PENSION FUND GOVERNANCE: THE POLISH EXPERIENCE

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Structure of presentation

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- Solutions aimed at diminishing the agency problem in voluntary pension funds
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INTRODUCTORY REMARKS

For many years the investment sector has been based on some presumptions related to the way financial markets function, i.e.:

- that the markets are relatively effective,
- that the market regulation is effective,
- and that financial innovations are always beneficial, etc [Woods, Urwin 2010].

As a result of the global financial crisis in 2008 some of the assumptions concerning the way financial markets functioned started to be questioned,

- not only by leftist economists (e.g. Stiglitz, 2004),
- but also by those who trusted that market (e.g. Greenspan, 2008) [Woods, Urwin 2010].

Despite a comprehensive pension related debate held in Poland, unfortunately, governance is not addressed, with reference to pension funds, the way it should be.

- This presentation concentrates on a small fragment of the pension system in Poland - voluntary pension funds .
- The presentation aims at attempting identification of issues to be faced by governance in voluntary pension funds that are managed by universal pension fund management companies (general pension society)

What is Pension Fund Governance?

- In a majority of legal systems, basic principles of corporate governance, depending on the legal structure involved, may also be applied in management bodies of pension funds [IOoPS 2008].
- Basic rules of corporate governance including transparency, accountability, fairness and responsibility are applied in this context [World Bank 2007].
- However, it is frequently necessary to establish additional or other requirements that govern issues of particular importance for pension funds [IOoPS 2008].

Pension fund governance refers to some framework that is used by a management body to make decisions concerning the way a pension fund operates.

The decisions in question refer to:

- structure of the management body;
- decision-making processes within the management body;
- required skills and competencies of the management body;
- means to be used by stakeholders to make the management body accountable for their actions undertaken [IOoPS 2008].

- Basic objective of pension fund governance is to minimise potential problems of agency or conflicts of interests that may arise between fund stakeholders and the fund management body and that may affect security of pension savings and commitments involved [IOoPS 2008]..
- Challenges to be faced by pension fund governance are, therefore, mainly determined by the form such funds are organised [Davis, Lukomnik, Pitt-Watson, 2009].

Agency relationships where decision-making powers are delegated

- Polish voluntary pension funds (VPF) may only be established by universal pension fund management companies (general pension society) that function in form of corporations.
- Major shareholders of universal pension fund management companies include different financial institutions like:
  - international insurance companies,
  - Polish financial institutions.
  - and various consortia of Polish and international financial institutions.
- Funds operate in form of mutual funds and offer defined contribution schemes – DC [Samborski 2013, 2014]

- Within voluntary pension funds, it is possible to identify two major groups of stakeholders, i.e. scheme participants and a management body.
- Scheme participants are interested in the amount of potential or present pension benefits.
- The management body is interested in the amount of fees and charges taken.
- In voluntary pension funds a conflict of objectives along with uncertainty may result in problems of agency in the same way as conflict of objectives along with uncertainty results in a problem of agency in corporations.

Solutions aimed at diminishing the agency problem in voluntary pension funds

- Delegating decisional powers within financial risk to be taken by a scheme beneficiary is a basic source of conflicts between members of the pension scheme and the management body.
- Therefore, conflicts in voluntary pension funds can be found in the following areas:
  - relationships between fund members and the fund management body,
  - amount of fees and charges taken by a universal pension fund management company,
  - and investment opportunities.

Major legal regulations aimed at limiting potential problems resulting from relationships between fund members and the management body refer to setting minimal standards that have to be met by both members of the board and members of the supervisory board.

Major legal regulations also define clearly tasks and roles of the supervision authority, informational duties and responsibilities of universal pension fund management companies.

Discussing regulations in question, one cannot forget about a necessity to appoint a depositary and the role of insurance ombudsman.

- In case of relationships between fund members and their management body, a major role may be played by a supervisory board.
- Legislator sets minimal standards to be met by members of both a management board and a supervisory board, which seems to be a very good solution.
- However, it is not totally clear why a general meeting – and not a supervisory board – is vested with powers to appoint or dismiss members of the board of universal pension fund management companies.

- As a result of the legal solutions adopted, financial institutions find it very easy to introduce their representative into both supervisory boards and management boards of universal pension fund management companies.
- Therefore, it is suggested to undertake some actions that would aim at increasing independence of supervisory boards in universal pension fund management companies and providing supervisory boards with powers to appoint or dismiss members of the board [Samborski 2013, 2014].

- Another potential source of conflict between voluntary pension fund members and the fund’s management body related to the fund’s open nature is the amount of fees taken.
- In case of a voluntary pension fund there are usually two types of fees, i.e. an initial fee and a management fee.
- There are also other fees and charges set in articles of association.

- In case of fees that are applied by the company, governance in voluntary pension funds has to deal with cost monitoring, which is a major challenge.
- Much attention is paid here to a so-called market mechanism, i.e. a free flow of fund members and voluntary nature of this type of pension saving.

- Other sources of conflicts between fund members and their management body can be found in the investment strategy adopted.
- In case of voluntary pension funds, investment decisions and transactions are made to the pre-defined limits and on the basis of the fund's articles of association and other internal acts in use.
- Deciding to select a particular voluntary pension fund, individuals are not given any choice of a specific investment option, e.g. sub-fund of bonds or shares.

- As far as investment opportunities are concerned, basic sources of conflicts between members of the pension scheme and their management body refer to delegating decision-making powers within the financial risk to be taken by scheme beneficiaries to a representative.
- A solution may be provided by introducing a possibility to share a part of contribution among different sub-funds within the pension scheme.

Conclusions

- Problems that are to be faced today by governance in voluntary pension funds that are managed by universal pension fund management companies are connected with their:
  - contractual nature,
  - individual form,
  - open formula,
  - and form of pension schemes offered, i.e. defined contribution schemes.

- Contractual nature of voluntary pension funds requires governance to make sure that the management body acts in the interests of the pension scheme members.
- An individual form involves some risk of ‘governance vacuum’ emergence, i.e. not taking interests of a collective beneficiary into account.
- An open formula poses a major challenge for governance when costs have to be monitored.
- On the other hand, defined contribution schemes involve providing adequate and appropriate investment opportunities.

Thank You

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