

The Role of Governance in Pension Systems

Úloha governance v penzijních systémech

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Abstract

Contemporary pension systems consist of more pillars and are administered also by very different providers. Corresponding governance systems are also very different, reacting to different interests of stakeholders pushing through their interests. In the interest of alignment of these interests the governance codices are issued, the OECD playing an important role in it. The governance cannot replace the basic defects of the pension pillars, of the quality of pension institutions supervision, nor the annuity markets failures, nor the imperfect competition in this sector. A mission of the World Bank played an important positive role in the formulation of the role of the governance and supervision of the Czech supplementary pension insurance. Lobbyists' pressures have a negative influence, mainly in the form of proposals for the reform of the public pension pillar and of the existing pension funds and their products, as well as in refusing the full implementation of the EU Pension Directive. By contrast the governance theory and practice highlights the interests of the clients of the pension institutions, with the exception of the private insurance companies where the general corporate governance model applies also in the world. The state support of the pension products may have a substantial role in the promotion of the clients' interests.

Keywords

public governance, corporate governance, pension reform, pension pillar, pan-European pensions, pension fund, life insurance company, social insurance

Abstrakt

Moderní penzijní systémy se skládají z více pilířů a jsou spravovány i velmi rozdílnými poskytovateli. Tomu odpovídají i značně odlišné systémy governance, reagující na rozdílné zájmy aktérů, prosazujících své zájmy. V zájmu sladění těchto zájmů jsou vydávány kodexy governance, s významnou úlohou OECD. Governance nemůže nahradit zásadní nedostatky penzijních pilířů, kvality dohledu nad penzijními institucemi, ani selhání penzijních trhů či nedokonalou konkurenci v tomto sektoru. Významnou pozitivní roli ve formulaci úlohy governance a regulace v českém penzijním připojištění sehrála mise Světové banky. Negativní vliv v Česku mají lobbistické tlaky, projevující se nejvíce v návrzích na reformu veřejného penzijního pilíře a na reformu stávajících penzijních fondů a jejich produktů, jakož i v odmítání úplné implementace Penzijní směrnice EU. Teorie a praxe governance naproti tomu staví do popředí zájmy klientů penzijních institucí, s výjimkou soukromých pojišťoven, kde se i ve světě uplatňuje obecný model corporate governance. Zásadní úlohu při prosazování zájmů klientů může mít státní podpora penzijních produktů.

Klíčová slova

public governance, corporate governance, penzijní reforma, penzijní pilíř, panevropské penze, penzijní fond, životní pojišťovna, sociální pojištění

Introduction

The origin and development of public pension systems in the 19th and 20th century was part of the increasing role of the state in the area of social security, this not only in this field. Although it is possible to see a number of general development tendencies in the social pension security, for example in the developed countries, there still have been and still are important differences between individual countries which can be attributed to existence and development of different social models (welfare regimes) in the most general meaning, as well as different parameters of the models in individual countries. During the recent decades, also the pension systems have strongly differentiated, as a rule into 3 (or even more) pension pillars, while the public pillar even is not always considered to be the basic pillar. In addition to the voluntary private pension pillar, resp. the pillar of corporate pensions and the pillar of individual pensions, the obligatory private pillar has been applied and is applied in many countries, requiring all fundamental public regulation. Individual pillars have quite different systems of operation, this even in comparison of the same or similar pillars in different countries.

The public regulation, as well as internal mechanisms of individual pension institutions operation are, or may be, relatively complicated and the resulting effects of the whole system, its pillars, as well as individual institutions usually depend much on activities and interests of individual involved parties which usually stress also their personal interests. The hierarchic structure and operation of the pension system, as well as individual institutions is generalized at the theoretical level by the agency theory – with its mandators or principals and executors or agents. Rectification of the mentioned entities is done not only through laws, decrees, but also by public governance and corporate governance which include also the corresponding provisions of laws and decrees. Considering the very quantity of publications, governance plays strongly different role in individual pension models and pension pillars.

1 Corporate Governance in Private Insurance Companies

Developing of the theory and practice of corporate governance was originally relatively simple in private life insurance companies which usually provide also private pensions – personal, as well as corporate. In those pension institutions, the general variant of corporate governance was originally applied in which the shareholders are considered to be the decisive involved entities (stakeholders). The most general objective of corporate governance in this concept is to generate “added value” to those entities. The generally conceived corporate governance pays special attention to protection of interests of minority shareholders in companies listed on the stock exchange.

Generally speaking, corporate governance differentiates between a number of stakeholders, in classification to internal and external involved entities (stakeholders). R. E. Freeman (1984) ranges among internal stakeholders the owner, the managers and employees and

among external stakeholders customers, shareholders, creditors, the government, the society and suppliers. Acts of those stakeholders are regulated by the state, in the insurance business it has always applied in a strongly higher extent resulting from the nature of products and the industry.

Regulation of the private insurance business in the EU is based on the EU directives which are implemented through laws and decrees of individual EU member states; the regulation includes also supervision over the private insurance companies operation. In this country, the key laws include the insurance business law (regulation of insurance companies), the law on insurance policy (regulation of products) and the law on insurance mediators and independent liquidators of insured events.

1.1 OECD Principles

Corporate governance has achieved more importance in the world in the recent decade. This fact was reflected, among other things, in issuing of the new Principles of Corporate Governance by OECD in 2004, following the principles of 1999. In individual OECD countries, new national codes are issued. Let us mention for example the Austrian Corporate Governance Codex containing 83 points (and 4 appendices), differentiated to obligations resulting from laws (L), to rules of "comply or explain" type which must be complied with or a variation from them must be explained (C) and recommendations (R). The Austrian codex was amended in 2010 with view of experience with the world economic crisis; among other things, it includes also prohibited provision of so called "golden parachute". The codex does not include special rules for banks and insurance companies. Pensions are not mentioned in the codex. In this country, the Securities Committee produced in 1999 the Companies Administration and Management Codex based on OECD Principles with fundamental cooperation of the British Know How Fund. In 2004, the codex was reworked based on OECD Principles of 2004.

In private insurance companies therefore the general principles of corporate governance applied, without any specific link to pensions provided by those insurance companies. Clients of the insurance companies who concluded voluntarily the pension insurance were not given any special support by corporate governance, except for annual reports of insurance companies produced, however, usually for the purpose of shareholders, supervision and possibly also in reduced marketing version for clients. Clients definitely were not perceived as important stakeholders in corporate governance of private insurance companies.

Times have, however, changed in many aspects. In 2005, OECD Board approved the directive for governance of insurance companies which is based on the fact that even in highly regulated sectors (like for example in the insurance industry) the regulation itself cannot achieve good practice necessary for integrity and efficiency of the sector. Also the companies themselves must develop internal rules and systems to achieve those objectives while governments and international institutions can be of assistance in creation of the rules and systems. The following are mentioned as the two main objectives: complementary development of protection of policyholders or shareholders (over the scope of the existing regulation and the present supervision) and complementary development of the general corporate governance for the purpose of the insurance sector. At the same time,

OECD endeavoured to take into account also conflicts of interests specific for the sector (agents and principals) and the big importance of insurance mathematics. The structure of OECD guidelines has 12 partial points structured into three blocks, all of this on 6 print pages. None of the partial points covers explicitly pensions. The opening comment to the partial points only mentions differences between life and non-life insurance, for example as to utilization of the insurance mathematics.

Evaluation of corporate governance in the Czech insurance business was performed by the team of the World Bank in 2005 upon request from the Czech government (WB, 2006). This document identified three distinct weaknesses of corporate governance of Czech insurance companies: excessive space for transactions and transfers of funds between linked companies, weak role of supervisory boards and audit committees in many insurance companies and absence of an efficient separation of life and non-life insurance in composite insurance companies. The overall concept of corporate governance, applied upon this mission of the World Bank, complies with the above mentioned OECD guidelines; however the document of the World Bank is, of course, much more specific and in fact directly applicable in amending of legislation and creation of the governance system for the industry and individual companies.

1.2 Influence of the Financial Crisis

The practical importance of corporate governance in the insurance business has been emphasized by the financial and economic crisis in recent years which broke forth at the time of final works on the new system of assessment of insurance companies' solvency (Solvency II). The main idea of Solvency II is to facilitate sufficient capital of insurance companies so that the probability of the insurance company bankruptcy in a specific year is lower than 0.5%. Simultaneously, legislation for insurance and the insurance business in the EU is almost permanently amended.

In this country, an entirely new insurance business law was adopted with effectiveness from 2010, implementing in particular the EU guideline on facilitation and the guideline on acquiring and increasing of ownership interest in the financial sector. The new law, however, includes also new important provisions which comply with the principles of corporate governance: these cover, among other things, the obligation to inform the supervision (CNB) about separation of activities with important nature, to produce (and discuss) annual reports of responsible actuary, to notify CNB of the insurance company's auditor.

The linked CNB decree implementing some provisions of the law on insurance business is focused, among other things, on the control and managerial system of insurance companies which plays an important role in corporate governance. Also important is implementation of the EU guidelines on financial tools market (MiFID) and the guideline on mediation of insurance (IMD) in corresponding Czech laws. An amendment of the new law on insurance business will result from implementation of Solvency II which is planned for October 2012. The main content of this legislation from the point of view of governance is to facilitate in fact smooth operation of private insurance business, its appropriate resistance against bankruptcies and crises.

1.3 Czech Specifics

The Czech insurance business was much less affected by the financial crisis. It probably was not because of the level of the Czech legislation or the quality of supervision. The main reasons for the mentioned positive phenomenon are, most probably, specifics of the Czech insurance market linked with the stressed high earnings of the Czech insurance sector. The Czech insurance sector has been in fact already “for long” fully private (excluding the state insurance of export credits), in contrast to Poland and Slovenia. Its structure is strong oligopoly, as well as in other post-communist countries, thanks to privatization of former state-owned monopoly insurance companies. In this country, as well as in other medium and small post-communist countries, only several global and Central-European players are efficiently involved in the insurance market. Entry of new insurance companies to the market – otherwise than by purchase of an already existing insurance company – is “blocked” by a high barrier in the form of existing intermediary networks and insurance portfolios. It results in the overall high profitability of the Czech insurance business. This is a positive thing for the sector stability, but for consumers it means worse products and higher prices.

We will document the hypothesis about worse products and higher prices with two examples from the unit-linked life insurance which is, from among the sold products, the closest to securing for old age. A well known case is the high commission for sale of the products – in comparison with the western countries and with mutual funds. The amount of the commission for long-term unit-linked life insurance can be seen from the following relations: in Germany, the commission is approx. 100%, in the Czech Republic 200% (and in Russia 300%) of the first-year current insurance premium. This fact will not be probably changed by issuing of the codex of corporate governance for private insurance companies or by obligatory notifying of the client of the amount of the agent’s commission. The second example includes the insurance conditions of one well-known product of the life-insurance market leader according to which the insurance company “can” collect fees from customers. The hidden fees for the product were criticized repeatedly and strongly in the magazine *Finanční poradce* (Financial Advisor) without any (visible) response from public institutions responsible for consumers protection. It is possible to consider that clients do not pay any visible fees for the product – and do not “have” to pay because the premium is invested into a special fund administered by an affiliated investment company only for purposes of the insurance company, resp. for purposes of the financial group as a whole.

Pension insurance is not, on principle, offered by Czech insurance companies. If it is offered, then rather due to completeness of assortment and its prices are usually high. The specific causes of this situation are the same like with other products.

1.4 Failure of Annuity Markets

A general problem of provision of private pensions in all developed and relatively developed economies is failure of pension (annuity) markets which is a standard finding of political economy textbooks. The failure of private annuity markets is derived from several facts, part of which applies only to the conditions of a market in typical private pension

insurance which is voluntary insurance. Only with the possibility to choose so called adverse selection of risks can occur when the tendency to conclude pension insurance cannot be expected from persons with below-average health. From this fact, directly results the necessity of appropriate correction of the used mortality tables with the risk margin in addition to that.

Even bigger, entirely fundamental problem is the fact that even persons with over-average health are not much interested in pension insurance. That is to say that pension insurance is too perfect method of securing for old age, upon "occurrence" of this insurance need, in comparison with usual thinking of people. In this context, "myopia" is mentioned, preferring today's consumption to uncertain future and possibly even stronger argument is the requirement of the "rate of return" of the funds invested into life insurance. This leads to preference of insurance with once-off settlement against insurance with life-long pension. This is documented also by behaviour of clients of Czech pension funds during the first decade of their operation when the law ordered them to use statistical mortality tables incorrect from the professional point of view (for this purpose); if those clients behaved rationally (and took life-long pension) then all pension funds offering life-long pension would fail. At the same time, however, it is true that for sale of life (and pension) insurance the decisive factor is marketing, not the quality and advantages of individual products. Also this fact shows the fundamental role of the state pension policy; it must express clearly which products are favourable for appropriate securing of most of the population. On no account it is possible to rely on the simple "market solution" in the form of classical voluntary pension insurance without strong state regulation.

To conclude with, we can state about corporate governance of life insurance companies that it in fact does not matter that no attention is paid to the "market" pension insurance and its consumers – at least because such clients in fact do not exist and will not exist. This, however, applies only in the case of voluntarily concluded individual insurance. If, however, obligatory private pension insurance or pension insurance sponsored by employers exists or should exist, this means an entirely different situation. The theoretical finding about failure of the annuities market does not lose validity, however a number of "parameters" change with the model impact on the price level. Very intensive regulation of the market in obligatory private insurance is a need, its results depend on how professionally the regulation is performed, as well as on influence of interest groups, in particular providers of the products.

The Bezděk advisory and expert body (PES), in which the interested representatives of those groups directly dominated, recommended implementation of the obligatory purchase of life-long pension for funds from the obligatory private pension savings without any mention of the issue of failure of annuity markets.

2 Governance of Pension Funds

The issue of governance of pension funds is a much frequented topic of discussions and studies. This might seem surprising under our conditions, particularly due to the Czech legislation for pension funds.

2.1 Different Types of Pension Funds

There is a wide range of pension funds in the world; pension funds can generally be classified into two main types:

1. Contractual type: pension funds without legal subjectivity designed as funds for pensions operated by one-purpose providers or other financial institutions (for example investment banks);
2. Institutional type: pension funds with legal subjectivity – in the form of a foundation or association or in the form of a company.

An interim type includes trusts pursuant to the Anglo-Saxon legislation; when a pension fund is in the form of a trust its trustees are entitled to dispose assets of the pension fund – while they must do so exclusively in the interest of the fund participants who benefit from investing of the fund's money. Trustees are not, from the legal point of view, part of the trust. Special legislation applies in the USA where the governing body can be both the trustee, and the "sponsor" (employer), and also a "third party". All this influence also the specific design of governance of pension funds.

Contractual pension funds are governed externally, this by a standard financial institution or by a management company specialized in pension funds the work of which is separated legally from the pension funds assets.

Institutional pension funds have an internal governing body. If this is a joint stock company there is one governing body (Anglo-Saxon version) or there are two pillars consisting of the board of directors and the supervisory board (German version).

It is said that there is no a priori reason to prefer any of the legal forms of pension funds. The choice depends on the nature of the product, resp. on the target group of clients (corporate or private pensions), on the legal tradition of the state and the tax legislation. Different legislations, however, result in different attitudes regarding governance of pension funds. This involves in particular conflict of interest, qualification of members of the governing bodies, etc. (Stewart – Yermo, 2008).

Czech pension funds are joint stock companies; from the global point of view it is a minority type of pension funds. Their product is defined by contributions (pension plans). Czech pension funds are not, on principal (from the point of view of governance) sponsored only by employers. Provision of contributions by employers for additional pension insurance of employees, however, also influences governance of pension funds.

Czech pension funds are joint stock companies, as well as Czech private insurance companies. Legislation of Czech pension funds is very special, even quaint. Legislation of pension funds and of the product provided by them is included in the law on additional pension insurance with the state contribution implemented in 1994, i.e. at the time when we did not have (and could not have) the Czech insurance legislation harmonized with the EU guidelines.

The Czech system of additional pension insurance with the state contribution is presented to the world as a system of pension funds, as a special pension system, although in fact they are only special life insurance companies, specialized in sale of a single product of private pension insurance. The only fundamental economic speciality of that product includes the high state subsidies – in the form of the state contribution, as well as in the form of tax allowance. The same product could be sold – from the legal point of view – also by life insurance companies, however under the applicable legislation without the state contribution. There is, therefore, no economic reason for existence of Czech pension funds.

2.2 Recommendations of the World Bank for the Czech Republic

Governance of the system of Czech pension funds was covered by the World Bank in 2005 (WB, 2007). That mission based formulation of its evaluation and recommendations on the applicable OECD guidelines for pension funds governance. In the document of the World Bank, we can find in page 5 the following thesis: “The primary objective of pension funds governance should be dual: (1) to protect rights and interests of members of the pension funds and (2) to arrange secure sources of the fund for payment of timely and reasonable pension benefits to those who have paid contributions to their pension.” This thesis documents entirely different attitude to pension funds governance and life insurance companies governance: while governance of insurance companies respects the dominant interest of shareholders, the present governance of pension funds emphasizes the basic protection of consumers – participants of the pension funds. The specific methods for pension funds governance strongly depend on the legislation for pension funds, as well as on the provided products. From the governance point of view, there is a fundamental difference between defined benefit and defined contribution products. Another important parameter for governance is whether the pension fund is “sponsored” by the employer.

The above mentioned mission of the World Bank resulted in 30 recommendations focused on creation of standard governance of pension funds under the Czech conditions, i.e. under the precondition of existence of the present (initial) state pension policy in this field. During the process, also already proposed reform measures in the field of additional pension insurance were discussed. It means in particular the proposed separation of the funds of participants from the funds of shareholders, and principal change of the product in the form of foundation of new pension institutions as implemented later on principle in the form of the state draft on pension savings. (The draft was submitted to the Parliament by Topolánek’s cabinet at the end of its rule; the draft was not included at all into the agenda of the Chamber of Deputies. Representatives of pension funds had the crucial influence on the concept and content of the law).

We will discuss in particular those recommendations of the World Bank which relate to the whole pension system. We have already mentioned above the initial credo of OECD, according to which the primary objective of pension funds governance is to protect interests of consumers, i.e. participants of the additional pension insurance. This should be reflected also in legislative provisions about tasks of members of the boards of directors and the supervisory boards. In particular, members of the supervisory board should act

as independent experts, not namely as representatives of the pension fund. It is noticeable that the World Bank (either OECD) does not pay attention to the fact that this undermines the basic goal of a private company operation. Both of that can be explained only by the fact that any private insurance for old age can be meaningful only under the condition that its stability will be sufficiently facilitated in the horizon of many decades. Otherwise, the purpose of the security could not be achieved; a client of a private pension fund must not have permanent or more or less regular fears about his/her long-life savings and the subsequent pension. The purpose of pension products, in fact, does not involve short-term or medium-term savings linked with wide state contributions, which is the present situation in the Czech Republic, while the original status was even worse. The World Bank's mission did not comment on the amount of subsidies for the additional pension insurance, either it compared the rate of subsidies with the so called private life insurance. Perhaps, also because nobody pointed out the mentioned connections. The uneven conditions on the savings market are the fundamental deformation factor of the market influencing also the demand for individual products. The Czech additional pension insurance is, according to comparison performed by OECD, the pension product with the highest subsidies from among all OECD countries (Whitehouse, 2006).

The mission of the World Bank mentioned the low real yield of the Czech additional pension insurance product; it provides the average rate of 0.5% p.a. (before the crisis!). In this context, the World Bank stressed the need of higher transparency in reporting of costs in annual reports including specification of standard cost coefficients allowing comparison of efficiency of pension funds. This includes also the necessity to report relationships with linked companies from the same financial groups including the amount of investment fees provided by investment companies from the financial groups. The World Bank points out also an increase in the achievable costs of pension funds in several recent years while this fact is better expressed in the ratio of the total costs of pension funds to the received contributions, not to the assets.

The mission of the World Bank criticized, among other things, also the purposeless dragging of clients between individual pension funds, not reasoned results achieved by pension funds and the related increase in the achievable costs and increase in DAC (deferred acquisition costs, resp. the sales expenses not reflected into the costs). Amendment of the law on capital market business of 2009 implemented also recommendations of the World Bank's mission that the employer cannot influence an employee's decision on the pension fund choice. The World Bank rejects such practice in the interest of unlimited competition of pension funds and in the interest of struggle against unwanted motivating of selected employees of the employer (earlier) deciding about the choice of the pension fund into which the employer would pay its contributions.

In the Czech model of pension funds therefore occurred – at least in legislation – elimination of the originally key role of the employer in formation of the pension fund as funds of pension insurance of employees above the scope of the social pension insurance. Besides, this was the initial intention of the system of additional pension insurance. To disable the employer to use the additional pension insurance as a tool of HR policy (cancellation of the policy by the employer when the employee leaves the company) he was not given the possibility to “insure” his employees. He only could make contributions to the employee's policy.

Later, implementation of very attractive state support for contributions of the employer to the Czech additional pension insurance helped the strong increase in employers' contributions. Since 2008, there has been a joint limit for contributions of the employer to the additional pension insurance and to the so called private life insurance of CZK 24,000 a year; up to this limit, the contributions can be included into the costs of the company and the social and health insurance premiums are not paid from the contributions (analogous to a subsidy of 45% of the gross salary) and the employee does not pay the income tax (another up to 15%)! The state support of employer's contribution is even higher than the state contribution to the participants' premium itself, it equals 94.5% of the equivalent net salary! Do not, however, see any theory behind, this is exclusively expression of rent-seeking by the involved financial groups.

2.3 Product Changes, Czech Specifics

The initial standard of pension funds systems in the western countries were corporate pensions, defined benefit (DB). This construction of the product generally well suits interests of the consumer, the pension is guaranteed – it is on principle a classical product of life insurance while the only important difference is calculation of the pension analogical to calculation of the pension in the social pension insurance. This product can be operated according to usual principles in private insurance which means creation of appropriate reserves based on insurance mathematics; pension funds with such operation are called “/fully/ funded”. On the other hand, there are also systems of corporate pensions entirely without creation of appropriate reserves based on insurance mathematics. And there are also many “variants in between” where reserves are created but not to the extent corresponding private insurance. The main initial problem of such funds governance is this insufficient creation of reserves within the meaning of principles of private life insurance operation. Most of foreign books about this matter of governance cover in particular this issue. Because we do not have this system in this country and its implementation is not proposed we will not deal with it in detail.

During the recent decades, private (as well as public) pension have changed fundamentally; the “defined contribution” (DC) system, resp. the product is implemented. DC product means in fact pension savings, resp. investing, the client bears the whole investment risk – unless the product includes the guarantee of the pension fund. With DC product it is not important whether the “saved” funds on the personal account of the client are paid in once-off payment, or in instalments, or whether payment of life-long pension will follow.

Governance of corporate pension funds with defined benefit product and with defined contribution product differs strongly. The differences, according to the World Bank, are caused namely by inherent conflicts of interest between members (clients) and financial market players, this even without attention to whether these are employer's (corporate) pension funds or not. The governance solution is very demanding under these conditions, unsuitable attitude can lead to “governance vacuum” and damage of the whole sector of pension funds.

The “governance vacuum” does exist, according to the World Bank mission opinion, also in the Czech sector of additional pension insurance; DC model implemented in this country

is specified by the mission as contractual in the sense that in fact everything is based only on an agreement between the client and a joint stock company. Besides, the company – pension fund often subcontracts the services to organizations linked with the pension fund. According to the author's opinion, money from the pension funds is drawn to other companies of the same financial group and through that, the legal provision on allocation of a pension fund profit between its participants (minimum 85%), the reserve fund and the company is overcome. An indirect evidence of that is the fact that none of the Czech pension funds has ever paid dividend to its shareholders; this is not normal for sure. The fundamental problem is that the real appreciation of money of the clients during the whole period of the pension fund existence is on average zero; now, after the crisis which had little influence on the Czech pension funds, it is a "negative zero".

The World Bank's mission specified the product of the Czech additional pension insurance as a variation of the "classical" defined contribution product (DC), with the reasoning that there is not direct connection between the assets value and liabilities value of a pension fund. This fact has a practical impact on governance, specifically in the area of disclosure of information and risk management.

A "classical" defined contribution pension fund not including any guarantees as to the amount of the "saved" money is for its provider very riskless, very comfortable – any investment risk is borne by the client. An advantage in sale of such a product, particularly under the existing Czech conditions, includes also the possibility to promise a higher appreciation in the case of provision of a fund with a higher risk exposure. The client is "drawn in" with the use of graphs and words about high yield and if he perhaps rejects the high investment risk, the fund with conservative anticipated yield is sold to him. This simple selling strategy suits best for simultaneous sale of three funds with differentiated risk profile. Insurance companies may create their "internal", separately not tradable funds, and some of them purchase such funds from their affiliated companies under special conditions as to commission and fees. This is exactly what is to be eliminated by governance or directly the state regulation.

The mission of the World Bank emphasizes preservation of long-term guarantees in a product or products provided by pension funds – only in this way it is possible to achieve the "final purpose" of additional pension insurance which is insurance for old age. Short-term guarantees therefore can be broken. Therefore it is not necessary to insist on the present practice when the amount of money on the personal client's account cannot decrease (in nominal sense), this even as a result of charging fees (which are not allowed at all for that reason). Under a long-term guarantee, guarantee of the amount of benefit at the moment of originated entitlement to the pension is understood.

One of the basic principles of Czech pension funds governance according to the findings of the World Bank's mission must be involvement of responsible actuaries to the extent usual (required) in life insurance companies. This applies also to the present pension funds with their existing simple products. This would apply even more in the case of the product change, for example in connection with transition to the mentioned long-term guarantees. And this would apply also in the situation when pension funds would pass the agenda of pensions provision to insurance companies which is in fact recommended by the mission, without specification of a clear reason.

An entirely decisive majority of the World Bank recommendations how to implement governance of Czech pension funds has not been implemented and nobody probably has worked on their implementation. The association of pension funds, on the contrary, carried through the governmental draft of the pension savings law the adoption of which would mean transition to products without guarantees, further increase in direct and indirect state subsidies and even implementation of simultaneous state contribution and the tax deduction of the client within the range CZK 500 – 700 monthly.

The existing Czech pension funds must be reformed already with the view of the EU legislation and the simplest solution is their obligatory transformation into life insurance companies. A radical reform of regulation of the market in additional pension insurance and competitive products is the precondition for implementation of a unified concept of corporate governance in the sector of provision of private pensions.

2.4 Pan European Pensions

Pension funds were originally established with the purpose to administer corporate pensions. The original main purpose of corporate pensions was motivation of employees to loyalty to the company. This included also the loss of the corporate pension when an employee left company.

Another development stage of corporate pensions in a number of countries was their larger expansion thanks to trade unions pressure which in several countries resulted even in the obligatory corporate pensions – trade unions helped to domination of private insurance.

The purpose of today's corporate pensions is, on principle, no more motivation of employees but utilization of the state support for corporate pensions which developed after the Second World War. All international institutions require transferability of pension entitlements upon a change of the employer which is the opposite to the former loyalty principle.

Through the change of the original purpose of corporate pensions this pillar of pension insurance loses its justification resulting from the interest of the company, resp. its owners. The primary interest in the corporate pensions moves to employees and trade unions. The key question is the state support of corporate pensions – if any; therefore corporate pensions become primarily a tool for utilization of the state support, not a tool of pension insurance. The basic issue is whether the state should provide the state support to corporate pensions at all. The theory does not in fact cover these issues which can be explained by the fact that in many countries those pensions are so widened that not anybody gets the idea that the classical second pillar of pension insurance could be cancelled. While the Czech practice documents that contributions of companies to individual pensions are an alternative solution. The modern reason of corporate pensions can be seen in the field of the costs of provision of pension in comparison with individual pensions and possibly also public pensions. Possibly also a pragmatic argument can be considered that with the use of corporate pensions higher clients' insurance coverage is achieved.

In some way or other, various pension funds are the reality in almost all developed countries and it is necessary to “grip” with this issue also within the EU. The EU has achieved the conclusion that where possible, it is desirable to create a unified internal pension market. For that reason, the directive on regulation of institutions providing corporate pensions was adopted in 2003 which endeavours to implement the regulated pan European market in corporate pensions intended to reduce the costs of the pensions provision. The directive expresses preference of the pension institutions providing products not undercapitalized. The directive does not apply to quasi insurance systems which do not create reserves like insurance companies. The directive does not interfere with national regulation, for example of private insurance companies.

European pension institutions using the EU pension directive establish separate divisions for individual EU countries which must comply with legislation of the specific country. The Czech Republic does not have created legislation for institutions providing corporate pensions and rejects to create it – today perhaps not due to ideological reasons like at the time of the additional pension insurance origin. From purely technical point of view, however, the problem is artificially generated: a number of Czech companies had their pension funds after 1994, and also today it is possible to have not only the existing pension funds (not compliant with the EU legislation) but also own life insurance companies which can provide corporate pensions.

If the European pension institutions obtain the licence for life insurance in any EU member country they can provide corporate pensions in the Czech Republic – if the project has the characteristics of life insurance. Insurance companies can provide, pursuant to the European legislation, among other things also a product in the field of life insurance called management of group pension funds. The Czech Republic has sufficient legislation for provision of corporate pensions in compliance with the EU pension directive and does not need to create special legislation for institutions providing corporate pensions; it is however necessary to convince the EC about this fact and incorporate this all into the insurance law. Increased competition on the Czech market in corporate pensions is, however, desirable. It is in the interest of this objective to remove the ban on influencing the decision of employees in choice of a pension fund which is absurd within the system of corporate pensions and also generally at least questionable. Upon implementation of a reasonable system of the state support of certified products it would be possible to remove the existing Czech condition for the state contribution to the additional pension insurance – to have only one policy on pension insurance. Transfers of funds of clients from the existing pension funds should be possible also to foreign pension funds with the EU insurance licence and with the Czech certificate of the state support.

We cannot lose anything if the law allows operation of foreign (European) pension funds (sale of their products) on the Czech pension market pursuant to the legislation of life insurance and life insurance companies. And with this policy, we need not invent or take from abroad specific solutions for governance of pension funds providing corporate pensions. Very important for efficiency of this solution is implementation of the above suggested concept of the state support of pension savings including certifying of products supported by the state.

The concept of pensions provided pursuant to the EU pension directive of 2003 is shortly marked as “pan European pension”. From publications it is clear that before the financial crisis there had been only low development of pan European pensions, resp. more strictly speaking, only considering of their implementation on the part of supranational companies. The crisis stopped everything. Now, fast progress is expected; providers are ready, supranational companies start acting. (Burnet, 2010).

Corporate (as well as other) pension funds have suffered deep financial losses during the crisis. The even more is stressed, in present discussion of corporate pension funds governance, the importance of risk management; in this context, the framework of infrastructure of governance is mentioned. C. R. Burnet (2010) formulates the following five principles derived from governance best practice, on the basis of principles of corporate risk management, all of that under prevailing legislation conditions:

- Effective committees (in the board);
- Written guidelines or policies;
- Appropriate accountability;
- Rigorous supervision and monitoring;
- Effective information flow.

Each of the five mentioned principles is, according to C. R. Burnet “independent and mutually dependent”. This is, of course, a high degree of generalization; nevertheless there are enough specific guides in studies about governance of corporate pensions and pension funds to all of these structured items.

3 Governance of Public Pension Institutions

Governance of public pension systems includes a relatively wide spectrum of issues while most of this topic is not characterized in publications as part of governance of those systems. Politicians are strong players in those systems as representatives of citizens, tax payers and after all also of pensioners – the present and the future, potential. The role of politicians is crucial and the fact that politicians change (are replaced and alternated) has been characterized in recent decades as a political risk related with every pension system. In practice, politicians can be in fact lobbyists. In the preceding text, we have noticed this fact only indirectly.

3.1 Political Risk and Rent-Seeking

The political risk exists also in relation to the private insurance business as a whole, to the life insurance or only pension (private) insurance and of course also in relation to corporate and individual pensions. Generally, also the risk of nationalization is included here which was “in the wind” after the First World War, was implemented namely in countries controlled by communists after the Second World War and to a lower extent it must be considered also in the future, in particular in countries which came under the attraction of privatization of public pension systems. Nationalization of private pension funds was a matter of fact in Argentina in 2008. The same risk existed also under the previous Slovak government and efforts in the same direction exist in a number of other countries.

The political risk of a change in the pension system is in practice considerably higher in countries where dictators or governments with fragile parliament support decide to carry through a radical pension reform regardless its opposition. It is (or should be) obvious to everybody and therefore it is a general finding that a paradigmatic pension reform should be made in the form of consensus of all main political powers. The main economic problem of performed (full, as well as partial) privatizations of public pension systems is that their protagonists promised high effects of the privatization for the national economy which, however, did not appear – and could appear only under entirely extraordinary conditions and only for a limited time. In fact, the main economic effect of privatization of the public pension system is a strong increase in the state indebtedness and increase in the tax rates. Namely for that reason, there are tendencies to de-privatize, resp. to nationalize what has been privatized in the mentioned especial manner. The Czech Republic and Slovenia are the only EU member countries from among the former communist countries to escape the privatization efforts in this context.

The Czech public pension system today is really endangered as a result of strong positions of lobbyists, while the fundamental difference against privatizations in Eastern Europe and South America in the past period is that our lobbyists do not promise any (positive) effects of privatization for the national economy – on the contrary, they (only) try to camouflage that “taking out” of for example 3% of salaries from the income of public budgets will lead to permanent additional shortage in the public budgets, resp. the increased taxation. The proposed partial privatization of the Czech pension system does not have any theoretical basis and it is based only on the reputation achieved by the lobbyists during their previous work in the public administration.

From the theoretical point of view it is in fact a standard situation in this context that privatization is strongly supported by directly interested and involved financial groups. From the point of view of public governance, pension and similar reforms must be prepared by commissions consisting of independent experts; any single member of such committee must not be even a bare employee of a pension fund.

Existence of various interests and interest groups is an obvious matter of fact when public pension systems are involved. Decision making about existence, construction and quality of the public pension system is subject to public choice in democratic conditions. Regarding governance the decisive factor should be the interest of clients; the specific implementation of this general thesis is, however, the matter of consideration of a number of economic, social and other circumstances. A number of public pension models have been developed on this basis.

3.2 Governance in Social Insurance

From the point of view of governance, any legitimate concept of the basic pension pillar is generally acceptable. Nevertheless it is true that the population usually prefer the system of social insurance as the basic pension pillar. While they expect from it also a decent benefit rate if the insured person was economically active for the whole life with a salary, let us say, within the range 125-150% of the nationwide average salary. For that reason, we will focus on governance of social pension insurance.

Legislation of the social pension insurance is, as a model, part of the integrated legislation of the whole social insurance, resp. part of the social code (Germany). Already since the Chancellor Bismarck, administration of the social insurance has been devoted to three interested entities, resp. their representatives: employees (insured persons), employers and the state. This concept has in particular political, resp. ideological basis linked with corporatism. Nevertheless, the tripartite administration of social insurance institutions has its practical purpose, this from the point of view of governance. Anyway, the tripartite administration should be considered only from the point of view of governance; it should not be considered as a certain generator of corporatism and for that reason it should not be rejected a priori.

An institution of social (pension) insurance is managed by its management; supervision over the management work is performed by, let us say, managing board. Although members of the managing board are nominated or elected by the corresponding interested entity they are personally liable for their work as a member of the boards. Their tasks include also acting in favour of stability of the whole system of social insurance devoted to the specific institution. Frequent changes with little concept in the social insurance system result in lack of confidence of clients and have negative impact on the system. The rules for good governance of the institution with tasks for individual members of the managing board and other managerial and other entities are included in the basic documentation which members of the managerial board work with. Responsibility of the managerial board can include also discussion of placement of disposable funds of the institution, resp. the reserve fund of the institution. (ILO, 2005)

Generally, it is also possible to imagine a model of social insurance without tripartite administration of social insurance institutions, namely if the social insurance institutions are nationwide. Also internal structuring of the nationwide institutions of social insurance can be an important issue. Much will for sure depend also on advanced level and culture of the specific country.

Federal programmes of social insurance in the USA are administered by the U. S. Social Security Administration (SSA), considered since 1994 as an agency of the federal government. Executive of the agency is lead by the Commissioner elected for a period of 6 years. The board of trustees has six members, one of them is the Commissioner, other three are ministers of the federal government and the remaining two members are external persons (representative of the public – public trustees), appointed by the President upon previous approval by the Congress. The American system of “social insurance” operates funds with large amounts. The board of trustees submits every year to the Congress a report on financial condition of the trust funds of social insurance. According to the report of 2010, the funds’ assets will be exhausted in 2037. Fundamental role in operation of the social insurance administration is played by actuaries; projection of income and expenses of the whole system for a period of 75 years is submitted every year. The American programme of social insurance is the largest institution of that type in the world, with big stability of financial parameters. Administration costs in 2009 represented 0.9% of the whole expenses.

3.3 Governance of Public Pension Funds

In the USA, publications pay attention to governance of public pension funds the purpose of which is to secure public employees above the scope of the federal programme for social insurance. In fact, these are systems of “corporate pensions” for public employees; it is considered implied that these are public pension funds. Their financial importance is large – according to the data of 1999, the pension funds owned 23% shares hold by institutional investors. (Schneider – Damanpour, 2002). These public pension funds (resp. “plans”) are sponsored by corresponding public institutions under the supervision of the board of trustees and are under administration of either the sponsor, or an independent institution. In comparison with operation of the private sector, a wide spectrum of interests is seen in the public administration. Public pension funds are, to a large extent, funded from taxes like other “usual” public expenses, competing with them. Most products have the characteristics of a defined contribution plan and often the amount of reserves is lower than would be accordant to the private insurance. Legislation for these pension funds is at a lower level – in comparison with federal regulation of corporate pensions in the private sector. Subsequently, there is a larger space for discussion in the style of the theory of public choice. The study Schneider – Damanpour (2002) confirmed some of the hypotheses. Other sources state that operation of public pension funds contributed strongly to improvement of corporate governance in societies where the funds operate as institutional investors. (Schneider – Damanpour, 2002).

Governance of public pension institutions is now considered as relatively very important. Codes of governance are not generally issued; separate importance of such codex cannot be expected especially in centralised institutions. Nevertheless, basic elements of the governance system are given already by legislation of public pension funds. Governance is given special strong importance in pension systems operating with reserve funds. Objectively, governance is focused namely on risk management and on internal and external audits. It is recommended to produce and publish actuarial reports about the status and prognosis of the institutions. (Daykin, 2004). It is mentioned that for wider investing activity of an institution, corporate governance is extensively used. (Bingwen, 2008).

An important objective of governance is also to eliminate undesired political influence on allocation of money from the reserve funds of public pension institutions. Similar governance standards should apply to public pension funds and management of investments like those included in OECD guideline for pension funds. (Yermo, 2008).

4 Governance in the System of Obligatory Private Pensions

Privatization of the public pension system was “invented” as part of the shock therapy for Chile during Pinochet rule. The theory of Chilean “Chicago Boys” was taken over and developed by the World Bank, in an integrated form in the research report. (WB, 1994). The very subtitle of the report promises support of economic growth if privatization is implemented. More or less privatized systems of obligatory pension savings or insurance have not developed only under the influence of Chile and the World Bank. In several countries, penetration of privatization was implemented as a result of pressure of trade unions and the appropriate private pension institutions were glad to implement it. Trade unions have in

fact always supported development of corporate pensions – and if corporate pensions are applied to vast majority of employees, there is just one other “small step” – to make the system of corporate pensions obligatory like for example in Switzerland.

In addition to distinct model examples like Chile or Switzerland, in a number of countries the obligatory private pillar plays an accessory role (in relation to the public pillar). It has developed according to the diversification theory and policy, resp. as a result of efforts of the involved interested entities – to carry through the obligatory private pillar in any extent, at least to “catch up”, and when it is impossible to achieve more. The same effort is now developed by lobbyists in this country. Situation has therefore developed when although private pension savings or insurance does not have much importance globally but in individual countries the situation is different and the specific design of the obligatory private pillar is in fact individual. This has fundamental importance also for governance of those systems.

The original idea of governance of Chilean private pensions was very simple: For private pension funds of insurance companies type, only corporate governance is possible because the basic efficiency of the system operation in relation to the clients will be facilitated namely by the pension market (according to neoliberals’ ideas), accompanied with the state regulation. Therefore, regulation will be implemented typical for pension funds, resp. in the specific case rather typical supervision over private insurance companies. This of course includes also the legislation itself for the obligatory private insurance as a product, in this case for a product with characteristics of the unit-linked insurance. Once it is initiated in this way, the state does not have to do anything more, the system will principally help itself. (Hyde – Dixon, 2008). Regulation of fees is not necessary, market forces are enough. “Good practices of corporate governance maximize the value of the society and therefore support economic growth. Pension funds in Chile contributed to improvement of corporate governance standards in particular in two ways: i) support of development and improvement of capital markets which allows development of more comprehensive financial industry, improvement of information flow and limitation of supervision costs; and ii) directly by protection of interests of minority shareholders”. (Hormazábal, 2009). Only during the pension reform in 2008, possible conflicts of interest between a pension fund shareholders and its insured persons started to be taken into account.

Today, it is possible to claim that governance is in fact considered to be the fifth of the five areas of design of the pension system with obligatory private insurance or savings: after specification of the type of insured persons, the title to benefits, the form of benefits and of the contribution payers (and the use of the contribution). (Hyde – Dixon, 2008). More detailed analyses of governance in this system have practical importance only under the specific conditions of a particular country – considering the big differences in the overall design of the pension system, regardless special conditions of individual countries.

In 2003, the World Bank developed an entirely new theory and policy which results in so called pan-European pension system, designed with priority for the EU countries. In that system, there is no obligatory private pillar at all. The central pillar of the system is a mod-

ernized social old-age insurance which is based on the principle of credits (deserved). The system also includes two “wings”: social pensions and private pensions. For both wings it is anticipated that they will be important pillars of the system. Social insurance is again the basic pension pillar, as well as it is in most countries and earlier theories. Private insurance summarizes the former pillars of corporate pensions and individual pensions which suggests also an equal access to those two former pillars. Social pensions used to be, in concept of the World Bank, the only public pension system, now they are a wing in the social insurance as the basic pension pillar.

Conclusions

The role of governance in individual pension systems is very different, in spite of tendencies to mutual influencing. Nevertheless, it is also possible to see growing importance of some elements of governance in all existing pension systems; this includes emphasis on qualified decision making of members of managing boards, on utilization of internal, as well as external audits, on increasing importance of actuaries and on long-term prognoses of development of pension systems and institutions. In systems based on competition of pension providers, the importance of governance, as well as general regulation of pension business increases, reliance on the self-regulating ability of the market is lower and lower. The role of the state and the state supervision is crucial in those systems and subsystems which on the other hand increases also the political risk including the risk of the state acting mostly in the interest of several financial groups interested also in self-purposeful origin and development of the specific system. This is especially strongly obvious in this country. Effective governance is the precondition for optimal operation of pension funds, it is not, however, a sufficient condition for good operation of any pension system.

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