

# Measures to Improve the Transparency of Pension Systems in Crisis Management

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**Abstract.** Social security and pension policies pursued by states in response to the global economic crisis are the priorities at the present stage. The purpose of this paper is to analyze the functioning of the pension system on the example of Kazakhstan during the crisis and develop recommendations to improve the transparency of pension systems. Kazakhstan combined in pensions both pay-as-you-go and funded model should react with the responsible behavior of financial market participants, to the challenges of global crisis. Using the fact, that the crisis exposes weaknesses, take steps to further reform of pension system, the most important of which is increasing the role of government regulation. Responsibility involves the transparency and credibility. The paper presents the incremental steps to improve the transparency of pension systems.

**Keywords:** Transparency, crisis management, pension system, social security, pension funds.

## 1. Introduction

The crisis is the time of the strong. The system of pension funds is strong enough to survive safely past the tests. At the same time, it is clear that the measures of state support, the need for which is particularly acute in times of crisis, should be developed and implemented in the practice of pension funds in the near future.

The crisis in the global economy has revealed an urgent need to increase the level of state regulation and control in each country. Unfortunately, in practice this did not happen. Until now, a lot of regulations remain unaccepted that determine the practical activities of the funds and their level of openness and transparency.

Further development of the pension is not possible without further steps in building a system of state regulation and control. [6]

The role of the pension sector in the economy of the Republic of Kazakhstan cannot be overestimated. The importance of the step undertaken in 1997 to reform the pension system, phasing out the distribution model in favor of pensions funded at the present stage to be recognized. Amid the global population aging and the possibility of collision with the problems of social welfare such populous countries as USA, China, India, Brazil, etc. [7]

Table. 1 The role of the pension sector in the economy of the Republic of Kazakhstan

Dynamics of relative performance	2010/01/01	2011/01/01
GDP (bln. KZT )	17 007,6	21 815,5
The ratio of pension savings to GDP (%)	10,9	10,4
The ratio of pension payments to GDP (%)	8,8	8,4
The ratio of net investment income to GDP (%)	2,8	2,6
The ratio of total capital assets to GDP (%)	0,4	0,4

- Data from the Ministry of Economic Development and Trade
- Exchange on 11/01/01 EUR 1 = 210 KZT

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According to World Bank data obtained from monitoring the activities of pension systems in Eastern Europe and Central Asia, the profitability of pension funds in Kazakhstan was one of the highest and most dynamic in the period before the financial crisis in 2008, but the stock market crash caused serious blow to the pension system in Kazakhstan. [4] This led to a decrease in the rate of return of pension funds to a negative value, especially in 2008. High inflation and falling asset values of pension funds have worsened their situation. The pension funds showed negative returns of total pension assets (weighted average yield of over 5 years - 34.20%), compared with the accumulated inflation rate for 5 years (2006-2011.) - 61.98%. [8]At the present stage in the country, there are eleven funds, aggregate retirement savings equals to 2651382205 (thousands KZT) about 18 billion Dollars (\$). The following funds are the backbone of pension markets: JSC "Accumulation Pension Fund "UlarUmit" it accounts for 15.58% share of the pension market, JSC "Accumulation Pension Fund "SAPF" (18.04%) and JSC "Accumulating Pension Fund of Halyk Bank of Kazakhstan", a subsidiary company of "Halyk Bank of Kazakhstan" (33.10%). The remaining eight pension funds account for 33.28% of the market.[8]

## **2. Methodology**

Theoretical and methodological basis of research were the works of famous domestic (W. Iskakov, L. Gosteiko) and foreign scholars in the field of economics (Andrews, Emily S.), social policy (R. Rocha and C. Thorburn) and pension economics (R. Lee, A. Mason, D. Cotlear and S. Valdes-Prieto) and sociology of labor, social and labor relations and social partnership.

## **3. Causes and Conditions of Reforming the Pension System of Republic Kazakhstan**

With the collapse of the Soviet Union, Kazakhstan's pension system was destroyed, pension payments turned into a minimum aids on survival. In the 1990-th, Kazakhstan had changed the economic model of development, causing the country's GDP fell sharply, grew unemployment and inflation, budget was desperately short of money. As a result, the state could not continue to actively fund the pension system, pension arrears increased. Also the demographic balance had changed. Since 1980, the proportion of pensioners in the total population increased from 11.9% to 17.1% in 1997. [2] Rising unemployment and the spread of informal and under-employment have led to the exit of the population of the mandatory pension system, whose contributions have been the source for the financial basis of PAYG pension system. In order to prevent the deterioration of living standards of both the employees and retirees, to ensure the smooth payment of pensions in the future, reform of the pension system was carried out by the Government of the Republic of Kazakhstan. Preservation of pay-as-you-go systems in the country could aggravate the situation in the society. It was therefore decided to abandon PAYG pension system in favor of full funding. [3]

In 1997, Kazakhstan was the first CIS country to have conducted a pension reform, and introduced the funded pension system, the essence of which lies in the fact that every citizen should take care of their own old age, for which the state creates favorable conditions. The basis of the pension reform was adopted by the Chilean model. [3] The pension system in Chile has no distributive mechanism and is completely based on the accumulation of funds in individual accounts of employees and market capitalization of contributions. [5] Everyone entered into funded pension scheme receives a personal account where his pension contributions are accumulated and the amount of which is installed and secured. These funds are accumulated and invested by private pension funds, and when the depositor reaches the retirement age, they become the source of his pension payments. In addition to the foundations of the Chilean model Kazakhstan adopted and adapted the experiences of other countries in accordance with its own characteristics, therefore is considered to be one of the most successful reforms in the world. [3] The main purpose of the pension reform was to build financially sustainable and fair system that takes into account economic growth, balancing the labor contribution and pension payments through a personalized account of pension contributions. In addition, the funded pension system has been designed to solve the following problems: to alleviate social tensions, to gradually release the budget from the burden of pension payments, to facilitate the emergence of interest of citizens to earn a lot and legally. As a result of pension reform, future pensions should be preserved and increased, and the economy would get one more institutional investors - pension fund.

One of the most difficult tasks was to change people's attitudes towards their pension. This problem is relevant today. Abrupt transition to the new pension system has not happened because there was a funded system to solve all the pressing problems, but also a PAYG system remained.

Pension provision in Kazakhstan at present is a system of three levels, combining both mechanisms of PAYG and full funding pension system. [1] The first level is a solidary pension system, inherited from the Soviet Union after the collapse of the latter, based on "intergenerational solidarity", a source of pension payments becomes the state budget through tax deductions working population, and other revenues.

The second level - a mandatory funded pension system, with a 10 percent fixed size of pension contributions from the monthly income for the citizens of Kazakhstan, foreigners and stateless persons permanently residing in Kazakhstan.

The third level - the storage system, based on voluntary and voluntary professional pension contributions.

Transformation of the national pension system takes long-term period - a full transition to a funded pension system is projected by 2040. [3]

#### **4. Results and Recommendations to Improve Transparency of Pension System**

Further improvement of the regulatory process of placing the pension reserves, pension funds and investing involves a transition from quantitative methods to regulate the composition and structure of the investment portfolio of pension funds to the wide spread of the world principle of "responsible behavior", which allows institutional investors to respond more adequately to market challenges, while maintaining transparency and investment security.

At the same time, funds that meet certain standards developed by regulatory state bodies should be given the right to self-invest their assets in financial markets. This will improve the transparency of the pension system and, accordingly, will add credibility to their activities.

Such a formulation is possible in connection with the growth of professional development and pension funds management companies, and in connection with giving a cumulative pension funds to the status of a qualified investor.

Pension funds, as an integral part of the pension system, must meet the level of associating their tasks. This requires decisive action to improve the transparency of funds, including:

Clarification of the requirements for the structure of the property fund and its size;

Development and implementation of standards, governing the professional activities of pension funds;

Practical implementation into pension funds of internal control that meets the requirements of the law;

Enhancing the role of the actuarial control of pension funds;

Organization of regular training and professional development of pension funds.

All the measures to increase the requirements for pension funds' assets requires of careful study and legislative strengthening procedures for reorganization (division, separation, merger and acquisitions), as well as liquidation (if necessary - bankruptcy) of private pension funds to guarantee the rights of depositor and the insured parties.

It is also necessary to develop series of graduated measures for the following entities of the pension market- issuers of securities in increasing transparency and accountability of their activities.

The priority of these measures is:

1. Changes in the law on bankruptcy of credit organizations' regulations, governing that, along with bank deposits of individuals, demands and affordable retirement savings of the citizens are satisfied with the bankruptcy of credit institutions in the first place;

2. Transfer to the State law requirements for credit default bonds, which are placed in pension reserves, or retirement savings are invested, and their replacement by a government liabilities;

3. Formation of the authority or rating agency to monitor all local issuers, which is a mandatory activity, analytical review, and issue forecasts which organizations are in a state of default before. In the case of unscrupulous business conduct for the admission of willful default on the bonds of the above measure will

identify such cases and would be good preventive maintenance, since such a body would monitor the company for a long period of time.

The work of pension funds is intended for a long time. The average duration of the pension agreement is from 40 to 50 years. During this time, there will be more crises, and the pension system should be ready for them now.

## **5. Conclusion**

Retirement market barely recovered from the global financial crisis in 2008 and having felt the vibrations of the financial crisis in Europe we have to prepare a series of anti-crisis measures to the third wave of the global crisis. The demographic crisis and the problem of aging are not far off as well, although some foreign and domestic experts suggest that this problem has long existed, and we have been living with it for the past decades, this is especially true for Europe and Japan, where the population is aging rapidly. These are developed countries with an already well-established pension system, which can meet the threat of the collapse of the distributive system. Many domestic economists are still unable to reach consensus on the feasibility of pension reform (1998) in Kazakhstan. In a response for this a reform took place and lasted well over 13 years.

At the present stage it is necessary to coordinate and resolve problematic issues as possible. The paper presents the conditions of the transition from PAYG model of pension provision to the accumulative system, analyzed the current status of the pension market, and what measures should be taken to improve transparency in this field.

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