

TA COMPLETION REPORT

TA NO./NAME: TA 2910-KAZ: CAPACITY BUILDING FOR PENSION REFORM				TA AMOUNT APPROVED: \$1,000,000	DIVISION: IEFI
				REVISED AMOUNT:	SOURCE: TASF
EXECUTING AGENCY: Ministry of Finance (MOF)				TA AMOUNT UNDISBURSED: \$181,380.27	TA AMOUNT UTILIZED: \$818,619.73
DATE:	APPROVAL: 12 November 1997	SIGNING: 26 June 1998	FIELD: 15 Aug 1998	CLOSING: ORIGINAL: 31 May 1999	ACTUAL: 31 July 2000 (expected)

TA DESCRIPTION: The TA supported the transition from a pay-as-you-go (PAYG) pension system to a fully funded defined-contribution system in Kazakhstan. In order to facilitate the transition and ensure the financial sustainability of the pension system, ADB approved the Pension Reform Program Loan (PRPL) of \$100 million in December 1997. The TA was an integral component of ADB's support that included the PRPL, two small scale TAs¹ to prepare the policy framework for the PRPL and to assist in the design of key administrative mechanisms, and two other TAs designed to support financial sector capacity building and improve public awareness of the new pension system.²

TA OBJECTIVES AND SCOPE: The TA aimed to strengthen the Government's institutional capabilities to introduce and implement a fully funded mandatory retirement income system based on individual pension accounts. This was to be achieved by (i) strengthening the capacity of the National Pension Agency (NPA) to implement an effective accounting and reporting framework that would allow it to regulate and monitor the operations of the State Accumulation Fund (SAF) and the private pension funds; (ii) developing a strategy for capital markets, focusing on long-term debt instruments; and (iii) developing a strategy for an efficient and competitive insurance industry that is capable of providing different types of insurance products.

TA INPUTS EVALUATION: Under the new pension system, workers make contributions to their individual pension accounts, to be held either in SAF or in one of the privately managed pension funds. In line with the understanding reached under the PRPL, the Government established an elaborate supportive institutional and regulatory framework comprising the State Pension Payment Center, SAF, NPA (renamed subsequently as the Committee for the Regulation of Accumulation Pension Funds), National Securities Commission (NSC) and National Bank of Kazakhstan (NBK). Against this background, the TA involved international consulting inputs of 20 person-months and domestic consulting services of 3 person-months. The consultants included experts in accounting, management information system (MIS) for capital markets, insurance industry, and commercial law. International Management & Communications Corporation of USA was engaged in August 1998 to implement the TA.

TA OUTPUTS EVALUATION: The TA outputs consisted of advisory support and recommendations in three areas: (i) development of the regulatory capacity of NPA, (ii) policy and regulatory reform of the insurance industry, and (iii) development of capital markets. The design and organization of the TA, including terms of reference (TORs) for the consulting services, were appropriate to meet its objectives. The consultants' advisory functions were carried out diligently and adequately documented in the final report. The performance of the team was satisfactory. While MOF's overall commitment to the TA was satisfactory, shifts among counterpart staff with changes in ministerial responsibilities caused some interruptions. The Bank's supervision of the TA was adequate. The following presents a summary of the achievements under the TA:

Development of the Regulatory Capacity of NPA: The TA provided support to (i) strengthen the MIS of NPA in compiling accurate work history and pension contributions data; (ii) procure state-of-the-art hardware and design software to manage financial reporting of SAF and private pension funds; (iii) strengthen the accounting, auditing and reporting processes, and the legal and regulatory framework to bring them at par with international standards and practices; (iv) improve regulatory procedures and reporting formats to collect, verify, and analyze data in the pension system; and (v) develop modalities for separation of accounting of the pension funds' own assets and those of the contributors. The overall pension management system at NPA was designed to strengthen prudential regulation and supervision and minimize the reporting burden on pension funds, yet at the same time ensuring adequacy and transparency of information. This component of the TA was coordinated with the United States Agency for International Development (USAID).

¹ TA 2780-KAZ: *Pension Reform*, for \$100,000, approved on 16 April 1997; and TA 2829-KAZ: *Enhancing Pension Management and Information System*, for \$100,000, approved on 23 July 1997.

² TA 2945-KAZ: *Financial Sector Capacity Building to Support Pension Reform*, for \$680,000, approved on 15 December 1997; and TA 3082-KAZ: *Public Information and Education in Support of Pension Reform*, for \$840,000, approved on 1 October 1998.

The TA support has had a significant impact on the operation of the accumulation system. The new MIS framework has provided a strong foundation for improved reporting. All reporting to the NPA is now done electronically by the pension funds. The system is also serving as the platform for USAID-funded efforts to unify regulatory reporting for the pension funds, the asset management companies and the bank custodians. The newly designed system will eventually help unify regulation and supervision of the accumulation system. Further, extensive training support has also been provided under the TA in software design, systems analysis and data-security to ensure self-sustainability of the system. USAID's assistance built upon the core system developed under the TA to improve regulatory reporting and analysis.

Capital Markets Development: The TA conducted an in-depth analysis of the state of capital markets in Kazakhstan and provided recommendations to create a broader range of financial instruments for the investments of pension assets. The regulatory framework was developed for tenge-denominated bonds indexed to the Consumer Price Index. However, since the Government has focused more on dollar-denominated bonds, these indexed products have as yet not been issued. The consultants provided support to NSC on removing constraints to the issuance of corporate bonds. The composition of corporate instruments in pension fund investments has improved marginally: on 1 March 2000, 2.5 percent of the overall pension portfolio was invested in corporate securities, compared to 1.7 percent in December 1998 (at the start of the TA). Growth in this area is likely to be gradual, given the strong preference of the pension funds to invest in eurobonds.

Improved Framework for Development of an Insurance Industry: The TA laid the groundwork for the development of the insurance industry. Extensive training was provided to the Department of Insurance Supervision (DIS) staff on the fundamental principles of insurance operations. The TA supported the adoption of basic insurance legislation that permitted the DIS to begin exercising limited regulatory authority. The consultants drafted regulations, and the basic legal framework for life insurance. The TA proved to be timely, as the Government has since decided to comprehensively develop the insurance industry including its legislative and regulatory framework by the third quarter of 2000. The TA was coordinated closely with other donor activities.

TA's OVERALL ASSESSMENT/RATING: The TA is rated as "satisfactory" as its objectives have been fully met to the satisfaction of ADB and MOF. However, while there were active feedback and interaction with MOF, the recommendations with regard to (i) expediting share offerings of blue chip companies; (ii) development of the corporate debt market; (iii) strengthening the share registry system; and (iv) creating a level playing field for tax rebates on interest payments on bank loans versus bonds, have not been fully implemented due to political constraints. While progress is expected on the blue chip share front, the other elements need to be monitored through economic and sector work and supported through future TAs.

MAJOR LESSONS LEARNED: The success of the TA is attributable to its appropriate timing. To improve the medium-to-long term impact of the capital market component of the TA, the Government needs to address the issue of lack of investment opportunities for pension funds. Most of the government debt has been short term in nature. New issuance of equity or debt by corporations is not likely to grow rapidly due to the reluctance of enterprises to provide financial information in an open and transparent manner and the weak competitive edge that tenge-denominated corporate bonds have over eurobonds in terms of pricing. Further, only a few enterprises are prepared to issue dollar-linked bonds, again due to pricing and exchange rate disadvantages. Moreover, the short-term government instruments crowd out any corporate securities given the short-term orientation of pension funds.

FOLLOW-UP ACTIONS AND RECOMMENDATIONS: Ongoing assistance from the USAID and the World Bank is carrying forward the initiatives under this TA. Further assistance for the development of the insurance industry has been requested from MOF, and is under consideration by ADB. Given ADB's active involvement in pension reforms, it is essential to ensure that ADB engages in policy dialogue in developing and deepening capital markets in Kazakhstan.

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