

PRIVATE PENSION SYSTEM IN ALBANIA

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Abstract: The role of private pensions in many developed economies has grown significantly in the past two decades. The situation is different for developing economies where private pensions are a new phenomenon and have a very low weight in the sector. Despite the diversity of retirement systems, these countries in many cases are characterized from low education level of the population for this service and not well-defined investment policy from the companies offering this product. The low education level implies that the publicity should be as simple as possible to be understood from considerable population and well-specified policies increase the self-confidence of the interest group. Developing economies in the same time are characterized even from high informal employment rate, influencing directly privet and public pension system. In this situation, new reforms and actions should be made in order to develop and incentivize the pension market. In the same time it is very important the pension model that has to be used, which should be in accordance with the economic, political and social characteristics of the country. The same can be said even for Albania, when it comes to pension system. The pension scheme in Albania consists of two pillars. The first pillar is PAYG funded system, publicly managed and “defined benefits” (DB) where benefits are calculated according to a specific formula based on the number of working-years, wages earned, as well as the contributions paid. The second pillar, as per international definition of it, does not exist in Albania. Instead there is a third pillar, privately managed, voluntary contributed and defined contributions (DC). During the past decade, the first pillar has demonstrated certain problems, like low net replacement rate, high dependency rate and considerable high level of evasion of contributions payment. The third pillar is a new one in Albania and the size and the development of it is very modest, as at the end of 2014,

this market accounted for 0.05% of the Gross Domestic Product, or in number of contributors only 8,491. Despite the small number it has been increased, so compared with 2013 the number has been increased with 7.66%. The paper will be focused on the detailed analyze of pension system in Albania, and more concretely in the privet one. The objective is to give a detailed overview of this sector in Albania, with its difficulties and obstacles that are encountered and the risks faced today and in the future.

Keywords: public pension system

INTRODUCTION

The term pension in many encyclopedias refers to an agreement which is offered to the employers to obtain a regular income when they are no longer in the employment relationship. For the first time the pension system was applied in 1889 from the German emperor, Bismarck. The system was applied only for the employers of the administration and it was based on the principle of solidarity between generations. In the period after the First World War, efforts of many European countries to increase social insurance schemes are quite present. But during World War II, in England Sir William Beveridge in his capacity as chairman of the state commission Parliament gave the idea of creating the social insurance, which will be based on three basic principles.

The first one is based on respecting tradition and experience of the time and also looking for a better solution which would consist in improving the existing system.

The second one is social insurance systems which must be linked to other bases of political reform. The last one has to do with the modernization of social insurance, with the joint action of the state as well as the individual.

It should be noted that in its beginnings, social insurance schemes offered protection to certain categories of workers, mainly for employees of state administration and military. With changes and new developments mainly towards industrialism of the countries, the need for the involvement of employees in different sectors of the economy and industry in the social insurance schemes was born together with the social problems which were encountered by individuals who were employed in different professions of the sectors.

Related to Albania the insurance system was created in 1947, but the first element of the insurance system was founded in 1923. The first notions of rights in the field of social insurance were included in the law dated 15.02.1923 "Resignation and pension for military". The law which is also known as the first law of social insurance in Albania is the law number 129, dated October 28, 1927, the law "The civil pension", published in the Official Gazette no. 91 dated November 8, 1927. According to this legal act, they laid the foundations

of a consolidated system of social insurance, which included protection for the civil employers of administration and it knew the pension rights for all civil employers after November 28, 1912, so since the recognition of Albania as an independent state.

Pension systems have been one of the serious issues, which all Albanian governments have been facing. They have been a constant source of criticism from international bodies and are one of the schemes that aggravate the state budget a lot, therefore impeding the development of the Albanian economy [Treichel 2001].

In the basic social security systems one of the main principles is the funding method "Pay as you go" which during the XX century it has been dominant in many countries. Over the past few decades private pension has expanded all over the world and people more and more are focusing and investing their money in private pension schemes. For developing countries private pension are attractive because they create high-income replacement rate which leads to financial market development and to economic growth.

In XXI century, at a time when birth rates are falling and people's average life expectancy is extended, the number of pensioners is increasing much faster than the pace of labor force growth. In this context, the old system of social security "Pay-As-You-Go" is going more and more to the inability to meet the needs of pensioners.

In these situations, private pension system has been developed and modified fulfilling the new system requirements. A private pension is a plan into which individuals contribute from their earnings, which then will pay them a private pension after retirement. It is an alternative to the state pension.

ADVANTAGES AND DISADVANTAGES OF PRIVATE PENSION SYSTEM

There are many pros and cons about the private pension system functionality. If we analyze the traditional pension models, including the model "pay as you go" we can discover many problems regarding these schemes. The problems are high evasion rates early retirement and their unsustainable nature in an ageing population. One of the phenomenons that we can easily notice over the counties of the worlds is the percentage of people over the age of 60 is expected to rise by about half over the next 50 years.

In the year 2050, about 30 percent of the population in those countries will be over the age of 60. This means an increase in the dependency ratio. Basically, there will be more people receiving pension compared to the number of people working and paying income tax. This is going to leave a black hole in government finances, relying on private pensions would avoid this problem

Europe is one of the continents with such alarmingly low birth rates. In 1997, Italy became the first nation in history with more people over the age of 60 than under the age of 20. Also in a few year Germany, Spain and Greece joined Italy among the ranks of prematurely aging societies.

This trend is one of the problems for state-run pension systems. Experts on the topic from all over the world predict that the current pension system will collapse if immediate reforms are not undertaken. The pension system known as "pay-as-you-go" is currently the most common of the world. Governments don't invest pension contributions. In theory, people pay taxes to make pension contributions, but, government rarely invest this money. Instead they pay pension payments out of current expenditure. This means with an ageing population, they will struggle to pay the pension commitments.

As M. Tanner, one of the experts on pension privatization recently said that the pay-as-you-go system is doomed. "Well, countries all over the world are realizing the traditional pay-as-you-go model of social security is no longer viable. Under the old pay-as-you-go system, what would happen is individuals would pay a payroll tax, but that tax would not be saved or invested for their retirement in any way. Rather, it would be used to pay for the retirement benefits for current retirees. Those new retirees would have to hope that another generation of workers would pay for their benefits."

In some Western countries such as Germany, Austria, Portugal and Spain the state's pay-as-you-go program is very profitable for retired workers because they collect large pensions, sometimes as much as 80 percent of their past salaries. But in most of the West, including the United States and Canada the pension is just enough to keep the elderly out of poverty. In those countries many workers see in private pension funds a good alternative to gain a better pension.

A *personal pension plan* is a private pension policy that is managed for you by a life assurance company or investment firm, usually investing in stocks and bonds and accumulates interest, increasing the amount without paying taxes. Private sector has profit motives to gain best return for investors, otherwise people will look elsewhere. This means in theory, private pension firms will take good care of the investments. If the fund performs well in the market, the workers' gains will be higher when they retire.

Many experts now advocate for governments those private pension funds. They encourage moving away from the state pay-as-you-go model toward a private system. This is profitable for both because it mean not only more money for pensioners, but also lower costs for government.

Benefits from private pensions:

- Pension can be fully drawn, or for how many periods you want;
- Unlike bank deposits, the pension fund is exempted from taxes;
- Can make agreement with the employer to set a monthly amount for private pension even if you are not insured;

- In case of death, the entire pension amount goes to the heirs;
- Pension can be taken 5 years before the official date of retirement.

Great Britain has been focused more on the private model. The majority of the retiree's past salary in British is based on private pension funds. The more you earned when you worked, the more you get when you retire. But many critics have been directed to this system. Mike Reddin, an authority on pension policy at the London School of Economics says:

"More and more people have been tempted to do that; it seemed to them quite financially attractive at the time. The pension companies promised them a great deal in benefits but has consistently and systematically let them down and failed them. And the government has had to keep returning to bail out those schemes and reinventing schemes and new rules and new regulations to give the people a fair deal in the pension market."

The financial crisis highlights the fact that private finance firms can go bankrupt. If people invest in a private scheme, that scheme may go bankrupt and people will be left with nothing for retirement. This has already happened with some private pension schemes. Therefore, there is an expectation the government will step in and rescue those pensioners who have seen their private scheme fail. The point is you can't rely on the free market to guarantee pensions.

The problem with relying on the private sector is that it would lead to great inequality. Some well paid workers can afford to save to a private pension. But, low paid workers, with high living costs, may not be able to afford much pension contributions. Therefore, when they retire, they are left with nothing – increasing inequality within society.

Still, according to some studies that the government have been made, by 2030 when most of the generation known as "baby boomers", the generation after world war II, will have retired the cost to the British government of providing pensions is projected to be 6.2 percent of gross domestic product. That compares with 6.8 percent projected in the United States, 14.2 percent in Germany, and 17.2 percent in France.

The private pension approach has grabbed attention around the globe because of these encouraging figures. The World Bank says some 30 industrialized countries will implement something similar to the British plan within the next 30 years.

PENSION SYSTEMS IN ALBANIA

In function of the supplementary insurance for more income in retirement age, private pension scheme is entirely voluntary and their mode of operation is defined contribution. Forms of financing such schemes are capital funding. In the law no. 7943, dated 01.06.1995 "Supplementary pensions and private pensions institutes," we can find trends and efforts to develop the private pension

market. But despite the fact that legal package was adopted in 1995 private pension institutes began work much later by the creation of a legal basis. Their rise was driven also by the creation of the institution which would monitor and regulate the functioning of institutions, as a central mechanism not only for the drafting of a legal basis, but also as a regulator for the operation of their pension market, in terms of managing risk and audit all activity of the subject. Law no. 10197, dated 10.12.2009 "Voluntary pension funds" consolidated the legal basis in the private pension market.

The pension scheme in Albania consists of two pillars. The first pillar is PAYG funded system, publicly managed and "defined benefits" (DB) where benefits are calculated according to a specific formula based on the number of working-years, wages earned, as well as the contributions paid. The second pillar, as per international definition of it, does not exist in Albania. Instead there is a third pillar, privately managed, voluntary contributed and defined contributions (DC). During the past decade, the first pillar has demonstrated certain problems, like low net replacement rate, high dependency rate and considerable high level of evasion of contributions payment. The international financial organizations like the World Bank and International Monetary Fund have been closely supporting and assisting the Albanian Administration to measure those problems, and provide studies and financial support to undertake several reforms. First the support consisted in parametric reforms under the first pillar:

- a. pension age increase,
- b. widening the contribution wage base (called assessment base, or contributory wage),
- c. reducing the contribution rate,
- d. introducing reduced pension (like, early withdrawal, but pension remains reduced along the lifetime),
- e. gradually equalization of pension amount in urban and rural areas,
- f. transferring the service of contribution collection to another governmental department, like Tax Authorities.

The first pillar is managed by the Social Insurance Institute, which is a government body under the Ministry of Finance.

As concern the third pillar, here again, under the assistance of the World Bank experts, the new law on Voluntary Pension Funds was drafted and approved in 2010, designed completely under the new concepts of corporate governance, fit and proper criteria for medium and high management level, risk-based supervision, EU directives on capital requirement, custodianship of assets, etc. This law is expected to improve the existing voluntary pension system in Albania and will probably have satisfactory impacts in population long term savings, reduction of the social burden to the government (not adequate first pillar pension amount would increase the pressure to the government), and increase the awareness

of the population towards this issue and push them to become more responsible for their future pension amount.

The new law has introduced new concepts and practices, such as the division of the concept of fund management from the pension fund, which is conceived as a set of assets created on a contract basis; the procedures of membership, suspension of membership, transfers and withdrawal; and the obligation of the management company to hold the assets of the fund in a depository. In addition, the law brought new concepts relating the criteria to be met by shareholders and directors of management companies which should meet the fit and proper criteria, and prevention of conflict of interest. All these new components are in favor of the development of the pension fund market.

In order to have an overview of the private pension market in Albania, it is necessary to refer to some statistics. In 2014 the number of contributors was 8,491, with an increase of 7.66% compared to 2013, and the net assets under management reached a value of 629,145,606 lekë, with an increase of 44.69% compared to 2013. For the period of 30.06.2015, the number of contributors reached 10,791 and the assets under management 754,826,347 lekë, which marked an increase of 27.09% and 19.98% respectively. Despite high growth rates, the size and the development of private pension market in the country are very modest, as at the end of 2014, this market accounted for 0.05% of the Gross Domestic Product. In this situation, new reforms and actions should be made in order to develop and incentivize the pension market. The current situation emphasizes the need for fast development of this pillar and the significant role of the asset management companies in establishing funds attractive to the individuals.

Those funds should be set up in accordance with investment strategy requirements by the legislation, and also tailored as per requirements and interests of different groups taking in account the low education level of the population. The low education level of the population implies that the publicity should be as simple as possible to be understood and to be effective.

Critical is the role of asset management company in explaining the role of the individual and the role of asset Management Company itself, what they have and have not in common, who is bearing the risk of investment and who is not. The risks involved will definitely determine the clients' investment choices and payout choices too.

The companies offering private pension should have a well-defined investment policy, in accordance with the legal requirements. The board of directors is responsible of approving investment policies in accordance with the Law and regulations, oversee the management of the pension fund investments, and ensure that the content and diversification is properly defined in its investment policy.

According to the legal requirement the investment policy should include elements such as limits on the amounts that may be held in particular types of investments; a clear definition of the types of financial instruments and any

other assets the pension fund can invest in; rules for safekeeping unit-holders' assets; assessment of the appropriate matching of assets and liabilities; and proper procedure for monitoring the level of liquidity. The assets of a pension fund can be invested only in assets specified in regulations issued by the Financial Supervisory Authority (Law No. 10197 of 10.12.2009 on "Voluntary Pension Funds").

PENSION FUNDS IN ALBANIA

Although, the first law regarding the pension funds is since 1995, only after 2006 these funds have started to develop somehow. Their low development relates to economic performance, culture and climate of trust of individuals toward these funds. In the next paragraph will be described some of the main pension funds operating in Albania.

IPP Capital

IPP Capital is a financial institution that deals with the collection of contributions from entities and individuals, their investment and their return in the form of pension. IPP Capital is licensed by the law Nr. 3, dated 09:12. 2005 from the Supervisor of IPPs and was launched in January 2006. It's activity is based on the law no. 7943, dated 01.06.1995 "On Supplementary Pensions and Private Pension Institutes" changed with the law no.10197, dated 10.12.2009 "On Voluntary Pension Funds".

a) Organizational structure

Its structure is:

- General Assembly which consists of two rooms:
 - Chamber of shareholders
 - Chamber of the Representatives of the insured persons.

Each chamber elects its own members in the Supervisory Board. Chamber of shareholders, has a veto on any decision of the General Assembly. Representatives of the insured persons are elected with a secret vote once in 5 years by the insured. Selection methods and rules are defined in the statute of the pension institution. Each shareholder shall have as many votes as the number of shares he owns to the pension institution.

The Supervisory Board consists in 7 members, of whom 5 members are elected by shareholders and two members from the representatives of insured persons in the General Assembly. Representatives of shareholders who are members of the Supervisory Board shall elect a chairman and deputy Chairman. Representatives of the insured persons to the Supervisory Council elect his second deputy. If they fail to agree on one thing, the Chairman shall appoint one of them as second deputy chairman of the Supervisory Board. Supervisory Board members are elected for a term of 5 years.

The Governing Board shall consist of not less than 5 professional members, selected by the Supervisory Board. One of these members will be elected as chairman and another as vice-chairman. President is the representative of the pension institution. The rights and obligations shall be determined in status. Authority is invited to participate in meetings of the General Assembly and the Supervisory Board.

b) Areas where can operate the Capital Fund Pension

In determining strategies to operate in the Albanian market, the Association of Pension Funds Capital divides in the following categories its potential customers:

- **Workers of hard professions**, who under the state system retire at age 65. Through private schemes give access to take early retirement until they reach this age, against contributions that employer and employee pay. These include the employees of mining, metallurgy, cement, construction and others.
- **Liberal professions** as lawyers, notaries, self-employed, individuals, etc., which by the state system are ensured to a minimum level. Through the private sector, they get a possibility to additional pension to maintain the economic level achieved by their work.
- **Non-budgetary state institutions** as I.S.SH., I.S.K.SH, Banks, Insurance Companies, KESH Corporation, Telecom, Post etc., Who until 2003 were provided by the state with supplementary insurance schemes. Through this scheme they can continue this supplementary insurance.
- **Immigrants** are very interested to be involved in private pension scheme. Immigrants who live and work in Italy and Greece, are potential clients for whom Capital seeks to penetrate, because a good parts of them are employed in various sectors and the contribution that they pay into the social security of the countries where they work estimated about 500-600 million Euros. Unfortunately, most of them do not benefit from these contributions, especially in the area of pensions. Through with private pension schemes they have the possibility to gain a dignified retirement.

In fact, IPP Capital did not achieve its objective, but could operate only with large companies and their employees. Currently, IPP Capital has registered over 2,000 insured people. Its current customers are large private companies that work in the insurance field as Sigal Uniqa Group Austria, Eurosig, Atlantic, Social Security Institute; Medias as Top Channel, Digitalb; construction and services companies as: Deka, Olympus, EUROALBA, Aurora, API etc. and individuals.

Raiffeisen Pensions

Raiffeisen Bank already owns the American Institute of Supplementary Private Pension, which was named Raiffeisen Pensions. Pension Company was the first private voluntary pension company licensed by the Inspectorate

of Supplementary Private Pension Institutes (now the Financial Supervisory Authority) in 2005 and continues to be the largest company in the Albanian market of private pension funds. Based on recent reports of the Financial Supervisory Authority, Raiffeisen Pensions maintains the leading position in the Albanian market of private pension funds, with 58.44% of the contributions. Raiffeisen Bank is expanding its investments in the Albanian market. Raiffeisen Pension Fund has as its object of activity, providing supplementary pensions to individuals during the "third age".

Each individual can choose to invest in the pension fund. In addition, employer contributions may also be shed on behalf of their employees. The fact that Raiffeisen Pensions has the highest number of contributors compared to other pension funds means that they are very active in the Albanian market. Many people are skeptical and often compare with pyramid schemes because in fact this concept is new. This is related even with the disappointment regarding the state and its supervisory functions. It is noted that the pension funds that operate in Albania do not engage this funds in educating and informing the public about the products they offer, the benefits that the individuals will have if they contribute in these funds.

Despite negative sides, the primary customers of the Pension Fund are simple individuals who are carrying since the previous fund, which has been "American Institute of Supplementary Private Pensions". Raiffeisen Bank is currently the largest bank operating in the Albanian market and many individuals associate this with the state bank. The fact that the fund has the same name with the bank can create a greater confidence to individuals to invest in its private pension funds.

Based on the data declared from the Financial Supervisory Authority on the number of contributors and the amount of contributions we can say that IPP Capital has followed the logic of Raiffeisen Pensions, where is more important the value of the contribution than the number of contributor. Based on this philosophy, we have a significant increase in funding contributors to IPP Capital, and Sigma IPP is less active. Regarding Raiffeisen Pensions, despite being the company that leads the market, there has not been significant growth. This can be interpreted as a market maturity point of the company which aims, in addition, to maintain existing market share. Raiffeisen Pensions success in the market is closely related to the fact that this company is part of the largest bank operating in Albania. Its favorite geographic extension and inheriting quite a considerable clientele from Savings Bank have served to this company as two facts that has led to an easier enter in the Albanian market.

CONCLUSIONS

Finally, based on the theoretical explanation and experience of developed countries and analyzing the case that we discussed above can be concluded that:

- Pension system reform and development is crucial since this system is facing problems that leads to black hole in government finances,
- Development of alternative schemes is necessary
- Promotion of private pension system because it mean not only more money for pensioners, but also lower costs for government.
- The reformation of the pension system related to the development of alternative schemes has to start with the preparation of preconditions supporting this process.

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