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Pension fund participants and fund managing company shareholder relations in Lithuania second pillar pension funds

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Abstract

Results achieved by the pension fund depend on how well they are managed or more specifically – on whether all decisions taken by the management are in favour of the fund participants. The goal of this paper is to examine how to harmonize interests of second pillar pension fund participants and fund managing company shareholders.

An interview with executives of all pension funds managing companies was performed twice – in 2011 and 2016. The answers allow to make conclusions about possible conflict of interest in pension fund management and measures taken by the companies and the state to minimize the risk. A survey of 507 pension fund participants was performed in order to obtain information on participants' attitude and expectations. Despite the fact that most of participants are dissatisfied with the pension fund performance results, they would not agree to allocate additional resources to hire more competent managers.

To protect the interests of pension fund participants the stability of the pension accumulation system as a whole must be ensured. Also it is important to promote mutual confidence of all interested parties, to provide participants with easily understandable information, reflecting real performance results.

JEL classification: H55; O16; G32

Keywords: Pension fund; Pension fund management; Corporate governance.

1. Introduction

Second pillar pension funds in Lithuania were introduced in 2004. Participation in second pillar is voluntary, employees have a choice to sign a contract with one of the pension funds managing companies and transfer certain part of compulsory social insurance contributions to one of its managed funds. In 2014 so called "2+1+1" scheme was introduced which was later modified into "2+2+2" in January 2016. This means that the pension

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fund participant in addition to 2% of compulsory insurance contribution may voluntarily pay an additional 2%, in this case an additional 2% of the average wage in Lithuania is added from the State budget.

However, pension funds managed by different companies had achieved different results although all of them operated in the same market conditions. Therefore, it can be assumed that the results achieved by the pension funds depend on how well they are managed or more specifically -– on whether all decisions taken by management are in favour of the funds participants. It is worth mentioning that in 2011 nine companies were in business, in 2016 only six have remained, but competition is still very tough.

Recently ideas and methods of corporate governance often offered to be applied to pension fund management. This methodology was developed in order to deal with a so-called principal-agent problem, when shareholders due to their large number and different locations cannot organize themselves and ensure that company's hired managers work exclusively on shareholders, rather than their own interests. It would not be acceptable to use the term "corporate management" for the management of pension funds because, as we shall see later, the pension fund and the company have some essential differences. In this paper we will use the term "pension fund management".

The pension fund can have hundreds of thousands of participants living in different areas, who do not know each other, unable to organize themselves in order to reach an overall agreement and to represent it. Therefore, pension funds managing companies face similar problems to the mentioned above, i.e. how to align the interests of the pension fund participants and the pension managing company shareholders.

In Lithuania pension fund managing companies are limited liability companies with one shareholder (parent company). Such second pillar pension fund management model is not very common, originally used in Latin America and the post-Soviet space.

The goal of this paper is to examine how to harmonize interests of second pillar pension funds participants and funds managing company shareholders.

In Lithuania participants of pension fund is responsible for many risks. Participants have to decide what kind of a pension fund (low or high risk) to participate in, i.e. they have to select the risk tolerance and the expected return on investment in short and long run. For such a decision making process at least basic understanding of the functioning of the financial market is necessary. We suppose that unfortunately it is not the case. A survey on people's comprehension of financial investment has been carried out in order to assess participant's expectations, attitudes to the pension fund performance, determine what criteria they apply when choosing pension fund. A quantitative survey method has been used for the investigation of pension funds participant approach and has been performed by the company specializing in this field.

An interview with executives of all pension funds managing companies was performed twice – in 2011 and 2016. Qualitative survey method was chosen, as expected, that the management models of different companies may differ in essence and therefore, answers "yes" or "no" might not disclose important information. The answers obtained allow to make conclusions about possible conflict of interest in pension fund management and measures taken by the companies and the state to minimize the risk.

2. Background

Pension fund can be influenced by many interest parties who have different or even contradictive interests, all of them trying to divert fund management decisions towards their interests (Blake, 2006b; Mackenzie, 2010). Fund management decisions can be divided into the set of sequential stages. One person or institution can be responsible for a few stages but also distinct stages can be carried out by different persons. Impact of different stages on final result is unequal (Muralidhar, 2001) therefore some stages require more attention and resources other – less.

The fact, that fund **founder** (or sponsor) had made a decision to establish the fund means, that he has interest in results of fund performance. A reason to establish the fund may be legal (to comply with legal requirements), social (funder seeks to create better life or work environment to certain group of employees or population) or commercial (funder expects to provide to the fund various services and earn a profit). Because an influence of the funder in the fund management usually is important or even crucial, it is important to understand his interests.

Beneficiaries – necessary part of each fund, an existence of the fund has no sense without them. Participation in pension fund is in one or another way obligatory in all countries (Martin Schludi, 2005). The goal of beneficiaries seems evident – to receive as maximize benefits in retirement, therefore they are interested only in one