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Pension fund participants and fund managing company shareholder relations in Lithuania second pillar pension funds

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Abstract

Results achieved by the pension fund depend on how well they are managed or more specifically – on whether all decisions taken by the management are in favour of the fund participants. The goal of this paper is to examine how to harmonize interests of second pillar pension fund participants and fund managing company shareholders.

An interview with executives of all pension funds managing companies was performed twice – in 2011 and 2016. The answers allow to make conclusions about possible conflict of interest in pension fund management and measures taken by the companies and the state to minimize the risk. A survey of 507 pension fund participants was performed in order to obtain information on participants' attitude and expectations. Despite the fact that most of participants are dissatisfied with the pension fund performance results, they would not agree to allocate additional resources to hire more competent managers.

To protect the interests of pension fund participants the stability of the pension accumulation system as a whole must be ensured. Also it is important to promote mutual confidence of all interested parties, to provide participants with easily understandable information, reflecting real performance results.

JEL classification: H55; O16; G32

Keywords: Pension fund; Pension fund management; Corporate governance.

1. Introduction

Second pillar pension funds in Lithuania were introduced in 2004. Participation in second pillar is voluntary, employees have a choice to sign a contract with one of the pension funds managing companies and transfer certain part of compulsory social insurance contributions to one of its managed funds. In 2014 so called "2+1+1" scheme was introduced which was later modified into "2+2+2" in January 2016. This means that the pension

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fund participant in addition to 2% of compulsory insurance contribution may voluntarily pay an additional 2%, in this case an additional 2% of the average wage in Lithuania is added from the State budget.

However, pension funds managed by different companies had achieved different results although all of them operated in the same market conditions. Therefore, it can be assumed that the results achieved by the pension funds depend on how well they are managed or more specifically -– on whether all decisions taken by management are in favour of the funds participants. It is worth mentioning that in 2011 nine companies were in business, in 2016 only six have remained, but competition is still very tough.

Recently ideas and methods of corporate governance often offered to be applied to pension fund management. This methodology was developed in order to deal with a so-called principal-agent problem, when shareholders due to their large number and different locations cannot organize themselves and ensure that company's hired managers work exclusively on shareholders, rather than their own interests. It would not be acceptable to use the term "corporate management" for the management of pension funds because, as we shall see later, the pension fund and the company have some essential differences. In this paper we will use the term "pension fund management".

The pension fund can have hundreds of thousands of participants living in different areas, who do not know each other, unable to organize themselves in order to reach an overall agreement and to represent it. Therefore, pension funds managing companies face similar problems to the mentioned above, i.e. how to align the interests of the pension fund participants and the pension managing company shareholders.

In Lithuania pension fund managing companies are limited liability companies with one shareholder (parent company). Such second pillar pension fund management model is not very common, originally used in Latin America and the post-Soviet space.

The goal of this paper is to examine how to harmonize interests of second pillar pension funds participants and funds managing company shareholders.

In Lithuania participants of pension fund is responsible for many risks. Participants have to decide what kind of a pension fund (low or high risk) to participate in, i.e. they have to select the risk tolerance and the expected return on investment in short and long run. For such a decision making process at least basic understanding of the functioning of the financial market is necessary. We suppose that unfortunately it is not the case. A survey on people's comprehension of financial investment has been carried out in order to assess participant's expectations, attitudes to the pension fund performance, determine what criteria they apply when choosing pension fund. A quantitative survey method has been used for the investigation of pension funds participant approach and has been performed by the company specializing in this field.

An interview with executives of all pension funds managing companies was performed twice – in 2011 and 2016. Qualitative survey method was chosen, as expected, that the management models of different companies may differ in essence and therefore, answers "yes" or "no" might not disclose important information. The answers obtained allow to make conclusions about possible conflict of interest in pension fund management and measures taken by the companies and the state to minimize the risk.

2. Background

Pension fund can be influenced by many interest parties who have different or even contradictive interests, all of them trying to divert fund management decisions towards their interests (Blake, 2006b; Mackenzie, 2010). Fund management decisions can be divided into the set of sequential stages. One person or institution can be responsible for a few stages but also distinct stages can be carried out by different persons. Impact of different stages on final result is unequal (Muralidhar, 2001) therefore some stages require more attention and resources other – less.

The fact, that fund **founder** (or sponsor) had made a decision to establish the fund means, that he has interest in results of fund performance. A reason to establish the fund may be legal (to comply with legal requirements), social (funder seeks to create better life or work environment to certain group of employees or population) or commercial (funder expects to provide to the fund various services and earn a profit). Because an influence of the funder in the fund management usually is important or even crucial, it is important to understand his interests.

Beneficiaries – necessary part of each fund, an existence of the fund has no sense without them. Participation in pension fund is in one or another way obligatory in all countries (Martin Schludi, 2005). The goal of beneficiaries seems evident – to receive as maximize benefits in retirement, therefore they are interested only in one indicator relation of return and risk. But in reality things are more complex. Most beneficiaries at certain time are contribution payers so interest of fund participant changes over time. How much certain person is able to harmonize his current and future interests depend not only on financial literacy, which is possible to gain, but also on general culture of the society, which can be changed only in the long term (Mitchell & Utkus, 2004).

Contributions are payed by employees and by employers. In some pension schemes contribution of employer is not defined, so he is called sponsor, because has an obligation to ensure fund final result (Muralidhar, 2001). Interest of such an employer is to reach final result paying less contributions, therefore he is very interested in fund management efficiency. In defined contribution pension funds which include second pillar pension funds in Lithuania both employee and employer pay fixed contributions which not depend on fund performance results. Contributors of this kind if they are not other interested party have no direct interest in fund performance.

In Lithuania second pillar pension funds are allowed to lend only in order to keep short term liquidity. Therefore, amount borrowed are small and for short time so banks and other potential **lenders** do not have too much interest.

Conventional market participant relations between pension fund and **other financial market participants** would be desirable. But it is possible, that one of interested parties of the fund, for example, sponsor also is participant of the financial market and has interest to sell his services or derivatives to the fund. Conflict of interests in this case is possible and measures must be taken to manage it.

In addition to interested parties mentioned above one more interested party is a **state**. In a case of low benefits from the pension fund most of the states provide certain financial support to their citizens. Therefore, state primary objective is to ensure, that sufficient amount of resources would be accumulated in the fund.

Pension fund managers have to combine interests of many parties, but the most important of them are interests of pension fund participants because on their interests fund was established (Bripi & Giorgiantonio, 2010; Clark, Caerlewy-Smith, & Marshall, 2007). Analysis of pension fund management rises following questions:

- What might be fund internal structure, functions of executive, board, council and how it depends on fund legal status?
- What are fund governing bodies election or appointment rules? Can fund participants delegate their representatives?
- What are responsibilities of governing bodies, which kind of decisions they can make?

Pension fund management structure depends on legal status of the fund. There are two types of pension funds (Stewart & Yermo, 2008). **Institutional** pension fund is independent organization having legal status and legal capacity. Fund is managed by board or council, so it sac be sayed, that fund is managed from inside. **Contractual** pension fund has no legal status, it consists of assets accumulated into one account by many owners. Fund is managed by external institution usually by the bank, insurance company or pension managing company. Strategical decisions are made by the board of managing company but independent supervision council whose role is to ensure that fund operates exceptionally on the interests of the participants is also possible.

Other important issue – qualification of the board members which varies in different countries (Ambachtsheer, Capelle, & Lum, 2007). Highest requirements set in Finland, where a candidate to the position of chairmen of the board must not only have degree in economics, but also 7 years' experience in investment management. One more proposal is so called fiduciary management. It means, that all decisions have to be delegated to external person or organisation, who has any relations to the fund or its assets (van Nunen, 2008).

Perhaps the most widely cited study (Ambachtsheer, Capelle, & Lum, 2006) reveal the relation between quality of pension fund management and fund performance results. In a study pension fund performance results in Australia, New Zealand, Canada, USA and Europe were examined. The actual return on pension fund was compared with a benchmark of passive investment, quality of management was identified by interviewing managers of pension fund. Conclusion, that in pension funds where modern pension fund management methods were applied return is by few percentage higher. In next article (Ambachtsheer et al., 2007) it was found, that the weakest chain in fund management is inadequate selection of fund board members process.

Main stages of fund assets management are the following: to set fund objectives, to establish strategic asset allocation and funding policies, identify tactics to outperformance, develop risk management tools and processes, do attribution and risk-adjusted performance analysis, reward skill-based activities (Muralidhar, 2001).

The fund can be sustainable in a long run if its assets balance will be ensured in a short and in a long prospective. Therefore, first, what fund managers have to do is to identify fund liabilities, amount of future contributions, and decide on investment activities to be taken in order to keep a balance. It is important to have in mind, that not only long term, but also short term balance must be kept. Forecasting a balance is complicated process requiring sophisticated actuarial calculations which differ for different type of funds.

In defined benefit pension funds the final payment amount as a certain percentage of future average wage usually is agreed. Participants do not have individual accounts, exact data of retirement is known, so calculations would be simple if average wage at that future time is known. Therefore, pension fund can with certain probability calculate its future cash flow. Because there are no individual accounts, all fund assets belong to the fund and risk is shared both inside of cohort and between cohorts. Such a fund can take more risk and therefore generate higher return (Blake, 2006a).

In defined contribution pension funds contribution amount is defined as a percentage of wage. Funs of this type do not assume obligations, amount of benefits depend on successful fund performance. For this type of funds clear definition of targets is especially important, because fund performance can be evaluated only comparing with them. Participants are interested in setting targets, because their future income depend on them (Blake, 2006a).

3. Research methods

The object of the research – second pillar pension system in Lithuania, its participants, stakeholders, their legal, financial, and social relationships is too broad to be discussed in single topic. Therefore, the research of the topic is concentrated on one aspect – conflict and coordination of the pension fund participants' interests and the pension fund managing company shareholder's interests. There are three parties, directly involved into this process – the pension fund participant, the pension fund managing company represented by its executive and shareholder of the pension fund managing company. Each of them operates within the limits set by law and internal regulations of the company, guided by its own interests necessarily combining them with other party interests.

Therefore, the investigation started from the legal environment in which all parties must operate e.g. Lithuanian legal framework. Existing legislation determines status of the pension fund and status of managing company, rights and obligations of fund participants, fund managing company, supervising authority.

However, fund management is not only formal relations, but also the individual decision-makers approach which, as it was briefly discussed in previous section, might have crucial impact on fund performance. This informal approach was object of the second part of the research – executives of all pension fund managing companies were interviewed in order to obtain their view on interest conflict and its harmonization problem.

Finally, it is clear, that the representation of interests of the participants depends on the participants themselves and on how they evaluate the situation in general, what information they have, how much they are active, who shaped their approach on the pension fund. A survey of 500 second pillar pension funds participants was performed and results were discussed in the third part of the study.

4. Legal regulation of second pillar pension fund performance

Second pillar pension funds in Lithuania are managed by private businesses entities, more precisely by investment companies established by banks or insurance companies. It means that pension funds in Lithuania are contractual. Like every business entities fund managing companies have main purpose to create value for shareholders. However, in order to do that the business must have customers, and this is possible only when it creates value also for them. In completely free market case it should be ensured by the competition between companies. This might be applicable to the third pillar pension funds, as the market for the companies and their customers in terms of mutual relations is free – both the company and the customer are free to choose whether to enter into a contract, whether not, there is much room for negotiations. For the second pillar pension funds the situation is slightly different – once chosen participation becomes obligatory. Participant may switch from one fund to another, from fund managed by one company into managed by another, but there is no possibility to leave the system completely. In 2011 there were nine, but today remained only six alternatives when choosing a service provider. Finally, even before choosing the participation in the second pillar, the alternative is only one – state

PAYG system, which is also experiencing not the best times and is not very attractive for the persons with high income.

In Lithuanian pension funds participants and shareholders do not interact directly, therefore triangle mentioned by Wilson (2008) would like to be 'straightened'. The pension fund management company looks like be trapped between millstones – on the one hand shareholders require to be profitable, participants on the other require to use resources to implement their goals.

Since Lithuanian pension fund managing companies have only one shareholder therefore they are easily and effectively controlled by it and corporate management problem in the usual sense (Bripi & Giorgiantonio, 2010; Clark et al., 2007) when question is about big number of fugitive owners and managers (principal-agent) problem for Lithuanian pension fund managing companies (not funds!) is not an issue.

The legal status and management structure of pension funds are established by Law on Pension Accumulation and Law on Pension Reform. To create a complete image must be examined Law on Companies, Law on Insurance, Law on Collective Investment and number of other legal acts, but the key provisions set out in two mentioned above laws.

Pension funds itself are not separate legal entities, all decisions are made by the joint stock company managing the fund. Company's management is regulated by the Law on Companies, the management hierarchy consists of the shareholders' meeting, the company's board, the administration and the head of administration. A specific requirement for pension fund managing companies – a board is obligatory, while that for joint stock companies in general is not.

Management rules for each pension fund are approved by the board of the company managing that fund and supervision authority – the Bank of Lithuania. The fund may start its activities only after Rules are approved. The law on Pension accumulation provides that the pension fund Rules must define following issues important to our present topic: the rights and obligations of pension fund participants, the rights and obligations of the company managing fund, fund's investment strategy, a procedure for the reporting of pension fund participants, the depository name, registered office, rights and obligations. It is also requirement that the management company must notify each pension fund participant of the respective pension fund rule changes not later than 20 days before the changes come into force.

Which of these provisions is the most important? As mentioned above, investment strategy results from 80% to 99% of the fund's investment returns. However, strategy has been approved at the establishment of the fund, while it is not a single participant, and hence the interests. Although the law requires the strategy must be reviewed at least once in 3 years, the provision that the fund Rules, which part and investment strategy is, must be approved by the Bank of Lithuania, as well as a provision that all pension fund participants must be informed about changes in written form makes the Rules and the investment strategy virtually invariable. "The pension funds investment strategy is to provide pension assets investment procedures and methods for risk assessment, risk management principles used in risk management procedures and methods of strategic pension asset allocation within the existing pension accumulation contracts related to the duration and origin." Therefore, it can be said that the most important part of the pension fund solutions had been laid down for the entire life of the fund.

Other two interested parties, who may impact pension fund managing company decisions – the shareholders and the state. Service providers may influence fund's performance by negotiating prices for services or providing higher quality services. The pension fund participant is not in the scheme, because the only way he can influence the fund – to switch to another fund managed by another company.

The participant signs a contract with the pension fund managing company, not the fund. A participant before signing a pension contract he must be acquainted with the pension fund Rules. This provision of the law shows that the participant, by signing a contract agrees with the fund Rules and does not claim to their amendment initiative. The only important for our topic participant's rights prescribed by law – to obtain information related to company's management activities and to receive from the company information about his pension account status, funds investment strategy and return on his investment, companies financial performance audit findings.

If compare the pension fund's asset manager's legal relationship to assets he manages, it must be concluded that it is the same as in the majority of other countries of the world except for the *trust* type funds in the United Kingdom. "Pension assets are shared ownership of the participants. The management company manages, use and dispose the pension assets of property trust status.

Legal provisions on obligations of pension fund managing company are strict enough. The management company must act in good faith and reliability of the participants interests and credibility of the market; act precisely, professionally and carefully, to implement and use the tools and procedures necessary; disclose to participant sufficient and relevant information; try to avoid conflicts of interest and, when they cannot be avoided, ensure that participants are treated fairly; to ensure that management procedures and accounting records systems are reliable and that all the counterparties, content, time and place could be identified; to determine whether the assets are invested in accordance with the conditions laid down in law and regulations; to establish internal controls to control managers and employees securities transactions in accordance with the supervision authority requirements; to keep transactions documents for at least 10 years from their maturity date, if other legislation do not set longer term; have an organizational structure preventing conflict of interest between the company and its participants, between different participants; to ensure that decisions on asset management makers have qualifications and work experience set by the supervisory authority [Law on Pension Reform].

In six pension funds investment strategies investment goals were not defined. In several investment strategies only the provisions of the Law related to the investment restrictions and risk management were replicated. In most strategies list of Stock Exchanges where fund intended to invest contains from a dozen to more than 30 Stock Exchanges. Having in mind that monthly amount invested not exceeds tens of thousands of euro extent of those activities is evidently unreal. In a couple of strategies AMEX, which was bought by NYSE few years ago, still exists.

In summary, it can be said that: formally pension fund participant has no influence on fund managing company decisions; legal regulation is strict enough to oblige the pension fund managing company operate in participant's interests. It can also be assumed that formally the investment strategy is approved, because required by law, but in reality every company has informal procedures and guidance.

5. The pension fund participants and pension fund managing company shareholders' interests' conflict: company executive's view

Semi-structured interviews with executives of all 9 second pillar pension fund managing companies were performed in May 2011 and repeated in May 2016 with executives of remaining six companies. Three of the executives remain in the same position after 5 years and three are newly appointed. Goal of interview was to gather as much as possible informal information on which side – the company shareholders or the fund participants interests are more important for pension fund managing company managers, the manner in which these interests are balanced, what external factors influence this process.

Question 1. What is your view on so called "2+2+2" scheme, the possible obligation to establish a life-cycle fund, the idea to create a council of experts to prepare common investment strategy for all pension funds? During 2011 interview "2+2+2" scheme was at project stage and was implemented in 2014 while other two proposals are still drafts.

In 2011 none of the respondents evaluated "2+2+2" project positively. The most positive approach on this proposal was "well, it is good that second pillar is not abandoned at all". All other respondents rated scheme proposed as bad or very bad. Such an approach was based on two arguments. The first – according to the opinion of respondents such a decision will cause that the absolute majority of Lithuanian residents will save in II pillar pension funds only 2% of the salary amount. For those who earn less than the average wage the scheme looks financially attractive, but these residents have no money to raise their contribution by 2%. For those who earn considerably more than the average salary scheme looks financially unattractive, making III pillar more beneficial for them. Therefore, only small part of the Lithuanian population will save enough to obtain an annuity, while the rest will be paid in a lump sum or periodic payments. The second reason – there was a fear that transformation will require the pension funds managing companies in additional investments.

The idea of life-cycle funds, respondents evaluate different from the "need" to "populism". However, in 2011 only one of the respondents did not object to the idea of life-cycle funds to be introduced in the near future. The remaining stressed that developing life-cycle funds pension fund managing companies will incur additional costs. They offered to postpone introduction of life-cycle funds for the period, when contributions and company's income will be recovered. Two of the executives expressed doubt about willingness to invest because of unclear pay-back of such an investment. They feared that shareholders can make a decision to leave business at all. In

2016 because of recovered contributions executives view was more optimistic, no one mentioned about possibility to leave pension fund managing business.

All pension fund managing companies' executives were sceptical about the possibility to establish a board of experts to develop the investment strategy, objectives for all second pillar pension funds. View was reasoned by the fact that investing in the financial markets requires specific experience in particular area and to be a "famous economist" might be not enough to find the best decision. Some companies use expertise of their parent companies and believe that it is more reliable.

In summary, the answers to this question can be argued that the pension company managers are aware that companies need to take care of the interests of fund participants, but shareholders clearly more important; as well as all pension funds operating company executives more or less sceptical about the Lithuanian people's awareness and understanding of the need to save for old age.

Question 2. Are you satisfied with the market share of your company?

All respondents indicated that the market share is very important, since company's revenue and profitability directly depend on it. The latter was pointed out as an important factor by all pension fund managing companies executives. It is worth to stress an answer, that important is not a number of participants, but number of "rich" participants. Companies were not very interested to expand the market share by collecting newly entering labour market employees because they do not have the funds accumulated and corresponding deductions. Deductions from monthly transfers represent a minor share of the income.

However, only one respondent pointed out the plans to increase market share in near future. All other respondents indicated that to change their market share is almost impossible because the participants are passive and allure them of the various proposals most companies are currently reluctant. Profitability in this business is small, so the investment pays off within 7–10 years. As trust in the state in 2011 was lost, and shareholders are hesitant of these long-term investments. Only those that are expected to pay off within 2 years are approved. In 2016 distrust in state policy was not mentioned, but the propensity to invest still was low.

It was mentioned in previous section that the size of the fund is important indicator for greater return on investment and risk ratio, because of risk spreading between the participants. However, none of the respondents mentioned importance of market share as a number of participants, not total revenue. Therefore, interpreting answer to this question can be concluded that the executives of the company's first think of ways to make a profit, not to increase return or decrease risk.

Question 3. How do you assess the fact that collected contributions will be transferred to pension funds monthly instead of quarterly?

Respondent divided into two groups. First group supported decision as good because then investments can be made in small portions, which reduces the risk, as well as the monthly transfers guarantee a stable, predictable cash flow, so if the fund needs to pay benefits, there is no need to hold cash reserves or withdraw investments to fulfil obligations in cash.

Another part of respondents pointed out that the transfers of funds on monthly basis is bad, because during transfer time transition of participants from one pension fund to another is stopped for a few days. In particularly decision is bad for those companies in which more people come in than go out, because during the time, when the transition process is suspended, participant may change his mind and stop transition. Moreover, transfer in each month increases the company's labour costs, and thus operating costs.

In summary, it can be said that one part of the pension funds managing company's executives primarily focuses on reduction of investment risk and increased efficiency, so act on the benefits of the pension fund participants, the other part – the company's cost reduction activities and thus shareholders benefit.

Question 4. What are main advantages of your company to compare with competitors, which you communicate to your potential customers? If I am/I am not your company's customer, what are the reasons for me to stay/move into pension fund managed by your company?

Most managers when asked this question were confused for short and then listed a few points.

The following advantages were mentioned: strategic and investment decision-making professionalism, competence (indicated by five heads), operational transparency, complete separation from the other company and shareholder activities (3), better actual performance, for example, lower funds value drop during the crisis, faster unit value growth in the after-crisis period and nowadays, better return/risk ratio (3), a wider choice of funds (2), the security provided by the group's reputation (4), lower service charges (4), specific investment strategy decisions

(5), the rapid growth of the company (3). All respondents pointed to the advantage of competent communication with the customer, convenient service, the provision of information, increasing customer financial literacy.

It should be noted that some of the responses were more marketing slogans than the real difference from other companies. For example, the group's reputation equally important for all companies and reputation of all of them is generally the same. Other example – answers about the specific investment decisions. Some respondents said that investing directly in equities is an advantage, because it is precondition for higher returns, while others said that their company's advantage – stopping investment directly into shares, because investments into derivatives are cheaper and with smaller fluctuations.

For our present topic is not so important whether the answer correspond to financial theory, how important are respondent's goals or interests. Therefore, the answers could be divided into two groups. The first group includes the answers, based on the company as a business entity competitive advantage, e.g. the opportunity to earn more profits. For example, strategy of informing current and potential customers about companies managed funds results compared with the corresponding funds managed by other companies mean for attraction of more participants and increasing income. Another group includes the answers, highlighting the satisfaction of company's managed funds participant's interests. Since most of the answers belong to the first group and only few – to the second a conclusion, that pension fund managing companies executives primarily are concentrated on business goals, and only then on service to fund participants.

Q5. What objectives company shareholder set for the company? Are goals settled by shareholders for the fund (not for the fund managing company)?

Shareholders control pension funds managing companies by establishing Supervisory Board. Members of the Board usually are employees of the shareholder, some employees of the company can be involved. An executive always is in the Board, at least participates at the meetings.

All respondents indicated that shareholders had established objectives only for the company, targets are the same, as for majority of other business – profit, sales plans and so on. Targets for the funds are not established by the shareholders, it's company's own competence.

All companies had to develop and provide to shareholders for approval business plan, which revenues and expenses have to be planned in accordance with at that time applicable law. Plans must be amended and reapproved when new regulations come into power. By investing shareholders expect to earn at least the average of the banking sector return on investment ROI.

In summary, the answers to this question lead to the conclusion that establishment of pension fund managing companies for the shareholders a normal financial business investment.

Q6. What solutions in your company are called strategic and how often are they reviewed? Which principle – "buy and hold" or active investing is of priority for your company?

It was mentioned in the previous section, that investment strategies determined in fund rules for equal risk funds do not differ much. Basically they are copied from the regulations issued by Supervisory authority.

All respondents indicated that most important decision – approval of investment trends. These decisions in some companies are revised quarterly, in other – every six months. All executives emphasized, that investment strategy means the borders in which company can operate. Daily decisions might be very dynamic but strategy is difficult to change. It is why there is no need to limit yourself by approving very detail strategy. In reality, each company has been working in a given much narrower corridor, so it can be said that these are internal limitations due to the investment directions. In theory, a few month period decisions are attributable to tactical decisions, pension funds managing company has the ability to adjust the portfolio according to the market situation and the situation of the fund. Such an investment portfolio management can be treated as active. Most of the pension fund rules state that equity investment "not more, than n%". This means that only the upper limit is determined, in reality, the proportion of shares may be lower and the fund, which, according to its name is designed for a long period investments and has to generate a higher return (and risk) is actually less risky and profitable.

In summary, the answers to this question suggest that at least some of the companies that manage pension funds apply modern asset management instruments. Investment strategy defined by fund rules says little about the real expected return on the fund's investments and risks, therefore even the educated participants do not have the possibility to choose the fund in accordance with their calculations.

Question 7. What is the company's management structure, what is strategic investment decision making process?

In some pension fund managing companies company management is separated from fund management, i.e. there are two bodies – one (usually called Board and appointed by shareholders) for company management, another (usually called investment committee and appointed by Board) for strategic investment decisions. In other pension fund managing companies, the same council or the board are responsible for both – company management and pension fund management decisions. Questions about the choice of auditor, the depositary selection are made by company managing board. Proportion of first and second type companies was 5/4 in 2011 and 5/1 in 2014.

In part of the companies company's management is separated from the pension fund management, and changes in this area would not be difficult to do.

Question 8. What people are involved into the strategic investment decision-making body (the shareholder representatives, the company's employees, independent experts)?

In five pension fund managing companies investment committees are established, and they make decisions on strategic investment allocation. Usually company employee's work at the investment committee, some consultants from other companies of the group can be attracted. Independent trustees who represent the fund participants or other interested parties are not in the committee.

It can be concluded that the main pension fund management decisions are made by collegial body, so human error risk is managed. Company regardless of the size of funds managed needs to have skilled professionals competing for them in the labour market. It must be kept in mind that the reduction of the company's profits may cause the investment decision making specialist qualifications risk. In pension fund managing companies, which fund assets are managed by dedicated investment committees, inclusion of independent trustees would be easy. The only question is who will pay for their services. Today all management costs are loaded on the company itself and do not depend on results achieves. Therefore, companies have a little interest to hire expensive professionals.

Q9. Who is making everyday investment decisions, what rights they have?

Two pension fund managing companies purchase investment service from foreign entities (members of the same group). Working for big centralized group employees can be better trained, achieve higher investment decision-making skills, share corporate experience, ensure faster growth and save resources. A physical location of the specialist is not important. Working in the group they can achieve deeper knowledge of the investment market they work in, the market characteristics and opportunities. In other pension fund managing companies daily investment decisions are made by dedicated employees of the company. They are free to decide within Investment Committee approved limits. Although one company has established a rule that even inside of defined limits direct investments in shares must be approved by the Investment Committee. All investment decision making specialists must have a license, but anyway decision making processes in different companies are different.

It can therefore be concluded that not all pension fund managing companies have enough own human resources to ensure consistently high quality investment decisions, but the problem is solved by outsourcing a function.

Question 10. What are investor's performance evaluation criteria?

All companies in assessing the performance of the investors require to achieve a defined return on investment, which is usually determined as the "market index + a certain percentage", as well as not to exceed defined tolerances. One of the respondents noted difficulty to determine the index, because often there are no comparable.

Most of the companies compare their with competitors' results.

Two executives mentioned the importance of not to reward employees on short-term results. One respondent mentioned that they take into account not only the investment results, but also the entire company performance, as investors duty is not only accept and implement investment decisions, but also to prepare recommendations to the Investment Committee for the adjustment of the investment strategy.

All pension companies had developed a number of internal rules and each employee therefore, has to find the best decision within limits defines by the law and internal policy requirements.

In summary, it can be said that in all companies' investors performance is evaluated according to examples of best practices.

Q11. According to what criteria the performance results are evaluated?

All pension fund managing company executives emphasized shareholders requirement to operate profitably. Also other indicators like market share, customer satisfaction (surveys carried out) are introduced. Two executives pointed out strict requirement of shareholders to operate within existing legislation, avoid possible offences and notes from controlling authority. Each company also measures employee satisfaction. In 2011 pension fund performance was not in scope. In 2016 only one company included pension fund ROI into evaluation criteria.

Table 1
Recommended funds for different age groups (2011).

	Up to 100% shares	Up to 70%	Conservative
Swedbank	Younger than 40	Younger than 50	Over 55
MP funds Baltic	Younger than 45	Younger than 55	Over 55

It can be concluded that the shareholders of the companies treat them as simple business entities.

Q12. What information do you provide to the fund participants?

All companies provide to participants information defined by law. Even public information is strictly controlled by Supervisory authority.

All executives both times (in 2011 and also in 2016) emphasized low financial literacy of the population. Some of young population are risk averse and participate in conservative funds, some of elderly take too much risk. Most of companies provide to their clients information, organize trainings.

The answers to this question showed that pension fund participants information problem – one of the most sensitive. Participants have incomplete, sometimes misleading information.

Q13. Our research is on the fund participants and company shareholder interest's conflict. Maybe you have other important information on that issue?

Most respondents did not see any real conflict of interest, or if it exists, is successfully managed. Pension company's income depends on assets accumulated, so both participants and shareholders are interested in fast grow of assets.

6. Participants approach

In Lithuania second pillar pension fund participants make their own decision which pension fund to participate in and correspondingly what return to expect and what risk to take. The ability to make a decision without intermediaries eliminates agent problem. But is the best final result always ensured? The aim of this research was to identify does decisions made by fund participants are in line with recommendations of investment professionals, what information fund participants use when making decision, what is participant view on the fund performance results. Survey results can also give an information on appropriateness of the scheme, when participants chose asset allocation proportions and the risk on their own.

507 completed questionnaires were received during a survey. A composition of respondents by sex and age group deviates from that of entire population less than 2%. A composition by sex is important, because it was found (Mitchell & Utkus, 2004), that women more tend to save than men, they are more risk averse. Distribution of respondents between pension fund managing companies for three biggest companies, who cover over 80% of participants, correspond that for pension fund participants.

Distribution of different age group participants in funds of different risk was analysed. Data was obtained from State Register of Pension Fund Participants. A significant deviation from professional recommendations was identified.

Almost half of participants of conservative investment funds were younger than 50 years old, and even 23% younger than 40 years. In equity funds 19% of participants are over 50. It was found that very few of them belong to the wealthy and high income group and can take a risk on purpose, because income form accumulated pension is not crucial for their wealth after retirement. Most of participants in this group take excessive risk and in case of corrections in equity market can face revenue shortfall.

Recommendations of investment professionals representing two banks are provided in Table 1. As we can see many pension fund participants are in different, than the recommended, funds what can cause lower than possible return or fall of assets without time for recovery.

What has a major impact on participant's decision when choosing between high or low risk funds? Answers are provided in Table 2. Even 54% of respondents referred to the recommendations of pension fund managing company employee; 33% pointed out their age and suitable risk. Fact, that almost one third of the participants understand (not always correctly) principles of their choice can be valued well. It is worth to point out, that very

Table 2
What had major impact on the decision on fund risk.

I‘m risk averse	It corresponds to my age	Recommendation of fund managing company employee	Friends advice	Don‘t know
9%	33%	54%	4%	< 1%

Table 3
Where from do you get information about fund performance results?

Fund managing company webpage	Letters sent by fund managing company	From media	Fund managing company employee	Other, don‘t interested
34%	43%	19%	3%	1%

good conditions for the improvement exist. If employees who distribute contracts have big impact on participants, it means that channel for information exists and just necessary to use it effectively.

Reasons for the choice of pension managing company. 23% of participants made a decision randomly "because agent of that company appeared first". For 29% of respondents reputation of the company and its parental company was primary argument, but for the majority (36%) of respondents crucial was advise of their bank employee. A fact, that many participants respect professional opinion is positive, but on the other hand too big influence can precondition certain manipulations with information. Especially having in mind that bank employee is directly interested to attract more clients.

Data about most popular sources of information is provided in Table 3.

Major influence is made by information delivered by letters and in the Internet. This information is strictly controlled by Supervisory authority. Some pension fund managing company's executives mentioned that their competitors sometimes spread misleading information. The only way to that is during fund participant and fund managing company employee meeting. Therefore, the fact that this source of information has low influence can be valued as positive. Despite of that it is worth to continue standardization and control of information delivered to fund participants.

Pension fund managing companies executives expressed an opinion, that many fund participants are passive, not interested what is happening with their accounts. Survey results give opposite information. Only 1% of respondents never interested about fund performance. 25% of participants will be interested once per quarter or even more often, majority (74%) – once per year.

Less than half of the fund participants are satisfied by fund performance. But when asked would they like to pay additional fees in order to hire qualified professionals to manage their investments, only 29% answered "yes".

7. Conclusions

Pension fund managing company has to combine interests of different interest groups the most important of them are pension fund participants and shareholder of the company. In theory conflict of interests between these parties always exists. Conflict can be managed by state regulation or applying modern methods of fund governance. The latter means involvement of fiduciaries, delegated by fund participants into fund managing council. In normal conditions legal regulations implemented in Lithuania are adequate but conflict can be amplified by economic recession or other unusualness. For public defined contribution contractual pension funds, as they are in Lithuania, solution is still to be found.

Major interest of pension fund participants is high investment return and risk ratio. The biggest influence on this indicator have proper asset allocation, choice of investor who is able to reach defined benchmark and risk tolerance, clear milestones for fund performance. In general clear and precise targets for the fund are very important, but in Lithuania this decision does not belong to fund management – it was made at the stage of establishment the fund.

In Lithuania pension fund participants, not fund managers, are responsible for the most important decision – a choice of investment return and risk ratio. When the fund was chosen, ratio mentioned above is defined. For this reason is very important to ensure delivery of clear, precise, objective, timely information to pension fund participants. For passive participants, who have no contact with the fund for several years automatic fund selection wood be useful to apply.

Pension funds are managed by business entities – joint stock companies, which must operate profitably. Executives of companies recognize that in theory conflict of interests between fund participants and fund managing company shareholders exists, but are aware, that interests of fund participants are secured by state regulation and competition between companies.

Study revealed that recommendations provided by fund managing company employees have the major impact on fund participant decisions. Result can be valued ambiguously. On one hand it is positive, because reliable channel for information distribution and participant education exists. On other hand fund managing companies can manipulate participants view by providing partial information.

Currently major task to protect pension fund participants interests – ensure stable and predictable environment for participants and funds, promote mutual trust and understanding of mutual benefits. Provision of precise, fund performance results objectively reflecting information is most urgent issue today.

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