

Statement to the Panel Central Bank, Macedonia

Opening statement - Pension reform in Macedonia: ex post view

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After quite long preparation eventually pension reform in Macedonia entered implementation phase in the first half of 2005 with the creation of the first two private pension funds. Since January 2006 35% of pension contributions started to be channeled into funded pension funds. In this occasion, I will give our view on some aspects of the reform from the perspective of 17 months of experience. I have to acknowledge that there is a risk it is too short period to draw some firm conclusions. Nevertheless, it can put on the table some points for further discussion on this panel.

1. In Macedonia was allowed existence of only two funded Pension funds for the second tier for the period of ten years. This was justified with the small number of expected members of the compulsory funded pension scheme. However, allowing the existence of such duopoly created rent-seeking behavior of the private funded pension funds:

- they agree for the fee;
- the main income comes from upfront fee on monthly contributions payments and not from asset management fee, that is not very transparent way of charging clients;
- there is not interest to compete for subscribers with better service and higher yield;
- no interest to attract highly skilled staff (the first certified investment analyst was hired only recently);
- no need to take risk on the market (at the end of the first year appx. 96% of the funds were invested in domestic sovereign securities and bank deposits; only 4% were invested on domestic equity market compared with the allowed upper limit of 30%; no investment abroad although the allowed limit is 20%).

Thus, if you want to create a competitive market that will contribute to development of financial markets it is necessary to allow existence of at least three compulsory funded pension funds, regardless of the size of the market. It will lead to lower fees and higher returns for beneficiaries.

2. Once regulatory framework has been established and tested with second pillar, the third pillar should be introduced as soon as possible. In Macedonia, third pillar is planned to be implemented in the next year. The advice would be not to limit the number of funds. Let the market decide is it profitable or not. Of course, the capacity of the supervision has to be appropriately strengthened for the increased volume of work.

3. In Macedonia investments of the funded Pension funds are by law subject of some limitations (investments abroad are limited to not more than 20% of the total funds and only in EU, USA and Japan). It is considered that the limit of 20% is not an obstacle having in mind the current level of know how in the pension funds. However, once the pension funds are staffed with investments analysts and risk managers, both, quantity and country limits could be reconsidered.

4. In the reformed pension system National Bank of Republic of Macedonia got a role being custodian for the two pension funded funds till 2010. The main rationale behind such decision of the pension system reformers was to increase credibility and soundness of the second pillar at its initial stage. However, this solution have several adverse effects:

- it is only an additional temporary obligation for the central bank and it has not incentive to allocate sufficient resources on it;
- commercial banks will not develop custodian services till 2010;
- therefore, it does not contribute to the development of financial industry.

Therefore, it is highly advisable to remove custodian services for the pension funds from the central bank as soon as possible and offer to the financial industry on a competitive basis.

Private savings in Macedonia are growing by 25-30% in the last three years. Having in mind the growing economy it is expected this trend to continue. However, the available financial services are still traditional. The main reason is lack of know-how. Therefore, increased savings are invested in bank deposits. Lately there is growing trend of individual investments in equity on the stock exchange. However, due to lack of investment advisors and investment funds individuals are exposed to uncalculated risk. The development of the domestic financial industry is inevitably dependent on the availability of local skilled financial analysts, investment analysts and risk managers.