Marija Ampovska, assistant professor, civil law department, Faculty of Law, UGD
Round Table “Reforms in the pension system in Russia and Macedonia
Faculty of Law, University Sankt Petersburg, 20 June, 2019

I LEGAL ASPECT OF THE REFORM

BEFORE THE REFORM

The North Macedonian pension system was based on the principle of generation solidarity, i.e. pay-as-you-go (PAYG), where the current contribution payments are used to finance the current pensions. This system of solidarity became inadequate and burred with lack of funding. The pension system was a single pillar system. This pillar was financed from the pension contributions of the employee`s (By the Law, every month 18 percentage[1] of the monthly income of the employee goes to this Fund), the central Budget and several years ago by dividends from the shares of the public share companies and the dividends from units from the limited liabilities companies (The Public Insurance and Disability Fund in the 90-tees became an owner of shares and units in many attractive companies in the country).[2] This shares and units from the trade companies were regular income to the Public Pension and Disability Fund.[3]

TIME FRAME OF THE REFORM

2000 – 2013

There was a reform of the system’s design that introduced the principle of fully-funded pension insurance, where in addition to the first pillar, two more pillars were added:

- Mandatory private pension pillar - Law on Mandatory Fully Funded Pension Insurance, Official Gazette No. 29/2002, 85/2003, 40/2004, 113/2005, 29/2007, 88/2008, 48/2009, 50/2010, 171/2010, 36/2011, 98/2012, 13/2013, 164/2013, 44/2014, 192/2015, 30/2016 and 21/2018

- Voluntary private pension pillar - Law on Voluntary Fully Funded Pension Insurance, Official Gazette No. 7/2008, 124/2010, 17/2011, 13/2013

New Laws and Bylaws

1. 2002 Law on Mandatory Fully Funded Pension Insurance
2. 2008 Law on Voluntary Fully Funded Pension Insurance

---

[1] This percentage vary by the life standard and the average salary.
[2] Law on transforming enterprises with Social Capital, Official Gazette no. 38/1993. By article 19 of this Law, the enterprises that were transformed 15% of their asset value were given as units or shares to the Public Pension and disability fund. Also, there companies were obligate on 2 % fix dividends per year.
[3]Ibid. Article 19, paragraph, 3.

3. 2012 the North Macedonian Parliament adopted a new Law on Pension and Disability Insurance[4],
4. 2012 - the Law on Payment of Pensions and Pension Benefits from Fully Funded Pension Insurance
5. In 2013, most of the secondary regulation was amended and harmonized with the Laws on mandatory and voluntary fully funded pension insurance and mostly with the Law on payment of pensions and pension benefits.

This was a period when vast new law and by- laws were brought in this area. Also, this is a period when the Agency for supervision of fully funded pension insurance – MAPAS was established, and the first two management companies for conducting mandatory Pension funds were established, and later the management companies for voluntary pension funds. New financial institutions comprise at the North Macedonian financial market. These management companies for the mandatory pension funds were established by the two most powerful banks in that period: Komercijala Banka AD – Skopje and Tutunska Banka AD- Skopje as domestic capital and holdings from R. Slovenia.

The voluntary fully funded pension insurance became operational in the second half of 2009 and the current pension companies were granted licenses for management of voluntary pension funds. Open Voluntary Pension Fund “NLB penzija plus” Skopje has started on July 15, 2009 while KB First Open Voluntary Pension Fund – Skopje on December 21, 2009.

II THIRD PILLAR IN THE PENSION SYSTEM

GOAL

The main objective of the Third Pension Pillar, independently of the state pension insurance, is to provide a higher income after the retirement of employees, pension income to people who are unemployed or fall into the category of long-term unemployed, persons hired by projects or foreign missions, persons who have no income on any basis, additional pension insurance to third parties – spouses, family members or pension income to any persons aged 15 to 70 who have not achieved their pensions in accordance with the Law on Pension and Disability Insurance are not users of the same, i.e. persons who do not withdraw funds in accordance with the Mandatory Fully Funded Pension Insurance Law and do not generate retirement benefits under the Voluntary Fully Funded Pension Insurance Law.

[4] Official Gazette No. 98/2012.

Voluntary Pension Insurance also enables voluntary collective pension insurance – occupational pension schemes where employers pay additional pension insurance funds for all or some of their employees.

The principle of fund capitalization and accumulation on either voluntary individual or professional accounts, supported by investment of the assets of Voluntary Pension Funds and the establishment of future pension benefits from Voluntary Funds (based on the amount and timing of payments, fees charged and investment yield) enables to define the level of accumulated funds to be used for payment of pension benefits from Voluntary Funds.

It is a funded system based on a voluntary membership. A member of the third pillar may have an individual account where on monthly basis (or other chosen method) the contribution is converted in fund units. The value of the individual account is proportional with the fund’s return and respectively with the fund unit’s value.

Open voluntary fund

Open voluntary pension funds are open for all the persons that show interest in joining them, while the membership in the closed funds is limited to the employees/members of the fund sponsors. The sponsor of a closed voluntary pension fund may be the employer, a union or an association. The sponsorships understand that the employees/members are enabled voluntary retirement savings under special conditions in comparison to those that apply for members of open voluntary pension funds. The sponsor also takes over the obligation of paying the contributions for the employees/members and actively participates in planning and carrying out of the investment policy of the fund.

Membership

A person may become a member of a voluntary pension fund by: • signing a contract for membership in a voluntary pension fund with the Voluntary Pension Company or Joint Pension Company and by opening a voluntary individual account • signing a contract for membership in a voluntary pension fund with a third person, who shall pay in the name and on behalf of the person (payer) and the company and by opening of voluntary individual account • participating in an occupational pension scheme organized by his/her employer or association were he/she is a member and by opening of occupational account. One person can have only one voluntary individual account and one occupational account. These accounts can be in the same or in different voluntary pension funds.

The voluntary fully funded pension insurance offers coverage for a larger group of the population in the Republic of Macedonia, as well as for persons that are not citizens of the Republic of Macedonia.

Contributions

The payment of the voluntary contribution is allowed only for the person that meets the membership requirements per the Law on Voluntary Fully Funded Pension Insurance. So, the members owning voluntary accounts may pay the voluntary contributions on their own, or a payer may do it on their behalf.

Year	Contributions paid in the funds	Assets	Members	Investment portfolio
2013	During 2013, in voluntary pension were paid 113 million denars	318 milion denars which represents around 0.07% of the GDP	18,500 (as individual members or as members of occupational schemes), where the numbers of members in occupations schemes is dominant (around 73% of the total membership).	Investment in domestic government securities, deposits and shares, as well as investments abroad.
2014	164 million denars were paid in the third pillar pension funds	506 million denars or 8.2 million Euros, or 0.10% of the GDP	20,400 members, out of which 69% are participants in occupational schemes and have occupational accounts.	Investment in domestic government securities (44%), deposits (15%) and shares (12%), as well as in investments abroad which include shares (5%) and participation units in investment funds (22%)
2015	217 million denars	As of 31.12.2015, the value of the	In 2015, the number of	Investment in domestic

		voluntary pension funds assets reached 0.7 billion denars, which is 0.13% of the country's GDP.	members in the third pillar increased by 6% in respect to 2014 and reached 21,750 members, out of which 68% are participants in occupational schemes and have occupational accounts.	government securities (49%), deposits (12%) and shares (10%), as well as in investments abroad which include shares (5%) and participation units in investment funds (23%).
2016	243 million denars were paid in the third pillar pension funds	998 million denars, which is 0.16% of the country's GDP.	In 2016, the number of members in the third pillar increased by 6% in respect to 2015 and reached 23,000 members, out of which 65% are participants in occupational schemes and have occupational accounts. The members in the third pillar, on average basis are older than those in the second pillar, and their average age is 43 years.	investment in domestic government securities (49%), deposits (13%) and shares (8%), as well as in investments abroad which include shares (6%) and participation units in investment funds (22%).
2017	270 million denars were paid in the third pillar pension funds	1.3 billion denars, which is 0.21% of the country's GDP.	Increased by 4% in respect to 2016 and reached 23,800 members, out of which 62% are participants in occupational schemes and have occupational accounts. The	The structure of the investment portfolio of the voluntary pension funds is very similar to the one of the mandatory pension funds

			members in the third pillar, on average basis are older than those in the second pillar, and their average age is 44 years. I	and of the last year's and it consists of investment in domestic government securities (49%), deposits (13%) and shares (8.5%), as well as in investments abroad which include shares (6%) and participation units in investment funds (21%).

According to the Law, voluntary pension companies charge three types of fees: fee from contributions, fee from assets and fees for transfers. They use these fees to cover the following functions: manage the voluntary pension funds assets, valuation of assets, membership, keeping of individual accounts, reporting to members, payment of fees to MAPAS and the custodian and covering of own expenses.

III SIMILARITIES WITH LIFE-INSURANCE

Since life insurance and voluntary pension insurance are products of various purposes, we cannot speak about the advantages of one over the other. The purpose of the voluntary pension savings is to ensure income in retirement, while life insurance primarily covers the risk of death of the insured persons. Besides, voluntary retirement savings are stimulated by state incentives, and the payments paid by the employer for his employee in the voluntary pension fund are a tax recognized expense, if the amount up to 500.00 kuna is paid per month per employee, i.e. 6,000 kuna annually, Unlike life insurance, any person which shows interest in becoming a member of a voluntary pension fund can do that, regardless of the health state and employment and age, while the saved assets can be used after the reached age of 50. At any moment, payments into a voluntary pension fund are flexible, and the balance on the account completely transparent.

Both pension funds and life insurance involve obligations to another party (members/policyholders) which may be of long duration and uncertain in nature to

have assets and future contribution/premiums which together with investment returns are used to meet these obligations or may have access to additional funds (deficit contributions/sponsor covenant/shareholder funds/free reserves) to meet shortfalls o are complex mechanisms with significant communication and financial awareness challenges for employees/policyholders and the public at large it may be appropriate to consider pension solvency in a similar risk based frame.

By contrast, insurers provide insurable benefits. Pure insurance products7 do not (and should not) assume those risks that are in the employer’s control e.g. pay inflation or other benefits like early retirement where some form of employer consent is required. Discretionary indexation can be provided through participating insurance business. Where such benefit design features are seen in arrangements with insurers, the employer finances them in the form of additional premiums as and when the additional benefit is triggered – in effect, a current unit type actuarial method is adopted. In other words, when the moral hazard is removed the risk becomes insurable.

Insurance operates in a fundamentally different way. It is a risk focused business activity designed to pay out its contracted obligations in all but the most extreme economic scenarios. With time, it has become a business where insurers operate internationally such that although different types of benefit and product designs may be provided across borders, insurers increasingly operate to similar industry and regulatory standards. Capital provides security to policyholders against the failure to deliver benefits. Capital has become the primary means to regulate and operate the global financial (insurance and banking) market. Because capital is expensive, using it efficiently and effectively is key to the operation of a competitive insurance market. Insurers around the world utilize similar techniques and approaches to manage capital. If pensions and insurance represent different delivery mechanisms for deferred pay, are they in competition for business or capital? For the accumulation phase of DC provision, they do compete in many countries today and were insurers to broaden their product ranges, or employers align their HR and other goals, pensions and insurance would likely compete to a greater degree in those and other countries also25 . Although there are many parallels between pensions and participating insurance, it is not clear that pensions and insurance are in competition for DB provision however o they are different markets DB pensions are a bespoke, internally focused or ‘closed’ market i.e. operated by a given employer for its employees only. Whereas insurance seeks competitive advantage from mass market one-stop-shop products to provide advantages of scale and risk pooling. Insurance and pension products within a market have different regulatory and♣ sometimes tax requirements and an employer’s choice of which product to take is as often based on these factors as well as the principle of risk transfer through insurance or risk retention through a pension product. In Spain, for example, an employer can tax

optimise its finances by using both an insurance product (GIP) and a pension product (CQPP) for different parts of the benefit design Insurers have been particularly successful in attracting pension business of small medium employers in many countries, it is important to distinguish between situations where the insurer acts simply as a manager of those funds (the employer retaining the risks) and those where the pension is insured with the insurer (i.e. the insurer bears the risks, or at least most of the risks). Taking three of the world's largest pension obligation countries by way of example Netherlands has a balance of both types of business for insurers; In Japan, true insurance of pension products is rare; In the US, insured pension business primarily takes the form of buy-out policies for plans in wind up.

Different risk appetites of the parties involved including factors such as benefit design and investment strategy. Perhaps because of the soft capital approach in pensions (contingent reliance on employer's covenant etc) employers/trustees are more inclined to take asset-liability mismatch risks and benefit designs have broader HR or social objectives containing more risky elements (salary growth, guarantees and member options, discretionary or conditional indexation) than are typical for pure insurance products Although insurance is designed to ensure payment of benefits in all but the most extreme scenarios, there isn't a similar framework in pensions on a plan by plan basis (with the exception of the Netherlands and the possible exception of the UK26) It would be interesting to reflect on what pension plan members think the risk of non or partial payment is in the plan they are a member of. And both what an acceptable risk of non or partial payment would be and what the member would be prepared to give up to increase security; with different regulation overseen often by different regulators In simple terms, pensions operate by a soft capital regime with checks and balances, and insurance is a hard capital risk-focused regime. In Europe, directional alignment on regulatory aims and themes, though not necessarily application of those themes seems likely.

Pensions and insurance contracts have different legal bases and 'pressure valves' if obligations become too onerous. Law generally provides for more flexibility for employers to amend the terms of pension plans/promises in difficult economic circumstances. Insurance obligations can generally only be amended prospectively to the extent permitted by the contract boundary clause o and although many countries operate guarantee arrangement (government or industry sponsored investor protection or financial compensation schemes) in the event an insurer defaults, few do so for pensions28 and different arms of government/industry are responsible for each.

Summary

1. Pensions and insurance represent different mechanisms to deliver a benefit promise from the sponsor to the beneficiary. It is not surprising therefore that

they bear many similarities. Both involve obligations that carry out a key social purpose to a third party and which obligations are typically of long duration (perhaps 60 or more years) and uncertain in the amount and timing of cashflows arising.

2. Life insurers and pension funds manage risks on the long term, which makes them important suppliers of saving products for the population. They are both important segment of the financial system
3. At the end of 2016, 15 insurance undertakings operated in the Republic of Macedonia's insurance market place, of which 11 offered non-life insurance, and 4 life insurance. The life-insurance segment's Gross Written Premium was MKD 1,29 billion (2015: MKD 1,10 billion and in 2017 1,44 billion which is 11,95% growth compared to 2016), showing an increase of 17.32% compared to 2015. During 2016, the insurance sector reported a profit after taxation in the amount of MKD 474,62 billion. The non-life insurance sector reported a profit of MKD 430,41 million, while the life-insurance MKD 54,21 million (in 2017 this profit is 81,78 milion).

The obligation arises from the employee carrying out a service (their job) for their employer, part of the reward for which takes the form of deferred pay. If the employer elects the insurance route, it pays a premium today for which the♣ insurer takes on the risk to pay the insured benefit to the beneficiaries in the future. As noted in the Preliminary section of this paper, there are instances and countries though where the employer retains risk even if the employer elects to finance its obligations through insurance. As a statement of the obvious, insurance contracts do not necessarily cover all the risks or the same risks everywhere. If the employer elects to finance its obligation through a non-insurance ('pensions')♣ route, the employer retains all of the financing risk and, depending on law, may fund the benefit in advance or otherwise record the liability on its books. Insurance is a hard capital regime, pensions a soft capital one. Participating insurance contracts are perhaps somewhere in between. Like insurance, funded pension plans collect and invest assets and future contribution/ premiums which together with investment returns are used to meet these obligations. And both may have access to additional funds (deficit contributions/sponsor covenant/shareholder funds/free reserves) to meet shortfalls. There are a number of key differences also. Primarily the history of the products, how risk sharing mechanisms operate, the nature of the regulatory regimes – in particular, the pace of funding/financing and the ability of the insurer/employer to change the terms of the contract/plan in difficult times – and governance that have built up over time to shape people's perceptions. Employment law shapes pension products (and may shape insurance products in some countries also). The concept of accrued rights accords well with the insurance concept of contractual benefits and the accounting concept of contractual obligations. But not all countries

operate accrued rights rules – employers or trustees (or their social partner equivalents) may be able to change benefits retrospectively if circumstances merit or agreement is reached otherwise. Insurance is an international business : through the IAIS, IASB and industry competition, the basis of statutory reserving, capital requirements and accounting for insurance business is converging. Particularly in Europe through Solvency II. Features of pensions like measurement, funding and governance are driven by in-country regulation, country social and fiscal preferences, market depth and size, culture and country politics. The EU aside, cross border influence on pensions is through bodies like the OECD, the World Bank, professional bodies like the actuaries, and businesses (employers, product providers and advisers etc) who operate internationally. They promote greater alignment through sharing of experience and best practice in benefit design, operational efficiency, and regulatory models and oversight. It is often noted that insurance is more expensive than pensions : this is not representative of a difference between the two products however. Rather the seeming extra employer contribution (premium) in insurance, over and above what may be seen in pensions36, is 36 The cost of a pension is viewed differently by different parties. The actual cost of a pension can only be determined when the last beneficiary dies and all the actual cashflows known. The short term cash cost is the funding contributions over a given time period. The short term accounting cost is the charge to the accounts over a given time period. Risk (financial, demographic, regulatory, political) is the expensive unknown until the last beneficiary dies. Some of these risk factors can be mitigated by purchasing matching assets. 17 consideration for the risk transfer in insurance. The absolute and relative costs of both insurance and pensions can be mitigated in part through the policyholder taking on more risk such as participating insurance contracts or more defined contribution elements in the pension design. Perhaps the key difference is that because insurance is a hard capital regime, there is greater clarity in the operation of the insurance contract (who bears what risk and who benefits from that risk, what capital is required etc) although participating insurance arrangements in particular are still criticised for lacking transparency. This flows through to Greater clarity about inter-generational wealth and risk transfer• Ringfencing of the capital available to finance the contract• Who benefits from surpluses, suffers from losses• What the parties risk appetites look like accordingly• These themes are also addressed in pensions of course but through different mechanisms set at country and plan level. A critical question remains however whether regulators, employers, employees and beneficiaries whose retirement benefits are covered by an insurance contact (whether participating in nature or not) or a pensions vehicle (whether defined benefit or defined contribution in nature, funded or not) have an equal understanding of the nature of the risks they face under those products and any national or industry level guarantee arrangements in place

around them. Actuaries have a key role to play in ensuring sound levels of financial awareness and understanding of products.