



Private Pensions (The Only Way to Increase Pensions System in Albania)

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Abstract

The private pensions market, even though it is known as a relatively new market in Albania, its study and analysis takes on a very special importance as this market is directly related to the growth of pensions as a whole. In the doctrine of financial law, three main pillars are recognized for the way the pension scheme works today. The first pillar is a state insurance system of the pay-as-you-go principle. This system is based on the principle of solidarity and continuity of generations. The second pillar is a combination of the state system and the private one, where every insured person in the compulsory state insurance scheme (the first pillar) is legally obliged to pay a part of the individual contributions to a private pension fund. In our opinion, this way remains one of the best ways for the development and growth of this market in Albania, solving at the same time a very big social problem related to the third age in our country. The third pillar is a completely voluntary system with private management, where every person who wants to have higher sources of income for the retirement period enters into an insurance relationship with these private institutions, which, through efficient management, ensure higher income large and additional benefits against the payment of contributions. This paper is a study of the private pension market in Albania and the analysis of some of its constituent elements, in an attempt to answer some important issues related to the development of this market as a whole.

Keywords: private pension, financial regulation, reformation, European legislation, insurance contract, pension fund

1. Introduction

A private pension is a plan to which individuals contribute from their monthly or annual income, which will then pay them a sum of money in the form of an old-age pension as provided for in the pension system legislation. This type of investment is an alternative to the state pension. Usually, individuals invest funds in savings schemes or mutual funds, run by insurance companies, benefiting from these schemes in what is called the third part of life. Private pensions, also called personal pensions, are usually defined contribution pensions, which means that the money you get in retirement is based on the money you paid in and the performance of your investments.

Private pensions are part of the non-banking financial market, where, together with the insurance and capital markets, they are currently under the regulation and supervision of the Financial Supervision Authority (AMF). In Albania, voluntary private pensions date back to the establishment of the democratic system after the 90s and the first legal regulations were made with the law no. 7943, dated 1.6.1995 "On supplementary pensions and private pension institutes"¹. This law provided for the organization and operation of the Albanian private pension market and the authority responsible for the regulation and supervision of this market. In October 2011, the Inspectorate of Private Supplementary

¹ Naim Hasa, former director of the Social Security Institute. Pension reform. Interview given in the Albanian Newspaper, 2009.

Pension Institutions (IIPPS) was established as a competent state authority under the Council of Ministers for the licensing and supervision of Private Pension Institutions, with the mission of creating suitable conditions for the operation of private pension funds. . Starting from this period, this institution took concrete steps in the legislative and organizational field to create the infrastructure for the earliest start of the operation of private pension funds.

The year 2006 marked an important step in the direction of reforming the supervision and regulation of the non-banking financial system. In order to reform the non-banking financial regulatory system, in October 2006 the integration of regulatory-supervisory entities for the activity of markets and entities in the field of insurance, securities market, and voluntary pension fund institutes was carried out. In this context, the unification of the Insurance Supervision Authority (AMS), the Securities Commission (KLV), as well as the Inspectorate of Voluntary Pension Fund Institutes was carried out, creating the Financial Supervision Authority (AMF), as the only institution responsible for licensing, supervision and regulation of all activity belonging to the non-banking financial sector in Albania.

The pension system is defined as an outline or a composition of legal, monetary and financial conditions that defines the rules and criteria for its operation, where individuals who have reached retirement age receive a payment that is the result of the contributions they have poured into the state coffers. Albania, like many communist countries, faces many economic and social problems that increasingly hinder the development of the country in the framework of a free economy. One of these problems is the pension system. With a shrinking and aging population, pensions are one of the biggest social and economic challenges for Albania in the long term. Private pensions are one of the alternatives that are thought to be able to ease the burden of the public scheme, in the long term, but which in Albania still remain very small.

2. Components of the Pension System

The pension system according to the recommendations of the World Bank during a conference held in Madrid, Spain in 1994 should be based on three main pillars.

The First Column is a state insurance system of the pay-as-you-go principle. It extends to all economically active persons and their families. It is based on the principle of solidarity and continuity of generations. This system currently operates in almost all countries of the world, the most developed in Europe.

The Second Column is a compulsory system with private management, where each insured in the compulsory state insurance scheme (first column) is legally obliged to pay part of the individual contributions to a private pension fund. In this way, upon meeting the conditions for pension benefits, the income of insured persons consists of two sources: one income (pension) from the mandatory state insurance scheme and another income (pension) from the private insurance scheme.

The Third Column is a completely voluntary system with private management, where every person who wants to have higher sources of income in the retirement period enters into an insurance relationship with these private institutions, which, through efficient management, ensure income greater and additional benefits against the payment of contributions.

Today, these systems operate almost all over the world, having different results in different countries, since the economic and social circumstances in these countries are not the same. Pension systems are very complex and very different, and their comparison is difficult. How well the standard of living can be maintained during retirement depends on how high the pension is compared to regular income. The so-called "net replacement rate" is the percentage that remains from the net income received on average over the entire working time.

Currently in Albania, the compulsory social security system is implemented and at the same time the third column, that of voluntary private pensions, is also activated.

3. Financial Risks Behind the Private Pension Scheme

The OECD² guidelines describe the requirements regarding the risk management systems of pension funds. The Basic Principles of the OECD Occupational Pensions Regulation state that: "Pension entities must have adequate risk control mechanisms to address investment, operational and governance risks, as well as internal reporting and audit mechanisms".

According to OECD guidelines, there must be appropriate controls to ensure that all persons and entities with operational and supervisory responsibilities act in accordance with the objectives set out in the pension entity's by-laws,

² OECD: *Institutional Investors in the New Financial Landscape*. 1998. p. 80

articles of association, contracts or trust instruments or in documents related to any of them and that they are in accordance with the law. These controls must cover all basic organizational and administrative procedures; depending on the scale and complexity of the plan. They should include performance appraisal, compensation mechanisms, information systems and processes as well as risk management procedures.

Another important authority in the field of voluntary private pensions is the International Organization of Pension Supervisors (IOPS) established in 2004 as an independent international body composed of national regulators and supervisors of supplementary private pensions. The objectives of private pension supervision are focused on protecting the interests of pension fund members and beneficiaries, thus promoting the stability, security and good governance of pension funds. Pension supervision includes the supervision of private pension institutions and the strict implementation of laws and regulations regarding the structure and operation of pension funds in order to promote a more functional private pension sector.

In addition, achieving stability within the pension sector is an important part of ensuring the stability of the financial system as a whole. Pension supervision is closely related to the financial system, thus bringing new innovations to this system.

The IOPS Principles³ for Pension Supervision are designed to assist private pension funds or plans. Pension oversight also includes monitoring the activity of pension plans or funds to ensure that they remain within the requirements of the regulatory framework, and essentially to ensure that legality is enforced. The Pension Supervisory Authority, referring to the principles, is defined as an entity for the supervision in whole or in part of the pension fund, which by means of legal, administrative and informational means makes possible the protection of consumers as well as the preservation of stability and transparency in the field of private supplementary pensions. During the drafting of these principles, the various diversities in the international arena were also taken into account, thus trying to draft universal standards applicable in all countries of the world.

4. Private Pensions in Albania

As a result of the demographic changes that are taking place, where the third population is growing at a very high rate, the state pension system, based on the solidarity of the continuity of generations, is unable to guarantee a peaceful financial life to this age. For this reason, in addition to the public pension scheme, it would be necessary to create private pension schemes, first as compensatory and then, why not, as dominant. According to the provisions that permeate the Albanian legislation, it appears that this scheme performs two main functions: firstly, it provides additional pensions above those provided by the mandatory state system, and secondly, it provides pensions under more favorable conditions than those provided by the basic scheme. For this reason, the legislator should take care and support it as much as possible, since this scheme is seen as a very positive solution for reforming the pension system as a whole.

In Albania, voluntary private pensions are regulated by law no. 10197 dates. 10.12.2009 "On voluntary pension funds"⁴. This law aims to establish rules and standards, the rigorous implementation of which would affect the stability and efficiency of the financial system. It regulates the creation, operation and supervision of voluntary defined contribution pension funds. The new law is divided into 17 chapters and deals with concepts related to the pension fund, management companies, depository, agent, professional pension scheme, pension fund investments, their marketing, management company fees, supervision, taxation, financial crimes and money laundering, etc.

The Financial Supervision Authority is the only legal authority that has powers for licensing, supervision and regulation of voluntary private pensions. It licenses management companies (joint-stock companies in accordance with commercial legislation and carry out the following main activities: collection, management and investment of assets of voluntary pension funds, and provision of benefits optionally) and custodians (custodians of pension fund assets) and regulates and supervises the voluntary pension fund (the pension fund is a group of assets owned by members of the pension fund).

In our country, private pensions offer opportunities for investment in a diverse portfolio of investments, such as shares, investment funds and bonds. The income collected from the investments can go into a private retirement account and be returned to the pensioner once they reach retirement age. Private pensions are offered by various companies, and participation in them is free. Private pensions in Albania are at an early stage of development, but have the potential to provide an important investment option for those looking to secure a secure source of income after retirement. The

³ The principles are taken from: *International Organization of Pension Supervisors (IOPS), IOPS Principles of Private Pension Supervision. August 2006. OECD Publication.*

⁴ Law no. 10 197, dated 10.12.2009 "On voluntary retirement funds"

pension system in general and the great problem presented by the financing of the development of this system in particular, have constantly attracted the attention of institutions interested in finding more efficient forms and methods in the administration of this scheme.

Statistics show that the number of individuals who contribute to a private pension is only 33 thousand, while the total net assets of private pension funds are only 35 million euros. Currently, the number of individuals contributing to a private pension is 4.2% of those paying contributions to the compulsory state scheme and approximately 2.7% of the total number of employees (based on the Labor Force Survey).

In recent years, the market is growing rapidly, but its size in terms of number of members and value of assets still remains small. Currently, the financial market of Private Pensions, and why with a modest weight to the Gross Domestic Product, during the 9th month of 2022 marking an increase of 7.29% compared to 2021, reaching a total of net assets of 5.4 billion ALL. The assets of this market are mainly invested in bonds of the Albanian Government and, unlike the state pension, it is inheritable.

5. European Integration

Although almost all European Union directives were taken into account when drafting this law, it was still not drafted in such a way as to comply with Directive 2003/41/EC on the activity and supervision of institutions for the granting of professional pensions (IORP Directive)⁵. This directive is one of the most important directives in the field of voluntary private pensions and all member states must adapt their domestic laws accordingly. This is also the reason why our legislator is working again to improve the law of the voluntary private pension fund in its alignment with the provisions of the IORP.

The Financial Supervisory Authority also implements the Council of Europe Directive 85/611/EEC⁶ on the coordination of laws, regulations and administrative provisions regarding the actions undertaken for collective investment in transferable securities (UCITS); it applies the OECD guidelines and has met all the IOPS principles for private supplementary pensions at near satisfactory levels. For these reasons, the performance of this authority has been evaluated as very positive by the Albanian government.

The accession of Albania to the EU is a very dynamic process, which depends on the fulfillment of the Copenhagen criteria adopted in 1993 and especially on the ability of Albania to adapt to the continuous changes of the *acquis communautaire* and their full transposition in the system Albanian legal⁷.

From the above, the pension system in general and that of voluntary private pensions in particular still remain a challenge for the Albanian legislation and authorities. The reform of this system is not only a need but above all an urgency of the time. It is necessary to work more in the direction of informing the citizens about the importance of this system in order to form in this way such a civic education that includes the individual in the solution of various social problems. Only in this way can each of us ensure a better and more stable living at the moment of retirement. The approval and implementation of this reform as soon as possible would be a long-term solution of the pension scheme in Albania.

6. Conclusions

The pension system in general and that of voluntary private pensions in particular still remain a challenge for Albanian legislation and institutions. The Albanian government is working hard in the direction of reforming this system, but again the lack of information and civic education in terms of private pensions among citizens is very low. What should be done in this case is the alternation of the public pension scheme with the private one (voluntary and mandatory), thus making the individual aware of the solution to social problems. Only in this way can each of us ensure a better and stable living at the moment of retirement. The approval and implementation of this reform as soon as possible would be a long-term solution of the pension scheme in Albania.

⁵ Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision.

⁶ COUNCIL DIRECTIVE 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)

⁷ Financial Supervision Authority, Annual Report, 2011. Tirana 2011. p. 55

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