

FORMATION OF THE RISK PROFILE OF THE FUNDED PENSION SYSTEM

Hanna Pysarevska
Hanna.Pysarevska@hneu.net

Abstract. The article is devoted to specifying the necessity and the implementation ways of accumulative pension fund scheme in Ukraine. The profile of risks which can be identified in the system of funded pension provision and practical tools for risk coverage is developed. The particularity is based on clarifying the types of risks and groups of their causes, which can allow to improve the management process, risk minimization and coverage.

Keywords: state regulation of private pension insurance, private pension, private pension funds, system of funded pension, cumulative pension, risk profile.

1. Introduction

The new pension system in Ukraine envisages the creation of three levels, namely the solidarity system (first level), the mandatory funded system (second level) and the non-state voluntary pension provision (third level). The development and reform of the pension system will contribute to the social development of the state, ensuring social stability in society. At the same time, reforming the pension system is a complex process fraught with social risks (Masola, 2014).

The introduction of funded pension in Ukraine is planned only after the formation of the necessary economic preconditions, primarily a deficit-free budget and the creation of an effective system of state supervision and regulation in this area, as well as the necessary infrastructure (Pro zahalnooboviazkove derzhavne pensiine strakhuvannia, 2003).

The pension reform, which began in 2004, envisages the replacement of the current pension system with a modern three-tier pension system and is aimed at:

- strengthening the interest of citizens and their employers in the payment of pension contributions as a consequence of increasing the dependence of the size of the pension on the labor contribution of the person;
- development of the national stock market through the investment of savings funds in the economy, which will help create a powerful source of investment resources for the growth of the national economy;
- insurance of future retirees from negative demographic trends and fluctuations in the economic development of the state through the distribution of risks of low pensions between the first and second levels of the pension system;
- improving the efficiency of pension system management by transferring the function of pension asset management to non-state companies;
- involvement of the population in active participation in the functioning of the stock market, increasing the level of relevant knowledge and personal responsibility of citizens to ensure their own well-being and increase social protection (Hnybidenko, 2009).

Thus, the proper conditions for the effective functioning of the funded pension system, which are provided by the pension legislation, have not been created.

The implementation of a mandatory funded pension system requires the practical implementation of pension reform, which contains social, economic, demographic, financial and

political components. This requires a comprehensive approach, harmonization of the pace and parameters of pension reform with the pace of economic development of the state, reforms of living standards and incomes, tax reform, stock market development (Kravchenko, 2010). A necessary condition for the effective solution of these problems is the unification and constant coordination of the efforts of authorized public authorities, financial and credit institutions and other organizations involved in the national pension system.

At present, Ukraine has a joint pension system. All employees finance pensions for current retirees, there is no accumulation of funds. The sources of pension payments are ERUs (22%), payments in pension fund of Ukraine, as well as subsidies from the State Budget. The accumulative system provides for the transfer of funds by employers from employees' salaries to individual pension accounts, as well as voluntary contributions of individuals to the participant's individual pension accounts in private pension funds. The participant's funds will grow due to the investment return.

2. Related literature review and hypotheses

Among the leading scientists who pay considerable attention to the theoretical, methodological and practical aspects of pension reform, it is worth noting: S. Achkasova, N. Biletska, N. Vnukova, A. Darienko, O. Koval, M. Kravchenko, T. Stadnichenko, L. Shalievskaya and other scientists. The analysis of scientific publications shows that the degree of study of the problem of introducing a mandatory funded pension system in Ukraine in the financial and economic crisis cannot be considered sufficient and therefore it needs further research. Insufficient development of the capital market, low level of corporate culture, creation and operation of non-transparent pension schemes require more detailed study of the risks of private pension funds in order to improve their work and avoid discrediting the private pension system at the initial stage of operation.

3. Data and methodology

The purpose of the study is to substantiate the benefits introduction of a mandatory accumulative system as a tool for social protection of citizens in terms of increasing the level of pension system, as well as analysis and generalization of risks of private pension funds in Ukraine and identifying ways to avoid or reduce them. The article used a system of general scientific and special research methods: methods of analysis and synthesis, abstract-logical method, method of theoretical generalization, system approach.

4. Risk profile of the funded pension system

The implementation of pension reform requires public administration influence on the institutional sphere (creation and development of the relevant legal framework and individual subjects of the process, strengthening their responsibility, increasing the level of professional training of employees of the private pension system); in the financial and economic sphere (ensuring the progress of the economy, the functioning and development of the stock market, increasing the reliability of investment instruments for pension funds); in the social sphere (conducting informational and explanatory work for different age groups on the rights and responsibilities of participants in the new pension system, raising financial and legal awareness of the population on pensions, overcoming distrust in the private segment of the pension system) (Kravchenko, 2010).

In the table. 1 shows the risk profile of the funded pension system, the difference between which is to clarify the types of risks that will improve the process of management, minimization and protection against them.

Table 1: Risks profile of the funded pension system

Risk group	The name of the risk	Ways to avoid
1	2	3
Financial	Risk 1. Increasing the vulnerability of the system to the general state of the economy and, in particular, crises, depreciation of pension savings due to inflation	Insurance, threat scanning, diversification in pension insurance, fight against inflation, guarantees for protection of pension savings. Creating reliable and investment-attractive financial instruments in the shortest possible time
	Risk 2. Risk of loss and / or impairment of pension savings due to lack of reliable tools for placement of insurance contributions to the funded pension system	
	Risk 3. Inefficient functioning of private pension funds and financial institutions that do not have sufficient financial resources to carry out their activities	
	Risk 4. Weak diversification of pension assets into income financial instruments due to insignificant amounts of pension contributions, reduction of the number of citizens who create pension capital for the future	
	Risk 5. Possible loss of funds due to poor investment of private pension funds	
	Risk 6. Lack of mechanisms for saving the of accumulations	
	Risk 7. Underdeveloped stock market, its low liquidity	
	Risk 8. Threat of destabilization of domestic financial and stock markets	
	Risk 9. Unbalance of the level II system due to not only domestic but also foreign crisis processes	
	Risk 10. Credit risk	
	Risk 11. Risk associated with estimating the value of assets and calculating the unit value of pension assets	
	Risk 12. Market risk	
	Risk 13. Systemic risk	
	Risk 14. Administrative and legislative risk	
	Risk 15. Regional, sectoral and production risk	
	Risk 16. Tax risk	
	Risk 17. Outflow of financial capital abroad	
Demographic	Risk 18. Aging population, increasing economic burden on the working age population, low birth rate, increasing life expectancy, low substitution rate	State programs to stimulate the birth rate; improving the quality and availability of medical services
	Risk 19. Social risk: death in retirement; loss of breadwinner; illness in retirement; disability in retirement	
	Risk 20 Risks of uncompetitive labor market	
Actuarial	Risk 21. Operational risk	Improving the level of qualification of the non-state pension fund employees; actuarial calculations
	Risk 22. Internal audit risk	

1	2	3
Management	Risk 23. Inefficient management of pension savings	Creating an optimal hierarchical management structure of a private pension fund, introduction of special pension programs for the non-state pension fund employees
	Risk 24. Illegal spending of pension funds, the influence of oligarchic structures on the use of resources of the funded pension system through corruption schemes	
	Risk 25. Non-target activities in connection with the possibility of investing in the assets of related parties of the founders	
	Risk 26. Risk associated with the fund management structure and transparency	
	Risk 27. Risk of assessment of insurance experience	
	Risk 28. Risk, limited set of opportunities to achieve optimal portfolio diversification	
	Risk 29. Legal risk	
Technological	Risk 30. Technological risk	Introduction of the most modern information technologies
Political	Risk 31. Political risk	Reducing the impact of the political situation on the economic sphere through integration into the world economic space
Psychological	Risk 32. Risk of cross-selling and marketing	Raising the level of awareness and activity of the population in matters of pension provision
	Risk 33. Distrust of non-state pension providers in the financial system and reduction of further pension contributions	
	Risk 34. Risk of business reputation	

Thus, the purpose of creating a risk profile is to further develop and reform the funded pension system legislative, organizational, methodological and institutional improvement, ensuring the formation of a risk-oriented system of funded pension provision, development scenarios of this system and directions of its implementation, taking into account the need to use risk parameters to solve pension problems in conditions of uncertainty that will overcome major social risks.

The formation of a risk profile will help to: reduce the gap in the size of pensions for men and women; proper differentiation of pensions; stimulating the payment of insurance premiums for the period exceeding the length of service required to receive the minimum old-age pension; elimination of disparities in the amount of pensions granted in accordance with special laws on pensions of certain categories of citizens, and pensions granted on general grounds; legalization of wages and employment; development of the financial sector of the economy and corporate governance; achieving an appropriate level of outreach and encouraging employers and employees to participate in the funded pension insurance system and private pension; raising the level of professional training of specialists of the subjects of the non-state pension system; introduction of reliable financial instruments for investing pension assets; wide public awareness

of pension issues; strengthening confidence in the pension system (Stratehiia rozvytku pensiinoi systemy, 2005).

5. Measures for minimization the risks of the private pension system

To minimize the risks of the private pension system, the following measures should be taken:

- coverage by the obligatory state pension insurance of all employees, assignment of pensions depending on length of service and paid contributions, ensuring minimum social living standards for pensioners at the expense of state social assistance (Stratehiia rozvytku pensiinoi systemy, 2005);

- creation of economic preconditions for reforming the pension system, including by ensuring the financial stability of the solidarity system (Stratehiia rozvytku pensiinoi systemy, 2005);

- ensuring a guaranteed minimum level of pension for any citizen of Ukraine upon reaching retirement age, regardless of the presence or absence of formal indicators (length of service and contributions);

- creating conditions for the population to form sufficient pension savings both through the mechanism of mandatory payments and in a way to encourage citizens to self-sufficiency on the basis of stimulating social partnership and individual initiative;

- setting standards in the field of actuarial activities;

- increasing the efficiency of state regulation and supervision in the accumulative pension insurance system, improvement of legislation in the field of funded pension; determination of the term introduction of the accumulative pension insurance system and the amount of contributions to it (Stratehiia rozvytku pensiinoi systemy, 2005);

- building a reliable system of guarantees at the legislative level;

- determination of the powers of the Authorized asset management company of the system of obligatory accumulative pension;

- determination of the general requirements and functions of the authorized custodian of the system of obligatory accumulative pension, his duties and responsibilities;

- determination of requirements to the authorized administrator, his capital, requirements to his activity, and his responsibility;

- determination of the principles of organization of personalized accounting of system participants;

- determination of requirements to the authorized non-state pension fund and its functions;

- bringing national legislation in line with the requirements of international standards, including the legal norms of the European Union and the transition of non-banking institutions to International Financial Reporting Standards;

- further implementation of the General Directive The United Nations, the European Convention on Social Security, the World Bank Concept for Pension Reform, and other international instruments;

- ensuring effective pension by strengthening international cooperation in the field of harmonization of national legislation with international recommendations;

- further development of existing regulators of the funded pension system (Koval, 2012);

- promotion of keeping the pension assets of the funded savings system not only in cash but also in securities (stocks, bonds, mortgage securities, etc.) (Koval, 2011) ;

- organizational and economic procedure for the introduction of a funded pension system should provide for the gradual coverage of employees, starting with citizens under 35 in the year of introduction, with a gradual expansion over 5 years (Koval, 2012);

- motivating the participation of employers and workers in private pension funds by promoting public awareness of the principles of the institution of private pension funds and the financial system, increasing confidence in them, as well as implementing measures to improve the image of pension funds;

- improvement of information support of the funded pension system by introducing a system of information disclosure by all subjects of the pension system by rating assessment of pension funds, strengthening information transparency of the Accumulative Fund, improvement and expansion of a single information space of electronic interaction of pension entities by creating an electronic database private pension funds and their financial statements;

- development of the system of non-state pension by improving the management of non-state pension funds, development of mechanisms of interaction of insured persons (pension fund participants), banks and non-bank financial institutions serving them and the state in implementing investment policy on pension funds; ensuring fair competition between non-state pension funds – second-tier entities through an even distribution of responsibilities;

- intensification of the development of corporate and professional state pension funds, creation of a savings fund with a clear organizational structure, strengthening of responsibility within the defined powers of asset management companies, administrators and custodians.

- changes in taxation that would encourage employers and employees to accumulate and invest pension savings by lowering the personal income tax rate, which will increase pension contributions; exemption from taxation of the part of income of individuals and legal entities that will be directed to the accumulative pension system, exemption from income tax on investment income received from the investment of pension funds;

- improving the activities of authorized public authorities in the field of funded pensions;

- coordination of the activities of the relevant bodies supervising the subjects of pension;

- Improving the means of monitoring the financial flows of private pension funds and counteracting the illegal and unproductive outflow of financial resources;

- creation of a professional supervisory board of the accumulative fund with established limits of liability to reduce the risk of cash outflow of the accumulative pension fund;

- establishing effective cooperation and collaboration between all subjects of accumulative pension;

- promoting the development of non-bank financial intermediation, domestic financial, as well as the formation of investment culture (Darienko, 2011);

- advanced training of specialists in the field of accumulative pension;

- ensuring effective investment of pension assets, which provides improving the infrastructure of the financial market (Stratehiia rozvytku pensiinoi systemy, 2005);

- development of mechanisms for the participation of pension funds in the management of issuers of shares (corporate rights) in which pension assets are invested, and investment of pension funds in foreign financial projects in accordance with the requirements of the law (Biletska, 2006);

- ensuring the efficiency and reliability of investing pension assets in the mandatory savings system by: limiting the list of permitted instruments exclusively to domestic ones, which consists of government securities, bank investments, shares and bonds of domestic issuers and mortgage assets; the existence of legislative guarantees and a clear mechanism for the return of

deposits of private pension funds from state banking institutions; special construction of pension bonds, which provides a combination of guaranteed yields at the level of inflation with the limitation of the range of participants in the circulation of such bonds by public financial institutions and members of the pension system of II and III levels (Koval, 2012);

- improving the management of pension assets, in particular more careful monitoring of the ratio "return-risk", the introduction of prudential rules of supervision and control (Stadnychenko, 2012);

- prevention of depreciation of pension savings due to inflation by gradually reducing inflation to 3% over the next 5 years and further stabilization at this level by 2050. Therefore, it is necessary to create conditions for accelerated economic growth, as a result of which the investment of pension assets will bring income that exceeds the level of inflation;

- creation of a system and mechanisms for reliable storage and accumulation of pension funds, their protection against risks, as well as transparent pricing in the market of corporate securities and service of pension funds;

- reduction of administrative costs, in particular remuneration of pension infrastructure entities (Koval, 2012);

- development, implementation, maintenance of adequate internal rules and procedures aimed at conducting an internal audit of the adequacy and effectiveness of authorized custodian systems and internal control functions (Pro zahalnooboviazkove nakopychuvalne pensiine zabezpechennia, 2019).

- improvement of the mechanism of interaction of all subjects of pension infrastructure (Vnukova, 2018);

- creation of a mechanism to ensure guarantees of preservation of pension savings by determining the amount of liabilities to be guaranteed taking into account the level of inflation, the definition of the subjects of guarantee, as well as guarantee instruments (Achkasova, 2014);

6. Conclusions.

Thus, the creation of a risk profile will ensure: restoring the financial stability of the pension system, increasing pension payments in accordance with the law, increasing public confidence in pension systems, introducing a funded pension insurance system, ensuring the development of state and private pension system, international experience in reforming the social insurance system and recommendations of the International Labor Organization, effective cooperation and constant exchange of information with pension entities, training of specialists in funded pension provision, increasing confidence in the functioning of the private pension fund and financial system.

7. Results.

The necessity and ways introduction of funded pension system was reasonable. The profile of the risks identified in the system of the funded pension system and practical tool of protecting from them is worked out. The types of risks and groups of their reasons were specified, that allows perfecting the process of management, minimization and protecting from them. The risk profile will contribute to the improvement of social and economic relations and the development of financial markets.

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