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Problems of Involving Population to Participate in Private Pension Funds

Abstract. Introduction. *The non-state pension system is the third level of the pension system. The foundation of the system is the NPF, which activity in Ukraine cannot yet be called active. The main function of any state is to provide the senior citizens with a standard of living not less than before retirement and, at the same time, to prevent the deprivation of this vulnerable population. In most countries, non-state pension insurance is an effective mechanism for optimizing of the state pension insurance system. It makes possible to avoid a number of risks when a person retires. Scientists say that the decision-making process has two dimensions: emotional (primitive) and cerebral (advanced). Accordingly, there are also two dimensions of risk: fear of risk itself («fear of catastrophe») and fear of uncertainty (fear of new or unknown).*

Purpose. *Pension risk is characterized by a low level in both of these dimensions - in most people, it causes neither a sufficient sense of catastrophe nor enough uncertainty, and thus does not encourage more adequate preparation for retirement or overcoming the problem of self-control. Thus, the problem lies not with a lack of awareness but with the inability to take appropriate action.*

Results. *Undoubtedly, it is of utmost importance to ensure the transparent activity of NPFs on the principles of fiduciary responsibility for the accumulation and investment of pension contributions. The fiduciary responsibility means that NPF managers have a responsibility to be fully committed to the interests of the fund members.*

Conclusions. *The development of a national pension system is only possible if a wide range of citizens is involved in NPF activities, which in many countries form the basis of pension systems. In Ukraine, even in the face of the stabilization of the economic situation, the problem lies at the formation of motivated citizens' desire for personal retirement savings within the NPF. We suggest applying approaches based on the behavioural theory of finance, which has become more active after the global financial crisis. Only under conditions of public confidence can the pension system function effectively.*

Keywords: *pension accumulation; private pension funds; financial instruments; accumulation of assets; consumption of assets.*

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Проблематика забезпечення участі населення в приватних пенсійних фондах

Анотація. *Недержавна пенсійна система є третім рівнем пенсійної системи. Основою системи є НПФ, діяльність якого в Україні поки не можна назвати активною. Основна функція будь-якої держави полягає в тому, щоб забезпечити літнім людям гідний рівень життя. У більшості країн недержавне пенсійне страхування є ефективним механізмом оптимізації системи державного пенсійного страхування. Вчені стверджують, що процес прийняття рішень має два виміри: емоційний (примітивне) і церебральний (просунуте). Відповідно, існують також два аспекти ризику: страх перед самим ризиком («страх перед катастрофою») і страх перед невизначеністю (страх перед новим або невідомим). Пенсійний ризик характеризується низьким рівнем в обох цих вимірах: у більшості людей він не викликає ані достатнього почуття катастрофи, ані достатньої невизначеності і, відповідно, не сприяє більш адекватної підготовки до виходу на пенсію або подолання проблеми самоконтролю. Отже, проблема полягає у нездатності взяти відповідних заходів.*

Вкрай важливо забезпечити прозору діяльність недержавних пенсійних фондів на принципах фідучіарної відповідальності щодо нагромадження та інвестування пенсійних внесків. Фідучіарна відповідальність полягає в тому, що керуючі НПФ зобов'язані бути повністю відданими виключно інтересам учасників фонду.

Розвиток національної пенсійної системи є можливим тільки в тому випадку, якщо в діяльність НПФ залучено широке коло громадян, які в багатьох країнах складають основу пенсійних систем. В Україні навіть в умовах стабілізації економічної ситуації проблема полягає в формуванні у мотивованих громадян прагнення до особистих

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пенсійних накопичень в рамках НПФ. Ми пропонуємо застосовувати підходи, засновані на поведінковій теорії фінансів, яка стала більш активною після світової фінансової кризи. Тільки в умовах суспільної довіри пенсійна система може ефективно функціонувати.

Ключові слова: недержавні пенсійні накопичення; пенсійні фонди; фінансові інструменти; акумуляція активів; декумуляція активів.

Problem statement. The main function of any state is to provide the senior citizens with a standard of living not less than before retirement and, at the same time, to prevent the deprivation of this vulnerable population. In most countries, non-state pension insurance is an effective mechanism for optimizing of the state pension insurance system. It makes possible to avoid a number of risks when a person retires. Non-state (private) pension funds (hereinafter – NPFs) act as institutions that accumulate pension assets in order to provide pension payments for the participants of such funds. The NPF system provides involvement in the formation of retirement savings both employers' and workers' contributions, and thus further contribute to raising the standard of living of citizens when they reach retirement age.

State supervision and control over the activity of the NPF is carried out by the National Commission, which provides state regulation in the field of financial services markets (hereinafter – the Commission). On a quarterly basis, the Commission publishes on its official website the results of the NPF activities for the relevant period.

According to the reports of the Commission in recent years, the authors analyzed the functioning of NPFs, current market trends, the potential of their development in Ukraine, considering that investing in such funds is one of the most affordable means of saving for old age.

Analysis of recent research and publications. Famous foreign and domestic scientists devoted their works to the

theoretical foundations and practical aspects of NPF activity [2, 6-13].

Considering significant scientific results these authors get, it should be noted that the role of NPFs in the pension insurance system, and therefore, providing social protection for Ukrainian citizens, especially in the post-crisis period, requires its further study.

Formulation of research objectives. The purpose of this article is the thorough analysis of the current condition of the Ukrainian non-state pension insurance market, description of the main approaches of the behavioural theory of finance, and suggestions for their use in governmental practice.

Presentation of the main research material. The non-state pension system is the third level of the pension system. The foundation of the system is the NPF, which activity in Ukraine cannot yet be called active.

According to Article 6, Paragraph 4 of the Law of Ukraine «On Non-State Pension Provision», NPF is a financial institution, a non-profit organization, established to accumulate funds for additional non-state pension and to make pension payments to fund members. NPF participants are persons who benefit from pension contributions to NPF, and contributors are persons who make such contributions (participants themselves, their employers, professional associations or members of the family). It can be three types of NPFs: corporate, professional and open (Fig.1).

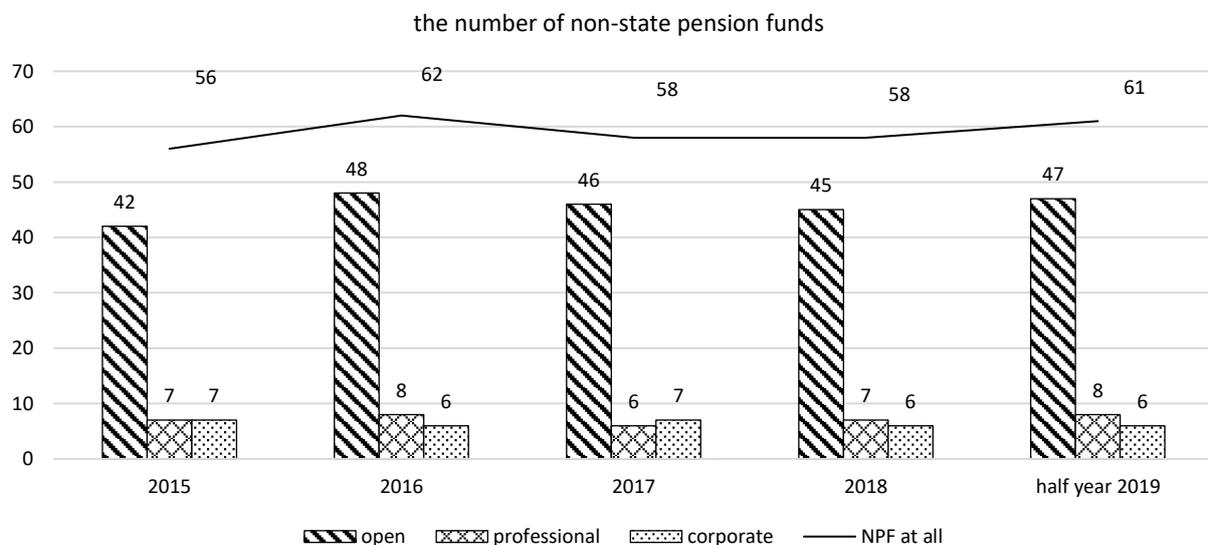


Figure 1 – Structure of non-state pension funds of Ukraine in the form of creation

Source: Compiled by the authors on the basis of [3]

The data in the figure 1, show that open funds are the most widespread form of NPF in Ukraine, which is explained by their greater accessibility to the general public, whereas only those who are related to their professional activity can participate in professional or corporate NPFs or have a working relationship with the founders or the employer who contributes to such funds.

However, it is obvious that corporate pension funds, whose number has not fluctuated and remained stable despite the problems because of the negative impact of the financial crisis.

In 2018, the State Register of Financial Institutions contained information about 58 NPFs. For the 1st and 2nd quarters of 2019, their total number has not changed [1]. NPF assets account for only 0,011% of Ukraine's GDP, while the world average is 70,4%, and in some countries it is much higher: the Netherlands – 167,9%, Switzerland – 122,9% [2].

The growth level of private pension provision is characterized by many factors, in particular: the number of pension contracts concluded; total number of NPF

participants; the level of pension contributions and benefits; the return on investment rate; profit from assets invested by NPF; the amount of expenses reimbursed from retirement assets, etc.

The dynamics of changes in the number of concluded pension contracts with NPFs is presented in Fig. 2.

The figure shows that over the last 5 years, the number of pension agreements has grown annually and peaked in 2017 – 66,4 thousand units. In 2018 the number of transactions has not changed significantly, although it decreased by 2,39 %. Overall, over the period under review, the number of pension agreements increased by slightly more than 7 thousand units.

Therefore, the number of participants has not changed significantly in the corresponding years: from 838 thousands in 2014 to 846 thousands in 2018 [3]. The total amount of pension contributions has kept a positive trend and has grown over 5 years by about UAH 200 million. This may indicate that the confidence in the NPF has increased and that people have the opportunity and free funds to invest in these funds.

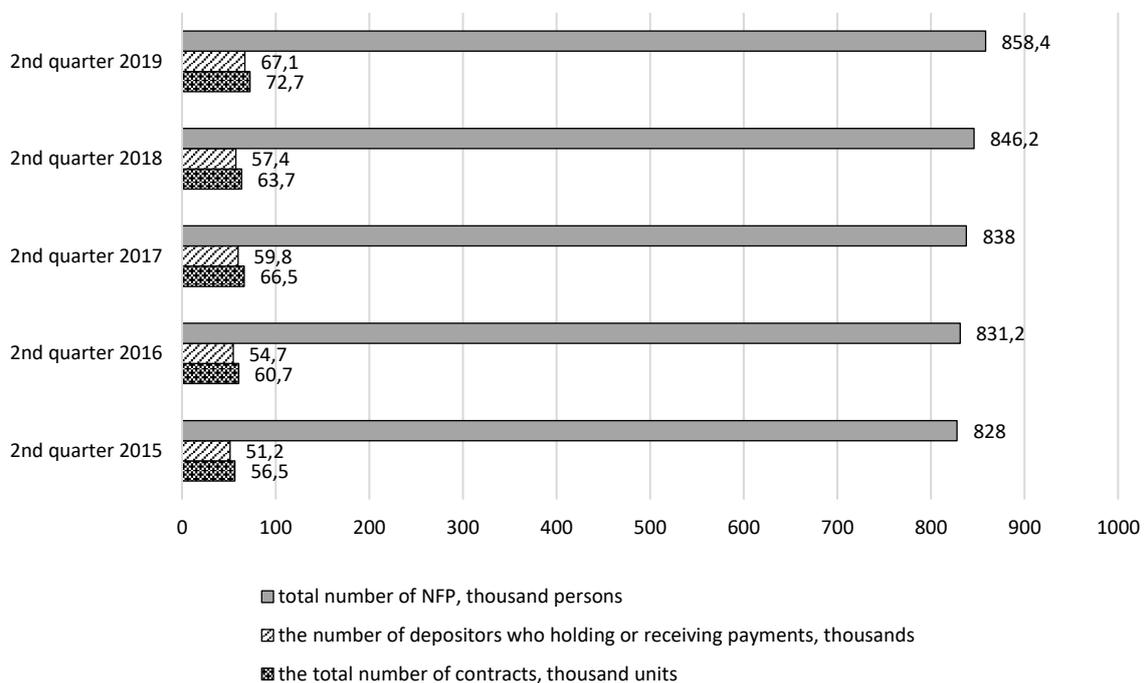


Figure 2 – Number of concluded pension agreements, thousand units

Source: Compiled by the authors on the basis of [3]

According to the Commission, as of September 30, 2018, the average pension payment per one NPF participant receiving a single pension payment was UAH 6,9 thousands and the average pension payment for a fixed term (annuity) per NPF participant was 55,49thousand UAH [1].

According to the contributions, the financial resources of the NPFs have also increased, and thus the volume of their investment portfolio, which has a positive impact on the results of the investment activity of the funds.

The preferred areas for investing pension assets are securities, the income of which is guaranteed by the Cabinet of Ministers of Ukraine, bank deposits and bonds of enterprises issued by residents of Ukraine [4].

As can be seen from the Figure 3, the lowest income in the last 5 years was obtained in 2016. However, total income from investing in retirement assets increased by 33,79% in 2017 and 25,19% in 2018.

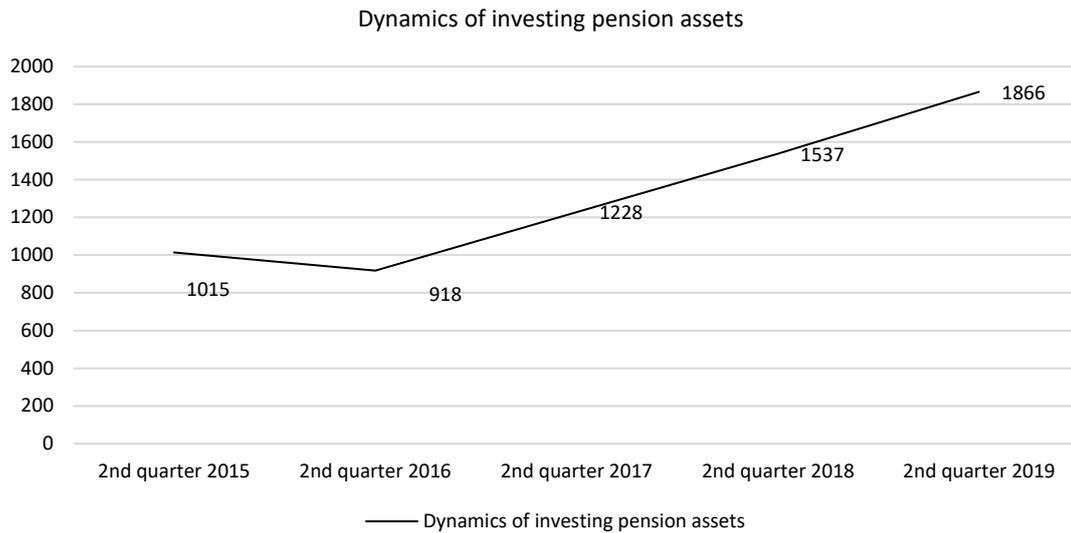


Figure 3 – The amount of income from investments, million UAH

Source: Compiled by the authors on the basis of [3]

This may mean that either the funds have refined their investment policy and revised their investment portfolio to make it more effective, or the improvement of the economic situation in Ukraine has had a positive impact on investment income.

According to their reports, the pension contributions of the NPFs are directed as follows: the major part of the costs is the payment for the asset management services of the NPFs. Next reason is the cost of paying for the management of the pension fund and the payment of the services of the keeper who is responsible for safekeeping the assets of the pension fund.

When writing the article, the authors were faced with the lack and inaccessibility of relevant information on the activities of the funds on their official sites, which eventually had to be obtained from other sources. Undoubtedly, it is of utmost importance to ensure the transparent activity of NPFs on the principles of fiduciary responsibility for the accumulation and investment of pension contributions. The fiduciary responsibility means that NPF managers have a responsibility to be fully committed to the interests of the fund members.

This responsibility in the United States is described as follows: "Many behaviours that are allowed in everyday life in a business relationship are forbidden to those who are involved in fiduciary responsibility. The trustee adheres to stricter standards than the morality of market relations" [12]. Only under conditions of public confidence can the pension system function effectively.

The development of a national pension system is only possible if a wide range of citizens is involved in NPF activities, which in many countries form the basis of pension systems. In Ukraine, even in the face of the stabilization of the economic situation, the problem lies at the formation of motivated citizens' desire for personal retirement savings within the NPF. We suggest applying

approaches based on the behavioural theory of finance, which has become more active after the global financial crisis.

According to this theory, people who plan to retire during their working lives are well-informed rational economic decision-makers who want to maximize the utility of their choices and strengthen their well-being [6]. In the classical literature, individuals are considered to be able to interpret and weigh information provided to them by the government and employers; appropriately evaluate and balance different options, review all alternatives, and then make an informed decision based on this analysis.

However, in recent years, scientists working in the field of behavioural finance have found that while individuals are trying to maximize their well-being, in the process of making individual financial decisions, they face several limitations:

- Rationality restriction [7] – some problems are too complex for a certain category of people to solve on their own;

- Restriction of self-control [8] – people do not have sufficient willpower to bring their plans to fruition;

- Limitation of personal gain [8] – although people seek to maximize their well-being, they have proven to be much more inclined to cooperation and altruism than a classic financial school state.

Recognizing the existence of these constraints has significantly changed the understanding of the modern science of the process of making individual economic and financial decisions, especially those related to long-term consumption and savings, such as accumulation (accumulation phase) and consumption phase of assets in the pension scheme.

Savings for a rational, economically literate person are the result of the trade-off between consuming income

today and deferring part of it to a later date. The Lifecycle model (LCM) assumes that individuals plan their consumer needs rationally throughout their lives. At a young age, people are usually «net-consumers»; they take out loans to buy a home, a car, and increase their current consumption (i.e., borrow from their future). At the middle age, they move to the phase of accumulating their retirement benefits, become «net contributors» and buyers of financial assets. When they retire, the retirement consumption phase begins and a new spending period begins, financial assets are withdrawn from the pension scheme and sold to finance old-age consumer needs. The overall goal of each person should be to smooth out the consumption extremes throughout the life cycle.

Making the right decision about retirement savings under this model requires accurate forecasting of future earnings, asset returns, interest rates, tax rates, inflation, and longevity. The vast majority of the population is unable to make such projections during their lifetime and accumulate sufficient resources before retirement [9]. As a result, many people experience a significant drop in quality of life in their retirement age.

Behavioural school representatives explain inadequate preparation for retirement with the concepts of «lack of willpower» or «limited self-control.» Individuals may wish to accumulate sufficient funds for their retirement benefits but cannot do so [10]. They understand the benefits of developing a plan for the future, and may even begin to implement some of its provisions, but are not able to stick to that plan for a period long enough to reach their goal.

One of the reasons why it is difficult for some people to save until retirement is that, in their perception, the «short-term discount rate» or «temporary benefit rate» is higher than the «long-term discount rate» [10; 11]. R. Thaler says that people have a high level of patience when it comes to long-term decisions: «If you can get one apple in 100 days, or two apples in 101 days, then another day can wait for the second apple,» but that's another matter. When the decision is to be made immediately - the patience disappears: «I would rather take one apple today than I expected for two until tomorrow.»

Scientists say that the decision-making process has two dimensions: emotional (primitive) and cerebral (advanced) [12]. Accordingly, there are also two dimensions of risk: fear of risk itself («fear of catastrophe») and fear of uncertainty (fear of new or unknown). Pension risk is characterized by a low level in

both of these dimensions - in most people, it causes neither a sufficient sense of catastrophe nor enough uncertainty, and thus does not encourage more adequate preparation for retirement or overcoming the problem of self-control. Thus, the problem lies not with a lack of awareness but with the inability to take appropriate action.

Conclusions and perspectives of further research.

This article analyses the reports of the National Financial Services Commission on the results of NPF activity in Ukraine for over 5 years (2014-2018).

The main conclusions of the authors are as follows:

1. Overall, indicators of the development of non-state pension insurance in Ukraine are rather modest, but they indicate about the potential available. The main advantage of NPFs participation in the pension system are that they allow sharing between its three components the risks associated with changes in the demographic situation (to which the solidarity system is most sensitive) and with fluctuations in the economy and the capital market (which most affect the storage system).

2. The confidence of NPFs from potential participants is increasing as, according to the analysed reports, their number and therefore the amount of contributions over the last 5 years have been gradually increasing.

3. The greatest dynamics in the activity of the NPF are observed during last two years. This may be due to the adoption of the Law on Pension Reform of Ukraine on October 11, 2017. Over the two years of improving the balance of the investment portfolio and increasing its volume by increasing the amount of contributions showed the result of investment income higher than in the previous years by 26-31%.

4. The main infrastructural element of the reformed pension insurance system in Ukraine should be NPFs. However, one of the most significant problems inherent in the cumulative system is the lack of investment experience among citizens.

5. The main problems for NPFs today are the optimization of operational processes, efficient use of resources, increase in their profitability. The solution to these problems are directly proportional to the increasing of the NPFs' numbers participants and, consequently, to the increasing of pension contributions.

6. It is proposed to facilitate the participation of the population in non-state pension insurance to apply methods of correction of people's economic decisions regarding retirement savings, taking into account their psychology and mentality.

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