

The legislative act on the retirement provision of certain categories of employees working in especially hazardous and arduous working conditions which entitle them to privileged old-age pensions or pensions for the years of service through corporate and occupational pension funds is at the stage of updating. The introduction of the Mandatory Occupational Pension System provides for additional load on the employer and the State Budget connected with the mandatory occupational pension contribution payment in behalf of this system participants.

The results of an analysis of the pension reform measures taken testify to the need to adjust the process of pension reform furtherance with a due account for the acquired experience and social and economic situation in the country. In doing so, further pension system reforming should be implemented in the following areas: enlargement of the contributions collection base, improvement of the Pension Fund of Ukraine’s financial situation; ensuring middle- and long-term sustainability of the pension system with gradual switching to strengthening the role of the pension system accumulation components as an income sources diversification factor; ensuring an adequate wage replacement rate by pension and mobilization of long-term investment resources required for the national economy modernization.

### **Purpose of the Concept**

The purpose of the Concept is further effective and systemic reforming the pension system of Ukraine intended to ensure the living standards of senior citizens and other categories of citizens who lost their ability to work that are adequate to their vital needs, creation of effectual protections of rights and interests of such citizens; ensuring stable operation and transparency of the pension system.

## **Ways and Means of Improving the Pension System and of Pension Reform Furtherance**

The improvement of the pension system and pension reform furtherance will be provided in the following areas: ensuring stable operation of the pension system; ensuring social justice in the solidarity pension system; formation of an effective and reliable system of non-state pension provision; improvement and simplification of the mechanism of operation and providing of comprehensibility of the pension system for individuals and employers; providing of public control over operation of the Pension Fund of Ukraine; unification of the pension legislation.

To ensure stable operation of the system it is required:

to strengthen financial discipline in insurance contributions payment to the Pension Fund of Ukraine;

to provide establishment of the adequacy, substantiation and acceptability of the level of fiscal load on payroll;

to expand the base of accruing insurance contributions, including that owing to legalizing wages and raising its level, reduction in part-time employment and unemployment

to elaborate the issue related to prevention of increasing a financial burden of employer in the course of financing pensions to the employees employed in underground working, in the workplaces with especially hazardous and arduous working conditions and in the positions which entitle them to privileged old-age pensions or pensions for the years of service;

**to improve the legislation concerning the powers in providing state oversight in the accumulation pension system, and also to strengthen the role of the MOE in the implementation of the mandatory accumulation pension system;**

to facilitate enhancement of investment attractiveness of debt liabilities, and liquidity of stocks issued by Ukrainian issuers.

In order to ensure social justice in the solidarity pension system it is required:

to improve the procedure of recalculation of pensions of working pensioners;

to eliminate disproportions in pension provision conditioned by preservation of special pension programs for certain categories of citizens which establish individual terms of pension provision and to switch stage by stage to unified rules of pension granting;

to streamline the amounts of bonuses in addition to pensions for different categories of people depending on the subsistence level for the persons who lost their ability to work in order to avoid using different approaches to computation of their amounts.

In order to form an effective and reliable system of non-state pension provision it is required:

to extend the areas of investment of pension assets if there are favorable conditions on the stock market and macroeconomic stability;

to unify the procedures of evaluation of pension assets and determination of amount of pension savings in the system of non-state pension provision and the of mandatory accumulation pension system, of introduction of daily calculation of a net value of pension assets (NAV) and of the value of a pension contribution (asset) unit according to a unified methodology;

to bring voluntary pension provision programs the implementation thereof is regulated by separate legislative acts in compliance with the Law of Ukraine “On Non-State Pension Provision”;

to define NPF administration services as non-state pension provision services and to apply to them the current taxation procedure which is envisaged for similar services;

to equate the procedure of taxation of pension benefits paid on a lump sum basis with the procedure of taxation of defined period pension paid from the NPF;

to facilitate issuance of special purpose mid- and long- term domestic government bonds;

to introduce international standards for investment activities and reporting for accumulation pension provision entities and for corporate governance mechanisms in the non-state pension provision system;

to take measures on the implementation of the accumulation system of the mandatory state pension insurance;

to unify the structure, rules and requirements to operation of the mandatory and voluntary components of the accumulation pension provision system;

to make participation of employers in the system of non-state pension provision more active;

to take additional measures on protection of the money participants of the system of accumulation pension provision from devaluation, losses and other risks with the purpose of strengthening confidence of the population in the accumulation pension provision system

to ensure development and implementation of compulsory occupational pension programs for certain categories of persons employed at works with especially harmful and especially difficult working conditions that give the right for privileged old age retirement or for length-of-service pension with simultaneous implementation of measures regarding employers’ creating working conditions that are safe for health, as well as for those employees for whom employers are not capable to ensure safe and harmless working conditions;

In order to improve and simplify the mechanism of comprehensibility of the pension system for individuals and employers, to ensure public control over operation of the Pension Fund of Ukraine it is required:

to standardize, automate and centralize technological processes in the solidarity system and in the mandatory accumulation system pension of pension insurance, to improve the quality and timeliness of public servicing;

to form a board of the Pension Fund of Ukraine on the basis of parity representation of the parties of a social dialogue;

to introduce a unified system of record keeping of pension rights acquired by individuals in the system of mandatory state pension insurance;

to introduce standards for disclosure of indicators demonstrating the current situation in pension system operation, as well as forecasts of its development;

to improve public awareness on pension reform through effective awareness raising campaign for the public, employers, trade unions, legal entities, specifically, on advantages and risks of operation of the accumulation pension provision system.

For establishing a universal and people-understandable legislative framework for further reforming the national pension system it needs to be unified on homogeneous groups of legal relations eliminating the practice of the regulation of pension provision terms for certain categories of citizens with individual

legislative acts. This will make it possible to create pre-requisites for further codification of the pension legislation. Pension provision issues must be regulated by laws exclusively.

### **Dates and Stages in the Concept Implementation**

It is expected to implement the Concept in the course of 2010 – 2017 in two stages.

At the 1<sup>st</sup> stage (2010 – 2013) it is envisaged to undertake the measures intended:

- to implement an effective mechanism of increasing pensions by improvement of the mechanism of their indexation for eliminating disproportions in the pension rates granted in different years;

- to ensure differentiation of an amount of a minimal pension payment depending on the period of contribution payments;

- to prevent delays in transferring social insurance contributions charged by enterprises, institutions and organizations to the Pension Fund of Ukraine (PFU), prevent incompliance of enterprise, institution and organization officers with the pension legislation;

- to make legislative proposals on cutting down unjustified privileges on insurance contribution payment as well as on elimination of a disproportion in pension provision conditioned by the implementation of special pension programs for some categories of citizens with privileged pensions and stage by stage switching to unified rules of pension granting;

- to ensure the stability of financing pension benefits, effective and rational pension assets utilization, improvement of financial planning methods, reporting and control over their spending;

- to amend the legislation in terms of improving the procedure of pension recalculation;

- to ensure transparency and predictability of the pension system and of the mechanisms of its administration;

- to legalize salaries;

- to prevent increasing a financial burden on employer in the course of financing pensions to the employees employed in underground works, in the workplaces with especially hazardous and arduous working conditions and in the positions which entitle them to privileged old-age pensions or pensions for the years of service;

- to optimize maximal wage (income) amount from which contributions are payable, and the pension amount;

- to raise the level of the legal requirements to asset management companies, administrators that manage pension assets, custodians of the accumulation pension provision system;

- to create an information and technical base for the operations of the mandatory accumulation pension system;

- to restrict acquisition or additional investment of pension assets in securities issued by legal entities that are related persons to founders of NPFs;

- to facilitate development of non-State pension provision;

- to amend the legislation regarding formation of the board of the Pension Fund of Ukraine on the basis of parity representation of the parties to a social dialogue and transformation of the Pension Fund of Ukraine into a nonprofit self-governing organization;

- to elaborate the matter of creating state guarantees for pension benefits to the insured persons - participants of the mandatory accumulation pension system;

- to improve regulation in the private pension area by way of expanding powers of the authorities supervising NPFs within the powers specified by laws;

- to implement economic incentives for pension contribution payment;

- to improve the legislation as regards exercising state oversight in the accumulation system as well strengthening the role of Ministry of Economy in the introduction of mandatory accumulation pension system and its development.

- to study the issues of participation of different financial institutions in the formation of accumulations intended for material support to citizens after their reaching the retirement age.

At the 2<sup>nd</sup> stage (2014 – 2017 it is envisaged:

- to complete preparation to the introduction of the mandatory accumulation pension system and to make its stage by stage introduction;

- to make a gradual redistribution of insurance contributions between hired employees and employers with simultaneous introduction of a mechanism of guaranteed compensatory wage rise to a hired employee.

- to ensure equality of citizens in the pension system by introducing unified rules of granting pensions;

- to free the budget of the Pension Fund of Ukraine from payments which are alien to it;

- to introduce a unified legislative framework of the pension system;

- to provide the development of the accumulation system of pension provision;

- to develop compulsory occupational pension programs for the employees employed in the workplaces where it is impossible to avoid an impact of occupational hazard in the working environment and provide their implementation.

### **Expected Results**

The Concept implementation will make it possible to provide:

- financial stability of the pension system;

- a constitutional level of pension benefits and compliance with provisions of the European Code of social security and the Convention No. 102 of the International Labor Organization concerning minimum standards of social security in terms of pension provision;

- introduction of a fair mechanism of pension benefit growth;

- creation of a fair, transparent pension system;

- gradual redistribution of the burden of payment of insurance contributions between the employer and the employee with simultaneous guaranteed wage rise to the hired employee which will ensure control over insurance contributions payment by the insured person – the future retiree;

- development of the system of non-state pension provision.

- introduction of the mandatory accumulation pension system;
  - augmentation of compulsory insurance contributions of citizens in the mandatory accumulation pension system, transfer of the accumulated capital in their ownership with the right of its succession as well as to heighten individual interest of citizens in payment of insurance contributions;
  - formation of the sources of long-term investment resources for the national economy;
  - prevention of the growth of a fiscal burden on employers in terms of social charges on the wages fund.

### **Evaluation of Financial, Material and Technical, and Labor Resources Necessary for the Concept Implementation**

Measures associated with the Concept implementation are planned to be financed by the money of the Pension Fund of Ukraine, the state budget, international and domestic donor and charity organizations and other sources.