

## Legal regime of voluntary pension funds in Albania

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### Abstract

Albania, after '90s inherited a pension system, similar to the systems of the other ex-communist countries in Central Eastern Europe. During almost three decades, many interventions to the system have been attempted, in order to improve its efficacy, sustainability and adequacy. Population ageing, significantly higher migration rates, weak economic environment, higher rates of unemployment, informality, and many other economic-social factors, make more and more difficult and challenging to achieve the pension policy objectives. The first attempt to introduce the voluntary private pension scheme (Third pillar) started since 1995, but the approved Law remained simply "on paper" and not applicable due to collapse of pyramid schemes. In continuous pressure for increasing the pensions as well as eager to decrease the state budget burden, based on the WB & IMF recommendations, in 2005 the Albanian government took the decision to start implementation of the law, by approving the required set of by-laws as well as creating the respective law enforcement institutions. After that, the first three pension fund management companies have been licensed.

The main purpose of this paper is to examine the development of the legal framework on voluntary pension funds in Albania. What are the new concepts introduced by the law regime? What are the key issues occurred during its implementation? In conclusion, the paper comes up with some general conclusions regarding the necessary improvements to the legislation which will give a boost to the development of this market in Albania.

**Keywords:** voluntary pension funds, public pension scheme, legislation, reforms, fiscal incentives.

### I. Introduction

For a long time, the pension system in Albania relied on the public contributory scheme based on the principle of solidarity (PAYG). Despite ongoing reforms, the public pension scheme (PAYG) did not promise sustainability and adequacy in the long term and continued to be a burden to the state budget.

Almost all the countries of the region that had just emerged from socialist systems, had inherited pension systems where the state had the main role in providing retirement incomes, with a weak link between contributions and benefits, consequently a system characterized by low profitability.

Supported by the World Bank, Central and Eastern European countries according to their development features, started to reform their pension systems. Countries such as Poland, Croatia, Bulgaria, North Macedonia etc, started to reform the public scheme as well as to introduce fully funded pension schemes (multi-pillar system), in order to increase the sustainability and profitability of pensions for their citizens. The multi-pillar system is a system supported and technically assisted by the World Bank in the early '90-'94<sup>th</sup> in all Central and Eastern European countries.

It consists mainly in three pillars:

1. Mandatory contributory system, publicly managed, including PAYG- First pillar

2. Mandatory privately managed pension schemes- Second Pillar

3. Voluntary privately managed pension schemes- Third pillar

Thus, Albanian government approach, following the model and experiences of other countries with similar historical, economic, social, and political features, was to introduce as supplement of the public PAYG scheme the fully funded private voluntary schemes, which would function in addition to the public scheme.

## II. Voluntary private pension scheme introduction

In 1995, Albanian Parliament approved the Law no. 7943, dated 1.06.1995 "On supplementary pensions and Private Pension Institutes", *de jure* introducing in this way the voluntary fully funded pension scheme in Albania (Third Pillar). In drafting this law, the experiences of other countries such as the Czech Republic, Poland, etc. were taken into consideration. The Inspectorate of Private Institutes of Supplementary Pensions was established under the Government Decision no. 475, dated 22.07.1998 for licensing and supervising the private pension institutes.

The 1996-1997 crisis as consequence of collapse of pyramid schemes dramatically affected the political, economic and social situation in the country. When these schemes collapsed the Albanian government fell, and the country descended into anarchy.

Consequently, the law no. 7943, dated 1.06.1995 "For supplementary pensions and Private Pension Institutions" remained only *on paper*. Hence, Albania for almost 10 following years continued to rely only on the PAYG scheme managed by the Social Insurance Institute.

The Albanian government assessed the postponing of the functioning of any fully funded scheme, as long as the public lost confidence in any investment scheme, but also due to the unstable country political and socio-economic situation during this period.

However, the public scheme PAYG (pay as you go), showed a series of problems conditioned by demographic developments in the country, population aging, emigration, informality in the economy, increasingly had a low coverage from an economic and social point of view to the needs of the insured persons.

Around 2004, the World Bank and the IMF alerted the Albanian Government that it was late in reforming the pension system, and the consequences would fall on future generations. Under many pressures, Albanian government opened the green light to the operation of the voluntary private scheme in addition to public scheme.

A series of bylaws were immediately adopted that would enable the implementation of the law and from the institutional point of view the regulatory authority, Inspectorate of Private Institutions of Supplementary Pensions which directly report to Albanian Prime Minister, started functioning;

Only in 2005, the first three private companies were licensed in Albania, for managing voluntary pension funds, thus paving the way for the development of fully funded individual and professional voluntary schemes.

Since 2005, the voluntary pension funds and their management companies became an integral part of the pension system in Albania.

In 2006, the law no. 9572, dated 3/7/2006 "On Financial Supervisory Authority" introduced a new Financial Supervisory Authority, as the sole regulator of the non-bank financial services, including pension funds management, under its responsibility.

### III. New legal and institutional regime

On 10th of December 2009, the Albanian Parliament has approved the new law no. 10197 "On Voluntary Pension Funds"<sup>1</sup>. The new law transforms the legal framework on voluntary private pension schemes, which somehow was obsolete and did not reflect the macro-economic changes and demographic trends<sup>2</sup> in Albania.

The new law "On voluntary pension funds" has been drafted taking into consideration some aspects of *Acquis Communautaire* and international standards settled by international organizations as OECD<sup>3</sup>, IOPS<sup>4</sup>, bringing a new mentality with regard to the private pension funds management.

The Voluntary pension scheme in Albania continued to be a defined contribution (DC) one, operating as a supplementary to the public scheme managed by the Social Insurance Institute.

The new law aimed to further develop the pension funds in Albania by promoting their financial stability, security, and good governance, giving thus a boost to the development of capital market in Albania as well.

- What are the most significant concepts introduced by the new legislation?

Introduction of the new concepts like "pension fund", "fund units", "unit-holders" *Depository Bank*", as separate concepts not only legally but also operationally, from the Pension Fund Management Company, means the first transposition of international standards in the law.

The fund is not a legal entity, is just a pool of assets established under a pension fund contract, in ownership of the fund members. The contributions to a pension fund are owned exclusively by the members (unitholders) and the ownership parts are represented by units in the pension fund.

Is the management company that represent the fund acting in the best interests of the unit holders.

Based on article 20 of the Law, management companies must be established as a joint stock company, registered in Albania, where at least 51 % of shares or voting rights are owned by Banks or financial institutions. The management company' structure is based on one –tier system, according to Albanian company law.

Minimum capital requirement of the management company is at least of 15 625 000 ALL.

This capital may not come from:

- a) public loans
- b) Bank loans
- c) Prepayments or loans from third parties.

Aiming to increase transparency and reliability on private pension funds toward the members, management companies are legally obliged to publish at least once a year an updated prospectus, which should contain accurate information on the pension fund and management company. The prospectus shall be attached to the pension fund contract.

Depository Bank, a new institution introduced by the new legal regime, shall be responsible for safekeeping of the pension fund's assets. Furthermore, depository

<sup>1</sup> Published in Official Journal no. 181, dated 31/12/2009.

<sup>2</sup> In a long-term perspective, the projections show the population ageing. *Albania Social Insurance Review*, World Bank, 2006.

<sup>3</sup> Organization for Economic Cooperation and Development.

<sup>4</sup> *International Organization of Pension Supervisors*.

has also monitoring and controlling role, assuring that client's assets in the pension fund are managed in compliance with the law requirements, as well as pension fund legal documents, like prospectus, fund regulations and pension contract.

For this reason, in order to avoid any potential conflict of interest, there are legal restrictions that related party of the pension fund management company is not allowed to act as Depository Bank of the pension fund; Depository bank should be an independent third party.

The new legislation defines that investment policies of the fund, should be designed by management company in accordance with the risk diversification principles. Due to the either financial or social impact that pensions funds may have in public, particular importance is given to reducing the risks from investment of pension funds, therefore investments limits are settled by Regulatory Authority, in the Regulation no. 1, date 28.01.2010 "On allowed assets, restrictions and maximum limits on investments"

Tax regime introduced by the law, introduced some incentives with the aim to make pension funds more attractive encouraging the membership, based on the EET system (exempt, exempt, taxed) This system exempts contributions up to a certain level (200 000 ALL/year) and fund incomes as well but taxes the pension in payment.

The fiscal incentives should apply not only to the members, but also to different companies in the case they sponsor an occupational pension plan for their employees. The new legislation also settled a strong role of the Financial Supervisory Authority, as the main regulator of the market in terms of risk-based supervision and monitoring of pension funds, not only through increased frequency of on-site inspections, but also through various reports that management company must provide. In this way the state has been identified as an important regulator protecting the interests of pension fund members.

#### **IV. Key issues during implementation phase**

Currently there are four voluntary pension funds operating in Albania, privately managed by licensed companies established by Banks and insurance companies. Although three of them were operating for almost 16 years, still the development of the scheme is not at the levels expected, due to many factors.

These factors are linked not only with the difficulties in implementation of legislation but also with economic, social, and cultural development of the Albanian society, Furthermore, there is a lack of financial education and public awareness, particularly among young people, on the importance of saving and investing for the future. They need to be aware that now is the time to take their financial future into their own hands. However, awareness campaigns remain highly sporadic.

Regarding the legislation, it needs to be harmonized with latest EU provisions (IORP II Directive) and best practices. Thus, occupational pension plans creation and governance, the rights of employees and the obligations of the employer as the sponsor of the occupational pension plan are not clearly defined in the existing law. Furthermore, the law has not any provisions regarding the mobility of the employees and transfer of the vested rights.

On the other side, the lack of harmonization of the pension funds law with Albanian tax law, led to the fact that different categories (e.g., self-employed, individual pension plan members, part-time employees, households etc.) are not able to take advantage of the tax incentives. Consequently, these categories are not encouraged to participate in the voluntary scheme; This remains an open issue, directly impacting

the development of the private pension scheme.

## V. Conclusions and recommendations

1. Albanian legislation on voluntary pension funds need to be revised, in order being harmonized with latest provisions of EU legislation as well as reflecting several issues that have occurred during 12 years of implementation. Alignment with the IORP II Directive should start as soon as possible, in order to provide a clear framework for creation and better governance of occupational pension funds, including the rights of employees and the obligations of the employer as the sponsor of the plan. The IORP II Directive improves the way occupational pension funds are governed and clarifies the procedures for carrying out cross-border transfers and activities.
2. Strengthening pension fund governance particularly focusing on enhancing information transparency and disclosure to pension fund members.
3. Implementation of the fiscal incentives for all the categories including self-employed, individual pension plan members, part time employees, households etc., through harmonization of the pension funds legislation with the tax legislation. In addition, drafting guidelines on the procedures, required documents and relevant forms that members must fill out to apply for fiscal incentives, is further required by the law. Furthermore, encouraging the participation of the public into the scheme, through the introduction of further fiscal incentives is highly recommended. The market participants have continuously proposed to change the tax base during the benefit payment, taxing only the return on investment.
4. Strategic campaigns led by Albanian Financial Supervisory Authority in cooperation with other interested public agencies, trade unions, market participants, aiming to raise the public awareness and to enhance the financial education especially among the young people, should take place on regular basis. As far as, there is an increased responsibility of the individuals to save for their future pension, absolutely it requires that people understand the information in order to make 'appropriate' pension decisions. Given the complexity of pension systems, it is important that people have institutions that they can trust and that can give answers to their questions relating to pensions.
5. Due to solid performance of the existing pension fund management companies and the recent development of the capital markets in the country, an introduction of the mandatory private pension scheme (II nd pillar), could be included in the government pension agenda.

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