

# Private pension system in Ukraine: its advantages and disadvantages

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**Abstract** - This paper analyzes the new reform of the pension system - the private pension system. There are defined the main advantages and disadvantages in choosing a funded pension system, as well as the dynamics of changes in key indicators of private pension funds is analyzed.

Keywords - private pension system, private pension funds, administrators of PPF, individual retirement accounts, insurance companies, banks, pension payments, investment activities, retirement savings.

## I. Introduction

Reforming the pension system is an urgent problem nowadays regardless of the level of economic development of the country. Parliament of Ukraine introduced a three-tier pension system aimed at balancing risks between its components caused by demographic, economic and social situation in the country. The main objective of private pensions is to increase financial independence and responsibility of citizens for their financial situation after the completion of employment.

## II. Results

Private pension insurance is a part of pension savings system, based on the voluntary participation of individuals and entities in the formation of personal retirement savings in order to receive additional pension benefits in the future. Implementation of the private pension system in Ukraine will increase the incomes of elderly people [1].

Private pension insurance (PPI) is provided by: pension funds, insurance companies and bank institutions.

As of 09 September 2013 in Ukraine in the State Register of financial institutions there are registered 80 private pension funds (PPF), and administrators of PPF who are licensed to operate - 29 institutions [2].

The special feature of private pension insurance is that payments made on personal savings accounts are additional to mandatory state pension benefits. Thus, the citizen has the opportunity to receive additional stable cash income, which provides the material well-being after retirement.

Using the PPI system gives the public a number of advantages, namely [2]:

1. Financial independence. Pension contributions and additional income derived from investing of personal savings will allow receiving the pension payments in the future regardless of the state pension payments.

2. Voluntariness. In contrast to the mandatory state pension deductions from wages, PPI is performed on a voluntary basis.

3. The right of choice. Every citizen has the right for personal choice of PPF, insurance company or bank institution to open a pension account. He also can choose the most convenient and attractive terms of payment of pension contributions and the scheme of pension payments.

4. Increase of pension savings. The funds accumulated in the PPF, insurance or bank institutions are invested in various financial instruments (stocks, bonds, property or other securities) to obtain additional income from investing activities. Percents obtained in the course of investment will be calculated both as the amount of pension savings and as the amount of money received in the course of pension payments.

5. Autonomy. Participants of the PPI can choose on their own their retirement age (plus or minus 10 years from the officially recognized one in Ukraine), the amount of pension payments (which depends on the size of pension contributions) and the frequency of it.

6. Control. Each participant is annually provided on a mandatory basis with an extract about the condition of the individual account (about the amount of receipts and payments) as well as at any other time at the request of participant.

7. Ownership. Capitals on the individual account as well as capitals from investing activities are the property of the PPI participant, regardless of who paid pension contributions in favor of the participant (employer or owner of the account).

8. Choosing of individual scheme payments. PPI participant is entitled to the following payment systems: pension for a fixed term (payments are made after reaching by the participant of his retirement age); a one-time pension payment (in case of disability or critical state of health, given the medical information is provided); in the event of death of the participant; when leaving Ukraine for permanent residence; lifetime pension (payment made by the insurance company under an insurance contract).

9. Ability to transfer savings, when changing the PPF, to another insurance company or bank and vice versa.

10. Inheritance of pension payments. Another feature of the PPI is that unlike the state pension system the pension savings are inherited in the event of death of the participant of the fund.

11. Tax benefits. Pension contributions are not taxed on personal income tax due to the fact that the pension savings are related to the tax credit.

PPI is a relatively new link in the system of pension insurance, which needs improvement and further development. Existence of significant tax benefits for the PPF:

- For employers-contributors - no income tax on pension contributions and the ability to carry the amount of contributions to total costs;
- For administrators and asset managers of PPF - exemption from value added tax (VAT).

Attention shall be drawn to the following negative aspects of the PPI:

First, the pension assets involved into investment activities are risky in their nature due to the fact that the amount of profit / loss that will be obtained from the following transactions is known in advance. To solve this problem, one should diversify the risks, which is to make restrictions on volumes and directions of use of pension savings. This will minimize the costs for investment activity, and keep the pension savings of the PPI participants. However, the amount of borrowed pension assets, which affects the amount of investment income is insignificant for the possible implementation of the diversification of pension assets in the incoming financial instruments.

During its lifetime, the PPI's total investment income is UAH 646.3 million (47.1% from the amount of contributions) [2].

Dynamics of total assets price, as well as of the income on investment of the PPF assets for the period from 2010 to 2012 is shown in Table 1.

TABLE 1  
DYNAMICS OF TOTAL ASSETS, AND RETURN  
ON INVESTMENT OF A FUND IN 2010-2012. [2]

Indicator	2010	2011	2012
The whole amount of PPF assets (UAH mln.)	1144,3	1386,9	1660,1
Income / loss from investing of the PPF assets (UAH mln.)	433	559,9	620,3

Investments made during the last three years characterized by returns, and brings additional income to fund participants from using their savings. Increased income from assets investment can be attributed to the increase in the total value of the assets involved in the PPF. Additional income from investments will enable the PPI participants to cover losses from depreciation funds from inflation to preserve the real value of money.

Another disadvantage is imperfect legal basis regarding regulation and implementation of PPI. There is no clear definition regarding the taxation of pension contributions and payments as well as tax benefits. The existence of proper legislation basis will organize the activities of the PPF and eliminate the possible losses of pension savings of fund participants. Activity on the stock market is not perfect and needs some changes and improvements. Proper division of responsibilities between the State Commission on Securities and Stock Market, National Bank of Ukraine, insurance companies and the state will help to effectively implement and regulate the activity of PPI system.

Another one, but not least, disadvantage of the PPI is the low level of public trust to the new and not yet known pension insurance system. The risk of losing their savings in connection with liquidation, bankruptcy of PPI organizations does not allow the private savings system to use its full potential for development.

Dynamics of main indicators of the PPF for the 2010 – 2012 is shown in Table 2.

TABLE 2  
DYNAMICS OF MAIN INDICATORS OF THE PPI  
IN THE PERIOD OF 2010 -2012. [2]

Indicator	2010	2011	2012
Total amount of participants (thousand persons)	569,2	594,6	584,8
Pension contributions (UAH mln.)	925,5	1102	1314
Pension payments (UAH mln.)	158,2	208,9	251,9

At the end of 2012 year the number of PPF was 584788 persons. [2]

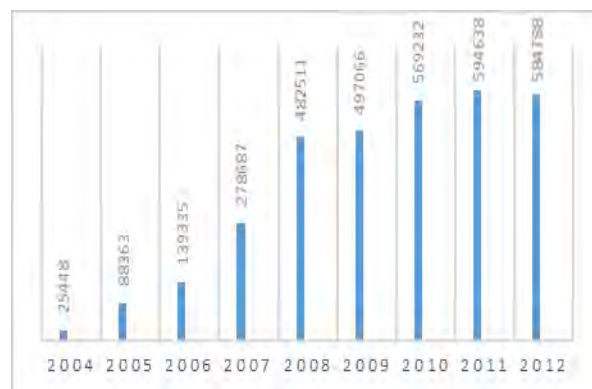


Fig. 1. Dynamics of the number of participants in 2004 – 2012 [3]

While analyzing the dynamics of pension contributions in Fig.1, it must be said that the amount of PPF participants is gradually increasing, which leads to an increase in contributions of PPI.

### III. Conclusions

Improving the PPI system will help to balance the demographic burden on the working population. Public awareness of private pension insurance as well as of the services they provide will contribute to the development of the insurance business, including the services of life insurance and lifelong pension. Providing the guaranteed income after retirement, the amount of which depends on the size of pension savings will increase the motivation of people to more productive work.

### References

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