The Governance of Occupational Pension Funds and the Politico-Economic Implications: The Case of Austria

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This paper analyses the efficacy of the governance structure of occupational pension funds (Pensionskassen – PKs) in Austria. Based on the results of the analysis, it further investigates the politico-economic implications for the political and legislative process regarding recent changes to the relevant Act (Pensionskassengesetz – PKG). The first section explains the exclusion of the beneficiaries' interests from the institutional interest of the PKs' association, i.e. the distribution of power, by the underlying governance structure of PKs. This section focuses on the structural conflict of interest PKs face, namely between their beneficiaries and their shareholders (almost exclusively large Austrian banks and insurance companies). The institutional interests of PKs are determined by the governance structure at the micro and meso levels and the interests of the stakeholders, in particular those of the shareholders, while the governance structure is treated as given. The second section focuses on the empirical investigation of the politico-economic impact of the findings in the first section. It analyses the role of the PKs and in particular the PK association (Fachverband der Pensionskassen) in the political process in a case study. It argues that the repercussions of the governance structure at the micro and meso levels on the political level can result in a vicious circle for beneficiaries and that the political risks associated with long-term guarantees for beneficiaries of occupational pension funds are substantial and aggravated by the governance structure at the micro and meso level. It employs an actor-centred institutionalism.

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Based on the results of the analysis, it further investigates the politico-economic implications for the political and legislative process regarding recent changes to the relevant Act (Pensionskassengesetz – PKG). The first section explains the exclusion of the beneficiaries' interests from the institutional interest of the PKs' association, i.e. the distribution of power, by the underlying governance structure of PKs.

The first section focuses on the structural conflict of interest PKs face, namely between their beneficiaries and their shareholders (almost exclusively large Austrian banks and insurance companies). The shareholders' instruments to control the PKs are largely determined by the joint stock company Act.[1] The PKG includes provisions that can be interpreted as means to counterbalance the shareholders' dominance and to ensure that PKs conduct their business in the interests of beneficiaries, but which were also motivated by the objective to sell PKs to beneficiaries and works councils. This section addresses the question, how effective the governance structure of PKs at the micro and meso level is with respect to the objective to counterbalance the structural dominance of shareholders? In this section the notion of governance developed in the New Institutional Economics literature is employed in the analysis. It is demonstrated that the institutional arrangements in place are not effective in realigning the incentives of PKs with those of the beneficiaries in conflicts of interest between them and the PKs' shareholders. The shareholders' interests are likely to prevail in a conflict of interest with the beneficiaries. In this section institutional interests of PKs are determined by the governance structure at the micro and meso levels and the interests of the stakeholders, in particular those of the shareholders, while the governance structure is treated as given.

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[1] Potential agency problems between shareholders and PKs' management board are not discussed in the paper as they are neither specific to PKs nor affect the structural dominance of shareholders relative to beneficiaries.

The second section focuses on the empirical investigation of the politico-economic impact of the findings in the first section. It analyses the role of the PKs and in particular the PK association (Fachverband der Pensionskassen) in the political process in a case study. In order to do so, a specific process is identified, in which the interests of the beneficiaries and the shareholders are diametrically opposed – the 2003 amendment of the PKG. This section treats the governance structure at the micro and meso level as endogenous and investigates the mutual interdependence of governance structures at the different levels (micro/meso versus political level). It finds that the interests of the shareholders do in fact prevail in this particular conflict of interest with the beneficiaries. It argues that the repercussions of the governance structure at the micro and meso levels on the political level can result in a vicious circle for beneficiaries and that the political risks associated with long-term guarantees for beneficiaries of occupational pension funds are substantial and aggravated by the governance structure at the micro and meso level. It employs an actor-centred institutionalism.

A substantial microeconomic literature analyses the optimal governance structure of occupational pension funds.[2] A rich body of research investigates the political-economy of pension reform.[3] These research areas consider either the political processes or the governance structure of occupational pension funds exogenous. This paper contributes to the literature by merging the two lines of research in an inquiry of the interdependence of the micro and meso level of governance of occupational pension funds and the political-economy of reform of the relevant Act. It also adds to the literature by its empirical focus on Austrian occupational pension funds (PKs).

The empirical investigation is restricted to Austria as the governance of occupational pension funds throughout the OECD is quite divers and an empirical assessment of its efficacy has to take into account the details of the relevant acts as well as the more general

[2] Rajan and Srivastava (2000), Ambachtsheer (2001), Besley and Prat (2003), Palomino and Prat (2002), and Deelstra, Grasselli, Koehl (2004).

[3] Inter alia Brooks and James (1999), Müller (2003), Ney (2003), Orenstein (2003), Weaver (2003) and the papers collected in Rein and Schmähl (2004).

provisions governing joint stock companies and market structure.[4] The EU-Directive on the activities and supervision of institutions of occupational retirement provision (2003/41/EC), on the other hand, does only contain very general provisions on pension fund governance. The relevant Level 3 committee (CEIOPS) has a consultative panel with 17 members, of which nine are representatives of financial industry associations, two represent consumers, and one trade unions.[5] This highlights the role of financial industry associations in the EU political and legislative process in the area of pension fund legislation and supervisory practice. As occupational pension funds are financial institutions similar structural conflicts of interest can emerge on the EU level and in other OECD countries as in the Austrian case study, which calls for an investigation of the underlying governance structures. In a survey of pension fund governance the OECD focuses on formal arrangements at the micro-level without investigating their efficacy.[6] This paper contributes to this literature by focusing on an assessment of the efficacy of the formal arrangements based on a more detailed and at the same time broader perspective (micro and meso level) on governance. It is indicative for other systems, in which occupational pension funds are organised as corporations (rather than as trusts or foundations)[7], in a comparative institutional approach.[8] In a report the World Economic Forum (2005) finds that transparency and accountability standards in pension funds and beneficiaries' influence on strategic fund management provide cause for concern. The lack of proper governance and incentive structures that realign the interests of pension fund shareholders and management with those of the beneficiaries is regarded as major obstacle for responsible long-term investment by pension funds, which would be inline with the beneficiaries' long-term planning horizon. The report recommends a voluntary "Fund Governance Code" that ensures the representation of beneficiaries' long-term

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[4] OECD (2004). The OECD Guidelines do not contain explicit provisions concerning the governance structure of occupational pension funds.

[5] http://www.ceiops.org (last visit: 25 November 2004).

[6] OECD (2001).

[7] According to OECD (2004) representation of beneficiaries in the governing bodies of occupational pension funds is common throughout the OECD, but substantially differs in detail.

[8] For a case study focusing on the UK trust system see Clark (2004), who also argues that beneficiaries have very little effective influence on pension fund governance in the UK.

interests in intent, capability and practice. These findings are particularly interesting as they emerged from a series of roundtables with representatives of fund management companies, investment banks, insurance companies and business networks, but largely excluded representatives of beneficiaries.

The paper is structured along the following lines. The first section presents the empirical analysis of the governance structure of PKs, which focuses on the micro and meso levels. The second section contains the case study of the political and legislative process regarding the 2003 PKG amendment and constitutes the politico-economic investigation at the political level. The third section summarises the paper.

1. *The Governance Structure of Occupational Pension Funds in Austria at the Micro and Meso Level*

The first section identifies the transparency problems and the principal-agent problems that beneficiaries face in PKs. It addresses the question, to what extent the governance structure at the micro and meso level, designed to overcome these, are effective?

Governance

The analysis in the first section is based on an *economic notion of governance*. It employs the methods of institutional analysis based thereon, i.e. the New Institutional Economics approach to principal-agent problems.[9] The notion of governance refers to a set of institutional arrangements that address coordination problems resulting from incomplete contracts due to asymmetric information and opportunistic behaviour. It comprises of institutional arrangements at the micro level – such as corporate governance and contracts between sponsoring undertakings and PKs – as well as at the meso level – such as the regulatory framework and the market environment. PKs are not publicly listed so that the potential governance roles of the stock market and takeovers are not considered. The principal-agent problem between shareholders and PKs' management is not further analysed, as it is largely governed by the joint stock company Act and does not pose problems special to PKs.

[9] Williamson (1985) and (1996).

The principal-agent approach is particularly well suited for the current investigation, due to the fact, that beneficiaries have a legal title to the funds invested in PKs, while the PKs operate under the formal, legal prerogative to administer them in the beneficiaries' interest. The approach highlights the role of incentives and sanctions and thus provides an appropriate conceptual framework for the empirical analysis. The latter focuses on empirically observable sanctions and incentives (e.g. legal provisions) rather than important but less observable factors (e.g. social norms, social status of PK managers).

Nevertheless, the New Institutional notion of governance has a number of drawbacks: The approach is focused on economic incentives and sanctions. It is less suited to take into account societal conventions, habits, and altruistic behaviour as motives to conduct the business of pension funds in the sole interest of beneficiaries. It takes the benefits of delegation of long term investment decisions to managers due to superior expertise as given, in principle. The approach presumes that the only problem in the relation between the parties is one of asymmetries of information rather than asymmetries of power between large financial institutions and beneficiaries. The second section exemplifies the substantial repercussions that these asymmetries of power have on governance at the micro and meso level. Finally, the approach interprets policy choices with respect to the governance structure of PKs from a functionalist perspective (namely to counterbalance the structural dominance of shareholders) and does not prima facie assume that they were solely motivated as symbolic policy measures to legitimise political change.

At the micro and meso level the regulatory framework is predetermined and treated as given for PKs, as are some of the determinants of market competition, such as barriers to entry, market transparency, asymmetric information and opportunistic behaviour, ads well as technological characteristics of the production function (e.g. economies of scale and scope).

Transparency and Principal-Agent Problems

PKs are financial intermediaries and incorporated as joint stock companies, which leads to a structural conflict of interest between beneficiaries and shareholders. This raises a

principal-agent problem (i.e. *moral hazard problems)* between the beneficiaries and the PKs.[10] The principal (beneficiaries) mandates the agent (PK and in particular its management) to reach a certain objective, but she cannot directly observe the agent's effort. An optimal contract would provide incentive-compatibility by relating the agent's pay-off to his effort. However, the agent's effort is unobservable and an information asymmetry prevails. If the beneficiaries could observe the output of the agent's behaviour ex-post, a contract, that relates the agent's compensation to the ex-post observable output, would improve the incentive structure for the agent. However, there are two problems involved: First, the output of investment decisions in an environment of uncertainty is not a deterministic function of the agent's effort. Consequently, the agent's effort can only be inferred with considerable noise from ex-post performance, it is difficult to separate effort from good or bad luck.[11] Second, the *lack of transparency* of financial institutions often makes it very costly for their customers to observe and analyse their performance ex-post.[12] Even if ex-post performance can be observed cost effectively, it poses additional problems for beneficiaries. Some risks can cause large losses in very short periods of time, such that it might be too late to react when they are detected. Others can result in small losses over long periods, but are very hard to detect at all. OECD (2001) lists examples of these risks for beneficiaries arising from the moral hazard

[10] Besley and Prat (2003) emphasise the principal-agent problem between beneficiaries and sponsoring undertakings in pension funds and analyse their governance structure in an incomplete contracts framework. To keep the model tractable, they restrict their focus to two periods, to a moral hazard problem between sponsors and beneficiaries, and to governance at the micro level. The three areas of control rights they take into consideration are funding decisions, asset allocation, and asset management. They find that in defined contribution schemes funding is usually constant, control rights should be allocated to beneficiaries, and that trustees should be caring insiders chosen by and accountable to beneficiaries (e.g. trade union officials rather than outside finance experts). Under limited liability the sponsors have an incentive for excessive risk taking following from the "gambling for resurrection-problem". See also Rajan and Srivastava (2000) and Palomino and Prat (2002).

[11] In fact PKs invest about 95% of their assets in investment funds, which gives rise to an additional principal-agent problem between the PKs and the investment funds with the corresponding monitoring costs. As many of the investment funds are administered by the shareholders of the respective PKs, the problem is partly internalised and not further analysed in this paper.

[12] The analysis of the transparency problems in PKs focuses on the observability of performance and costs, rather than on broader notions of transparency such as procedural transparency, transparency of the capability to absorb risk or market transparency.

problem such as outright fraud, abuse of funds to support issues of securities underwritten by shareholders, churning of portfolios, and suboptimal effort levels.

Substantial losses cannot always be compensated by increased effort in the following periods and can result in long-term welfare losses for beneficiaries in the form of lower pensions. That implies that the individual and the ensuing societal welfare losses (in the form of old-age poverty) of a purely market based ex-ante enforcement of prudential investment are potentially very high and can induce substantial uncertainty. Societal welfare losses might give raise to another *moral hazard problem* – this time between the public authorities (government/legislature[13]) and a coalition of beneficiaries and PKs – providing incentives for beneficiaries and PKs to regard the potential socialisation of financial losses as an implicit insurance against substantial losses in PKs, which could lead to excessive risk taking.[14] This paper focuses on the principal-agent problem between beneficiaries and PKs, only.

In addition, beneficiaries' room for manoeuvre to sanction disappointing ex-post performance crucially depends on the governance structure of the occupational pension fund and the intensity of competition in the relevant market.

The promoters of the PKG in the Austrian parliament recognised the sensible social role of occupational pension funds and attempted to address the potential lack of transparency and the principal-agent problem between beneficiaries and PKs in a number of specific rules.[15] That does not preclude, that these provisions were also motivated by the objective to sell PKs to beneficiaries and works councils. These rules contain provisions to increase the transparency of PKs, to ensure beneficiaries' participation in the governance structure, and to restraint the set of admissible actions (i.e. investments) of the agent ex-ante. In addition to presenting these and assessing their efficacy, I will

[13] While the coalition of PKs and beneficiaries is clearly defined, their counterparty in this principal-agent problem is less so. Most bail-outs do require actions to be taken by the executive and the legislative branches of public authorities, due to the rule of law in the Austrian constitution.

[14] Public bail-outs of beneficiaries and PKs can take various forms, such as softening regulation rather than enforce it under distress (e.g. reducing own funds requirements in periods of financial distress), capital transfers to PKs under distress, and direct social transfers to beneficiaries hit by old-age poverty.

[15] Stenographisches Protokoll 143. Sitzung des Nationalrates der Republik Österreich XVII. Gesetzgebungsperiode Donnerstag 17. Mai 1990, 16581-16620.

discuss the extent to which market forces and competition among PKs, i.e. the intensity of competition in the market for occupational pension funds, might function as a governance mechanism.[16]

The Market

At the end of 2004 thirteen single-employer and seven multi-employer Pensionskassen (PKs) were licensed in Austria. In the year 2004 their total assets increased from EUR 9.12 billion to EUR 10.13 billion (+11.1%). Household claims against PKs amounted to about 3% of their total financial assets.[17] At the end of 2004 about 10.600 contracts between sponsoring undertakings and PKs were established covering 413.000 beneficiaries, of which 44.000 were pensioners. Between 1990 and 2004 the performance of PKs averaged 6.9% nominally p.a., while PKs faced losses in 2001 (-1.6% p.a. nominally) and 2002 (-6.3% nominally p.a. or EUR 379 million).[18] The following section refers to occupational pension funds that administer occupational pension schemes for more than one sponsoring undertaking (multi-employer PKs). In a small number of areas special provisions concerning the single-employer PKs are stipulated in the PKG, which are not further considered in this paper. The vast majority of pension scheme of multi-employer PKs are defined contribution schemes (DCS), such that the paper focuses on these.

Legal Foundations

The legal foundations for the emergence of occupational pension funds and occupational pension schemes were laid in 1990 with the *Pensionskassengesetz* (PKG – Federal Act on the Establishment, Administration and Supervision of Pensionskassen) and the *Betriebspensionsgesetz* (BPG – Company Pension Act).[19] The BPG was motivated by the objective to safeguard company pensions in the Austrian labour and social law by offering the opportunity to transfer the accumulated entitlements to future pensions from the

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[16] To some extent the assessment is intrinsically subjective, so that the aim the presentation of the findings is to make the assessments comprehensible.

[17] Source: OeNB.

[18] Source: Fachverband der Pensionskassen.

[19] The paper is based on the legal foundations as in force before the amendment, as the case study refers to 2003.

employer to a PK. In addition, the entitlements become vested, after a period of maximum five years even if the employee leaves the company before the pension is due. Vesting was supposed to guarantee a high degree of security for prospective pensioners by decoupling the stability of the pension scheme from the stability of the employer, the sponsoring undertaking. Furthermore, it was expected to increase the mobility of labour as employees – under the previous legal regime – usually lost their pension entitlement, if they changed jobs.[20]

The objective of the PKG was to establish the governance structure of PKs and to introduce the relevant regulatory regime. Legislators coupled the objective to channel savings to institutional investors, in order to promote the Austrian capital market, with the social objectives of the bill and, thus, gave raise to potential conflicts of interest between the two often incongruent sets of objectives. One of the promoters of the PKG in 1990 pointed out that pension funds play an important role on financial markets in many western countries: "Therefore, PKs have a considerable prominence in economic policy, and we believe that, if they develop reasonably, we will be able to establish the long missed large investors, so called institutional investors, in our country."[21] The Minister of Finance, who promoted the bill as well, highlighted that institutional investors would serve the promotion of Austrian capital markets and provide considerable support for industrial initiatives.[22]

The business of PKs is defined in § 1 (2) PKG as a legally binding commitment to grant retirement benefits to prospective pensioners [referred to as beneficiaries in the PKG] or paying retirement benefits to pensioners [referred to as beneficiaries (recipients) in the PKG] as well as accepting and investing the respective contributions to the fund. The PKG further stipulates that PKs have to conduct their business in the interest of the

[20] These objectives of the BPG and the PKG were explicitly put forward by the sponsors of the bill at the parliamentary debate in May 1990 (Stenographisches Protokoll 143. Sitzung des Nationalrates der Republik Österreich XVII. Gesetzgebungsperiode Donnerstag 17. Mai 1990, 16581-16620).

[21] Dr. Taus, Stenographisches Protokoll 143. Sitzung des Nationalrates der Republik Österreich XVII. Gesetzgebungsperiode Donnerstag 17. Mai 1990, 16587.

[22] Dr. Lacina (Minister of Finance), Stenographisches Protokoll 143. Sitzung des Nationalrates der Republik Österreich XVII. Gesetzgebungsperiode Donnerstag 17. Mai 1990, 16597.

beneficiaries with specific regard to the security, profitability, liquidity and the diversification of the assets (§ 2 (1) PKG). Thus, the beneficiaries act as principals and PKs as agents, which leads to a principal-agent problem. PKs are incorporated as single license credit institutions.

Legal Provisions Addressing the Transparency Problem at PKs

The PKG requires PKs to obtain a license from the Financial Market Authority (FMA) (§ 8 (1) PKG)[23], which also acts as supervisor (§ 33 (1) PKG), and stipulates a *single license-principle* for PKs (§ 2 (3) PKG), which implies that PKs are financial intermediaries, but must limit their activities to the business of occupational pension funds.

In addition, *PKs are required to notify the FMA* on a number of issues: PKs have to notify the FMA, if the composition of the board changes, on any circumstances that could endanger the pension obligations of the PK, on any violation of the capital requirements and on significant changes in the composition of the shareholders (§ 36 PKG). Effective as of 31 March 1997 a regulation on the quarterly reporting requirements stipulates that the assets of each investment and risk sharing group and their composition must be reported to the FMA exceeding the requirements of § 36 PKG. A detailed business plan has to be provided by PKs which contains the types of benefits offered, the presentation of the circumstances which are significant for the safeguarding of the interests of the beneficiaries (including details as the bases of the relevant calculation as well as the type and management of volatility reserve (§ 20 PKG). PKs have to appoint an actuary to be responsible for the preparation of the business plan and for monitoring compliance (§ 20a PKG). In addition, PKs appoint an independent auditing actuary for actuarial auditing of the business plan (§ 21 PKG). The FMA has to be notified on both appointments. The business plan has to be approved by the auditing actuary and the FMA. The audited annual accounts of each PK and the audited report on activities of each investment and risk sharing group have to be submitted to Oesterreichische Nationalbank (OeNB) and the FMA.

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[23] Before the establishment of the FMA in 2002 the license had to be obtained from the Ministry of Finance.

Furthermore, *beneficiaries have the right to obtain information* via various means: The beneficiaries and the competent works councils (representing them) have the right to obtain copies of the audited annual accounts and the audited report of activities at their request (§ 30a (2) PKG). The beneficiaries are represented in the advisory committee of each investment and risk sharing group, which has the right to obtain information concerning the business of the investment and risk sharing group (§ 28 (2) PKG). In addition, the beneficiaries are represented at the supervisory board and have the right to attend the general meeting, where they have the right to obtain information concerning their investment and risk sharing group. PKs have to keep an account for each beneficiary (§ 18 PKG). Each year the beneficiaries shall be informed in writing about their current claims and all changes of their employer's contribution and to their pension benefits. The beneficiaries have the right to obtain yearly information from PKs about their expected benefits (§ 17 BPG). Effective as of 1 January 2005 Minimum Standards for information of PKs for beneficiaries[24] entered into force. The Minimum Standards are intended to increase the transparency of PKs for beneficiaries. They contain provisions concerning yearly information on the yield and volatility of assets, investment policy and expected benefits. The information has to be comprehensible for beneficiaries and to provide a realistic scenario of future developments based on the FMA Regulation of parameters (e.g. Rechnungszins, rechnungstechnischer Überschuss)[25]. In defined contribution schemes the PK has to make clear that the beneficiaries bear the relevant market risks. In addition the Regulation contains information requirements vis-à-vis beneficiaries upon joining the PK, upon retirement or at the moment the beneficiaries leaves the sponsoring undertaking.

The legal provisions addressing transparency problems in PKs are effective in increasing transparency for the supervisor and for the beneficiaries with respect to the performance of the relevant PK regularly. They do not address and are not effective in increasing market transparency and the transparency with respect

[24] http://www.fma.gv.at/de/pdf/041216_m.pdf, last visit 13 June 2005. GZ: 9 080 110/05-FMA-II/1/04-Pensionskassenaufsicht.

[25] http://www.fma.gv.at/de/pdf/rechnung.pdf, last visit: 4 November 2004.

to the PK's capacity to absorb risk. However, the question remains which actions beneficiaries can take in response. This in turn depends on the governance structure of PKs and the intensity of competition in the PK market.

Provisions Addressing the Principal-Agent Problem: 1. The Governance Structure of PKs

The governance structure of PKs constitutes a prominent means to address the principal-agent problem between the beneficiaries and the PKs. It comprises of the following components: (*i*) supervisory board, (*ii*) advisory committee, (*iii*) management board, (*iv*) internal auditing unit, (*v*) general meeting.

The PKG requires beneficiaries to be represented on the *supervisory board* of multi-employer PKs[26], but also states that the representatives of the shareholders outnumber them by two, unless laid down otherwise in the articles of association (§ 27 (1) PKG).[27] In fact, the supervisory boards of the PKs have a minimum of six and a maximum of 14 members. The representatives of the shareholders outnumber those of the beneficiaries in all but two PKs, of which one is a single-employer PK. In addition, the works councils of employees of PKs are entitled to delegate a representative to the supervisory board. The chairperson of the supervisory board needs approval by both, the majority of total members and the majority of the representatives of the shareholders, which usually ensures the election of a representative of the shareholders. The representatives of the beneficiaries are elected at the annual general meeting. The representatives are frequently experts of the Austrian Trade Union Association (ÖGB).[28] In addition to the general

[26] „It is for the first time, according to my knowledge of Austrian law, that beneficiaries are represented on a board such as the supervisory board." (Josef Taus, Stenographisches Protokoll 143. Sitzung des Nationalrates der Republik Österreich XVII. Gesetzgebungsperiode Donnerstag 17. Mai 1990, 16586; my own translation of the verbatim protocol).

[27] In the supervisory board of single-employer PKs the representatives of the beneficiaries are ensured at least the number of seats of the shareholders minus one, unless it is arranged in an agreement between the PK, the sponsor undertaking, and the beneficiaries that the regulation for multi-employer PKs applies.

[28] Control rights allocated to a large dispersed group of beneficiaries gives raise to a multilateral, non-individually attributable positive externality that leads to sub-optimal exercise of control rights (free rider problem). Their delegation to representatives is intended to overcome this free-rider problem and to ensure the necessary expertise to exercise the rights effectively. The accountability of representatives in general meetings addresses the ensuing principal-agent problem.

regulations applying to supervisory boards for joint stock companies[29] the supervisory board's consent is required on certain investment decisions and the establishment of investment and risk sharing groups. The most effective means of governance at the disposal of the supervisory board are the rights to information on the business of the PK, the approval of strategic decisions, and the appointment as well as the potential termination of contracts of the members of the management board. The sponsors of the PKG argued that pension commitments are to be considered a component of wages and that, therefore, beneficiaries' participation in decisions concerning the administration and investment of the respective funds was necessary.[30] However, due to the fact that the beneficiaries are outnumbered in the supervisory board, they cannot sanction management for perceived underperformance. They can be voted down by the representatives of the shareholders in a potential conflict of interest.

PKs can, but are not obliged to, set-up an *advisory committee* for each investment and risk sharing group (§ 28 PKG). It has the right to make proposals concerning the investment policy of the respective investment and risk sharing group, to examine its annual accounts and the report of activities, to obtain information concerning its business from the management and from the supervisory board and to report to and to table a motion at the general meeting as well as to make proposals to the supervisory board. Its members are to be appointed by the supervisory board based on nominations in equal parts by the management board and the representatives of the beneficiaries in the supervisory board.

The PKG does not include specific provisions concerning the *management board*, such that only the Stock Corporation Act (§ 70 AktG) applies. The management board is responsible for the conduct of business of the PK and has to take due regard to the interests of the shareholders and the employees as well as to the public interest. This provision is in conflict with the general provision in § 2 (1) PKG stating that the PKs shall

[29] According to the Stock Corporation Act (§ 95 AktG) these contain the obligation to supervise the management board, the obligation to convene a general meeting, if deemed necessary for the company, to obtain information from the management board and access to the accounts and assets. In addition, a number of decisions of the management board require the consent of the supervisory board.
[30] Ewald Nowotny, Stenographisches Protokoll 143. Sitzung des Nationalrates der Republik Österreich XVII. Gesetzgebungsperiode Donnerstag 17. Mai 1990, 16589.

operate their business in the interest of the beneficiaries. In this regard, Farny/Woess (1992) argue that the management board is obliged to harmonise the structural conflict of interests of the shareholders and the beneficiaries. They conjecture that the objective of PKs is to reach a sustainable return on capital rather than profit maximisation, such that dividends above market average should lead to a reduction in the costs of the PK to the beneficiaries. Schiemer/Jabornegg/Strasser (1993) on the other hand argue that the very general provisions of § 2 (1) PKG cannot be an effective basis to deduce concrete duties of or rights vis-à-vis the management board.

The management board is the most important component of corporate governance of PKs as it holds the exclusive right to represent the PK and to manage its business affairs. Its decision monopoly is only restrained by the competencies of the other bodies of the PK, in particular by the supervisory board. Its main instrument to realign the managers' interests with its own is the power to (re-)appointment members of the management board as well as the potential termination of their contracts.

Every PK has to set up an *internal auditing unit* (§ 32 PKG). It shall report directly to all members of the management board and focus exclusively on the continuous and comprehensive audit of the business and the operation of the PK with respect to the lawful, proper and expedient conduct. The unit must dispose of resources commensurate to its duties. Since it reports directly to the management board, it does not effectively contribute to the resolution of the structural conflict of interest between beneficiaries and shareholders of PKs.

The PKG confers the right to attend the *general meeting* also to the beneficiaries (§ 29 (1) PKG), whereas the Stock Corporation Act reserves that right to the shareholders (§ 102 AktG). The election of representatives of the beneficiaries to the supervisory board has to take place at the general meeting. Due to the fact that "the beneficiaries have an immediate interest in the performance of the PK"[31] they were entitled to rights to information in the general meeting (§ 29 PKG) otherwise reserved to shareholders (§ 112

[31] 1328 der Beilagen zu den Stenographischen Protokollen des Nationalrates XVII. GP, explanatory notes to § 29 PKG.

AktG). The management board are obliged to disclose information relevant to the agenda of the general meeting upon request. The information has to be truthful, complete, and comprehensible; violations of these requirements can be sanctioned (§ 255 AktG).[32]

In addition to the relevant provisions in the PKG, employees' participation in the selection of a PK should be further secured by the provision that any contract of a sponsoring undertaking and a PK must be based on a *collective* or *works council agreement* (§ 3 (1) BPG), which must contain the claims of beneficiaries to the PK and the participation of the beneficiaries in the administration of the PK (§ 3 (1) BPG). On the *political level* the PKG prescribed an advisory council for company pension funds at the ministry of finance (§ 35 PKG), which was abolished in 1997, due to a lack of interest by all parties involved. Subsequently the relevant provision was deleted from the PKG. The performance of capital markets in the 1990s resulted in relatively stable returns to PKs, so that substantial conflicts of interest did not emerge.

The governance structure of PKs provides means for the beneficiaries and their representatives to monitor the performance of the PK ex-post. However, the governance structure does not enable the beneficiaries to effectively sanction perceived underperformance of PKs (i.e. the management board). Thus, it is not effective in providing ex-ante incentives for the agent to realign his objectives with those of the principal and to tackle the moral hazard problem between beneficiaries and PKs.

Provisions Addressing the Principal-Agent Problem: 2. Investment Rules, Guaranteed Minimum Yield, and Own Funds Requirements

In order to address the specific risks associated with funded pensions, the sponsors of the bill (PKG) emphasised the important role of investment rules[33] and of the guaranteed minimum yield[34].

[32] Schiemer, Jabornegg and Strasser (1993).

[33] "And now the most important question: We have introduced investment rules, which attempt to combine a high degree of security with a high degree of investment opportunities … ." (Josef Taus, Stenographisches Protokoll 143. Sitzung des Nationalrates der Republik Österreich XVII. Gesetzgebungsperiode Donnerstag 17. Mai 1990, 16586; my own translation of the verbatim protocol).

The *investment rules* for PKs are stipulated in some detail in § 25 PKG. The admissible investments are limited to claim rights (basically bonds), shares, and profitable land and buildings in an OECD member country. Euro-denominated bonds must amount to at least 35%, while investments in shares are limited to 50% of the assets of an investment and risk sharing group. Investment in investment funds issued by an investment company in the OECD are admissible unless they conflict with other investment limits included in § 25 PKG or imply cost disadvantages for beneficiaries. In fact PKs invest more than 90% of their assets in investment funds. Since 1990 the investment limits were adapted frequently; the minimum share of bonds decreased, while the admissible maximum quota of shares and that of foreign currency assets increased steadily. With the revision of the PKG in 2005 the prudent person principle was introduced and the investment constraints were further liberalised. The FMA has to issue a directive concerning investment constraints, but does not only consider the beneficiaries' interests in doing so, but also the general economic interest of a well functioning PK system. The liberalisation of the investment constraints substantially increased the room for manoeuvre for PKs and their managements and, hence, it increased monitoring costs as well as potential risks for beneficiaries in the principal-agent relation and aggravated the principal-agent problem.

The sponsors of the bill (PKG) intuitively recognised the role of the *guaranteed minimum yield* as a mechanism to provide incentives for PKs and to internalise the costs of underperformance. The requirement to pledge own funds against the guaranteed minimum yield is referred to as a "liability of the own funds of the PK and, thus, the PK itself for a certain minimum yield."[35] The provisions concerning the guaranteed minimum yield were changed substantially in 2003 at the expense of the beneficiaries. The political-economy of this reform is discussed in detail in the case study that constitutes the second

[34] "What seems particularly important to me [Johannes Bauer] in this context [specific risks of funded pensions relative to public PAYG systems], is though, that the legislator … requires a minimum yield of two percent [at the time it was about 2.8% p.a.]." (Stenographisches Protokoll 143. Sitzung des Nationalrates der Republik Österreich XVII. Gesetzgebungsperiode Donnerstag 17. Mai 1990, 16611; my own translation of the verbatim protocol).

[35] 1328 der Beilagen zu den Stenographischen Protokollen des Nationalrates XVII. GP, explanatory notes to § 2 (2) PKG.

section of this paper. In this section I focus on the provisions put in force by the 2003 amendment (§ 2 (2) and (3) PKG).

The minimum yield is defined as at least half of the average monthly secondary market yield of government bonds over 60 months minus 0.75. If the average annual investment income of an investment and risk sharing group does not equal at least the minimum yield, the beneficiary's (recipient's) pension shall be credited with the superannuation of the deficit in the following year from the PK's own funds.

Beneficiaries do not receive compensation, if the minimum yield is not reached over the past 60 months. In that case a reference value of the respective assets is calculated based on the hypothetical asset value based on the minimum yield. The time period for the calculation of the reference value is extended by 12 month each consecutive year the minimum yield is not reached. Effectively the period over which the minimum yield must be reached is extended, too. Each year the deficit (calculated over a five year period) and the reference value (calculated over the extended period) are compared and the superannuation of the higher value is credited to the pensioners' pension in the following year. For beneficiaries, who have not yet retired, both values are computed until either of the two following cases materialises: first, the minimum yield is reached again, such that the actual value exceeds the reference value again and no further action is taken; or second, the beneficiary retires at a moment the actual value is still below the reference value and his pension is credited with the superannuation (in addition to the pension resulting from the actual value of his claim) corresponding to the difference between the reference value and the actual value from the PK's own funds.[36]

PKs must at any time hold sufficient *own funds* to cover their risks and at least 1% of the premium reserve (§ 7 PKG).[37] In addition, the reform in 2003 introduced a minimum yield reserve, which may only be used for obligations arising from the guaranteed minimum yield requirement. Each year 0.45% of the total value of the premium reserve

[36] An amendment of the PKG in 2005 introduced the option to waive the minimum yield guarantee in the contract between the sponsoring undertaking and the PK.

[37] Investment and risk sharing groups for defined benefit schemes, in which the sponsoring undertaking bears capital market risks, are exempted.

have to be allocated to this reserve until it reaches 3% of the total value of the premium reserve.

The direct costs of PKs for beneficiaries largely consist of an administrative expense, which are calculated as share of the regular contributions. In addition, PKs charge an investment administration expense, which is calculated as a ratio of assets under administration. Does this cost component provide positive incentives for PKs? Unlikely, as these costs mostly reflect the expenses of PKs for the investment funds they invest almost 95% of their assets in, such that they hardly influence the maximisation problem of PKs.[38]

The provisions concerning the investment rules are to some extent effective in addressing the principal-agent problem. By restricting the set of admissible action for the agent (PK), they reduce the costs of monitoring for the principal (beneficiaries) and limit the beneficiaries' maximum risk exposure and their potential maximum losses. **Their liberalisation has reduced their effectiveness by enlarging the set of admissible actions of the agent and increasing monitoring costs.**

The provisions concerning the guaranteed minimum yield are only partially effective in realigning the incentives of the PK with those of the beneficiaries.[39] The instrument of a guaranteed minimum yield internalises the costs of suboptimal effort by the PK up to the minimum yield, but not beyond that level.

The provisions concerning the own funds do not affect the incentives of PKs, as they are to a large extent independent of the actions taken by the agent at the margin (i.e. independent of the investment policy and the performance of PKs). PKs are required to hold own funds commensurate with their risk exposure, which would make an increase in risk exposure costly at the margin. However, experience shows that supervisory authorities do not enforce this provision,

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[38] Source: OeNB.

[39] How their effectiveness was influenced by the 2003 PKG amendment will be discussed in the second part of this chapter.

which is rather vague and subject to various interpretations of "commensurate with risk exposure". Consequently, the own funds requirement reduces to the provision to hold at least 1% of the premium reserve and are effectively independent of PKs' decisions concerning the risk characteristics of the portfolio at the margin. Nonetheless, they do play an indirect role as the minimum yield requirement has to be met from PKs own funds.

Intensity of Competition in the Multi-employer PK Market

The sponsors of the bill (PKG) were well aware of the role of competition in contributing to the realignment of the incentives for multi-employer PKs[40] with those of the beneficiaries and, hence, introduced explicit provisions that ensure that the cancellation of PK contracts by sponsoring undertakings is possible.[41]

If an employer and/or a PK cancel a PK contract, the beneficiaries' assets have to be transferred to another PK for the cancellation to be admissible and legally effective (§ 17 PKG). The notice period shall be one year. The minimum value of the assets to be transferred is 98 per cent of the premium reserve and of the volatility reserve. The PK contract and the underlying collective or work council agreement have to contain the share of assets to be transferred (§ 15 (3) PKG and § 3 (1) BPG). The cancellation of a PK contract and the transfer of assets usually induce losses for the beneficiaries, such that the transaction costs cannot be considered negligible.[42]

The PK contract is concluded between the PK and the sponsoring undertaking (§ 15 PKG). The beneficiaries are only involved to the extent that the PK contract must be

[40] The relevant market for the analysis of competition consists of the market for the seven multi-employer PKs only, as by definition single-employer PKs are part of the sponsoring undertaking. Competitive conditions in the multi-employer PK market, though, can influence the "make or buy" decision to either establish a single-employer PK or to join a multi-employer PK.

[41] "Another important regulation and provision, which increases competition, it seems very important to me, that the cancellation of the contract is possible, as otherwise competition would be restricted." (Johannes Bauer, Stenographisches Protokoll 143. Sitzung des Nationalrates der Republik Österreich XVII. Gesetzgebungsperiode Donnerstag 17. Mai 1990, 16611, my own translation of the verbatim protocol)

[42] Farny and Wöss (1992, 313).

based on a works council agreement (§ 3 (1) BPG).[43] It must contain the claims of beneficiaries vis-à-vis the PK, the participation of the beneficiaries in the administration of the PK, and the detailed conditions for the cancellation of the PK contract by the sponsoring undertaking. Other important provisions of the PK contract for the beneficiaries – e.g. the choice of PK, the admissible forms of investment, and the principles of investment policy – do not require the participation of the beneficiaries. As the latter are not party to the PK contract, they cannot cancel it in response to perceived underperformance of the PK. Potential exit cannot substitute for the lack of voice in the governance structure and cannot realign the incentives of the PKs with those of the beneficiaries. Beneficiaries would have to convince the sponsoring undertaking to sanction the PK for perceived lack of effort. According to one interviewee the selection criteria of sponsoring undertaking concern not only the interests of the beneficiaries, but also the PK's relation to the sponsoring undertaking's main bank (Hausbank) of the sponsoring undertaking.[44]

The PK market seems to be quite concentrated. The top three multi-employer PKs control 66.14% of the market in terms of total contributions and 70.32% in terms of total premium reserves.[45] The competition for existing customers seems to be limited. Despite the negative performance of PKs in 2001 and 2002 only two sponsoring undertakings switched multi-employer PK in 2002, ten in 2003, and twelve in 2004.[46] These numbers are rather low compared to a market size of about 9.500 PK contracts with multi-employer PKs[47] at the end of 2003.[48]

[43] If the beneficiaries are not represented by a works council, an agreement between the beneficiaries and the sponsoring undertaking must be based on a model contract. The latter must be approved by the ministry of social affairs.
[44] Dr. Otto Farny, Chamber of Labour (telephone interview 29 September 2004).
[45] Source: Annual Reports of PKs. Data refers to end of 2003.
[46] Source: FMA. Until 2001 the Ministry of Finance (BMF) acted as supervisory authority, but did not document the data. According to the BMF the numbers were negligible and amounted to about two sponsoring undertakings switching PKs per year between 1990 and 2001.
[47] Source: Fachverband der Pensionskassen.
[48] Market transparency is low, so that no data on the relative performance of PKs is available. If all PKs experienced similar losses, beneficiaries would not profit from switching.

Due to the low intensity of competition in the PK market for existing customers, non-negligible transaction costs, and the fact that the beneficiaries are not party to the PK contract, **the efficacy of competitive pressure to address the principal-agent problem between beneficiaries and PKs is low**. **There is no direct effect of competition on transparency to monitor performance ex-post.**

The central results of the first section of the paper are, that (*i*) the governance structure of PKs at the micro and meso level (corporate governance, regulatory regime, and market competition) are effective in ensuring transparency to monitor performance of PKs ex-post, that (*ii*) the internal governance structure of PKs does not provide an incentive structure that addresses the principal-agent problem between beneficiaries and PKs, and that (*iii*) the competition in the PK market cannot substitute for the shortcomings of the governance structure in realigning the incentives for PKs with those of the beneficiaries.

To sum up the results of the first section, the investigation shows that PKs are involved in a structural conflict of interest between the interests of their shareholders and the interests of the beneficiaries. The governance structure at the micro and meso level is not sufficient to ensure that PKs administer the beneficiaries' assets solely in their interest and that the beneficiaries' interests prevail in an actual conflict of interest with the shareholders or the management. Much rather PKs – as joint stock companies – are legally required to act in the interest of their shareholders.

2. *The Politico-Economic Implications of the Governance of Occupational Pension Funds on the Political Level*

The second section of the paper focuses on the empirical investigation of the findings of the first section and their politico-economic impact. It analyses the role of the PK association (Fachverband der Pensionskassen) in a case study, in which the interests of beneficiaries and shareholders were diametrically opposed. The analysis identifies the political process and legislative process in the case of the 2003 amendment of the PKG as

a relevant empirical example. The analysis addresses the following questions: *(i)* What is the empirical evidence concerning the structural conflict of interest between shareholders and beneficiaries in PKs? Whose interests prevailed in this particular conflict of interest and whose interests did the PKs actually represent? Are the empirical results in line with the derivations of the first section? *(ii)* What are the politico-economic consequences of the findings of the first sections? How do the governance structures of PKs at the micro and meso level influence the political process? What are the repercussions of the political process on the governance structure at the micro and meso level?

The empirical inquiry rests on primary sources such as drafts of the respective proposals for the relevant PK amendment and the enclosed explanatory notes, the protocols of the parliamentary debate, the report of the parliamentary Social Committee, the official opinions submitted during the legislative process and interviews with politicians, experts as well as civil servants involved.

Political Economy and Actor-Centred Institutionalism

Underhill (2001, 7) defines political economy as the investigation of "… the relationship between the market (and the private interests and prerogatives it includes) and political authority at various levels of governance (and the notions of public interest which we like to presume are inherent in politics)." He points out that the market cannot be conceptualised without the state. They are often complementary, interdependent institutional arrangements that govern social relations within societies. Consequently, politics and market forces constantly interact, reinforce and constrain each other. Sometimes they act in accordance with each other sharing common beliefs, objectives, and strategies. Sometimes they are antagonistic representing conflicting interests, visions, and approaches. In the following section the interaction between political and economic actors in shaping a specific political process is investigated and related to their institutional interests.

The power to define, what is public and what is private interest, constitutes one of the most effective instruments of power in shaping governance. The notions of public and private interests are themselves subjective and have strong ideological connotations.

Therefore, we analyse which institution is most effective in presenting its own institutional interest as public interest. At the political level the governance structure of PKs is considered to a large extent endogenous. The case study focuses on an amendment that reforms this governance structure.

The analysis employs *an actor-centred institutionalism,* which focuses on the ways in which actors influence policy change and attempt to further their institutional interest within the prevalent setting of political institutions. The analysis has to identify the relevant political process, the respective actors, their institutional interests, their power resources and their strategies. The latter, in turn, are influenced – but not determined – by the prevalent setting of political institutions.[49] It is regarded as the appropriate method to investigate the role of the PK association as one of the actors in the political and legislative process. In the first section institutional interests of PKs were endogenised. It was demonstrated that they are shaped by the governance structure of PKs and the interests of the parties at the micro and meso levels. In the second section the actors involved (incl. PKs and their association as well as the representatives of the beneficiaries) are regarded as agents pursuing their institutional interests. In the particular conflict of interest investigated their homogeneity and coherence is interpreted as substantial enough to justify their treatment as coherent actors. The actor-centred institutionalism assumes that agents act intentionally rational, which "suggests that rationality is a social practice subject to cognitive limits and the vagaries of the environment in which decision making takes place rather than a universal once-and-for-all state of mind."[50]

Case Study: The Political-Economy of the 2003 Amendment of the PKG

The case study focuses on the 2003 amendment of the PKG and further restricts the analysis to changes of the provision concerning the guaranteed minimum yield. In this

[49] Scharpf (2000). The relevant actors are the PKs, their association, their shareholders (mostly banking and insurance companies), the bodies representing beneficiaries and certain proponents of the government (Ministry of Finance) and parliament. Political institutions are defined as reducing the complexity of underlying conflicts of interest and increasing political capacity to actually attain a solution by excluding some of the interests at lower levels, such as legal and political procedures, routines, socially constructed perceptions of society et cetera (March and Olsen, 1989).

[50] Clark (2004, 241).

particular case the interests of the individual parties to the process and the allocation of costs can be identified clearly and the ensuing conflicts of interest are pronounced.

The Effects of the Reform of the Guaranteed Minimum Yield in the 2003 PKG Amendment

The 2003 amendment of the PKG induced financial losses on beneficiaries. Instead of crediting the asset accounts with the deficit that resulted from a performance below the guaranteed minimum yield, the pension that results from the reference value is paid out from the PK's own funds. The value of the assets remains unchanged. The pensioners experience a (potential) financial loss induced by the amendment, as they forego potential investment income on the credited deficit. The (potential) loss occurs, if the investment income exceeds the minimum yield in the following periods. The loss corresponds to the (potential, positive) difference between the investment income from the deficit in the periods following the underperformance of the minimum yield and the hypothetical investment income based on the minimum yield.

The PKs' shareholders profited, as the provision to credit beneficiaries' asset accounts from PKs' own funds (shareholder equity) was abolished in a moment the guarantee was expected to be invoked. As the PKs' own funds were too low to cover the (potential) deficit, shareholders would have had to provide additional capital. Furthermore, the likelihood to underperform the minimum yield in the future was reduced by two measures: (*i*) the scope of the guarantee was reduced to the superannuation for recipients rather than the value of assets for all beneficiaries and (*ii*) the relevant averaging period was extended from five years to the entire period of membership in a PK until retirement. According to the FMA the potential gains for shareholders (and the beneficiaries potential financial losses) at the time of reform were in a range of about EUR 300 mio. to 400 mio.[51]

In addition, the amendment had a negative indirect effect on beneficiaries in the long run. By reducing the potential losses for the owners of PKs related to the minimum yield

[51] Austrian Press Agency APA0375 5 WI 0597 13 June 2003. Gains and losses can be estimated only roughly, as problems stemming from the guaranteed minimum yield requirement have not materialised in 2003, but were expected for the years 2004 onwards.

requirement, the governance mechanism addressing the principal agent-problem between beneficiaries and PKs was weakened.[52] Furthermore, the amendment had negative repercussions on the stability of the financial system and on systemic governance. The forbearance of supervisors, regulators and the ensuing "ad hoc"-legislation reduced the incentives for shareholders and PKs to comply with financial regulation and to engage in proper risk management. It can have negative repercussions for the reputation of the governance structure of the Austrian financial system. Thus, it did not contribute to financial stability.

The amendment caused financial losses for beneficiaries and did not contribute to financial stability. It was in the interest of the PKs and their shareholders, who averted to cover (potential) financial losses for beneficiaries by own funds.

The Political-Economy of the 2003 Amendment

The interests of the shareholders and the beneficiaries were diametrically opposed in the reform process. If the PKs represented the interest of their beneficiaries, they would have had to oppose the amendment, according to the provision to operate their business solely in the interest of the beneficiaries (§ 2 (1) PKG). Whose interests did the PKs and their industry endorse? Which role did the latter play in the political process? Whose interests did the government endorse and why?

[52] 1328 der Beilagen zu den Stenographischen Protokollen des Nationalrates XVII. GP, explanatory notes to § 2 (2) PKG. The important role of the minimum yield guarantee was discussed in detail in the first section.

The government's institutional interests

The government's institutional interest is to actively promote institutional investors.[53] In addition, the government frequently pointed out that it wants to actively promote the second (i.e. PKs) and the third pillar of the Austrian pension system.[54]

If shareholders refused to provide additional capital for PKs in order to enable them to cover the (potential) deficit, the PK system in Austria would have faced a crisis. It could be argued that the government's institutional interests would incline it to endorse the shareholders' interests, as a crisis of the PK system would have had negative implications for the Austrian capital market and the prospects of private pensions. However, that conclusion is not unambiguous. First, it was highly unlikely that the shareholders would actually allow PKs to go bankrupt.[55] Second, it could be maintained that the 2003 PKG amendment was not in the governments' interest, as it hampered the growth of the second pillar by reducing its appeal to (prospective) beneficiaries and could have a negative impact on financial stability (by reducing incentives for compliance with financial regulation) and the reputation of financial governance in Austria. In addition, about 400.000 beneficiaries (and voters) were negatively affected by the amendment. Therefore, it was likely to be costly for the government to endorse the shareholders' institutional interests.

The institutional interests of the representatives of beneficiaries

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[53] The Action Plans of the Government Envoy for the Capital Market 2002/2003 and 2003/2004 highlight the role of institutional investors of the second and the third pillar of the Austrian pension system in promoting the Austrian capital market (http://www.bmf.gv.at/Finanzmarkt/Kapitalmarktinitiative625/aktion.pdf, November 2002 and http://www.bmf.gv.at/Finanzmarkt/Kapitalmarktinitiative625/pkkapitalmarkt.pdf, August 2003; last visited: 9 November 2004).

[54] E.g. Government Declaration 2003 http://www.bka.gv.at/2004/4/20/regierungserklaerung.pdf, 6 March 2003 (last visited: 9 November 2004).

[55] Notwithstanding, that it was highly unlikely that the shareholders would have actually allowed PKs to go bankrupt and to destabilise the PK system. The market for private pension products is expected to expand rapidly in the near future. New products such as the tax-subsidised Zukunftsvorsorge and Mitarbeitervorsorgekassen as well as cuts in the public PAYG system ensure a growing market. The shareholders of PKs are usually involved heavily in the other market segments as well and would hardly allow insolvencies to undermine their reputation in the market. Consequently, neither concerns about the instability of the system nor about potentially ensuing fiscal burden would have credibly motivated the government to endorse the shareholders' position.

The representatives of the beneficiaries issued formal expert opinions on the amendment and strictly opposed it. The Trade Union Association and the Chamber of Labour both argued that the guaranteed minimum yield formed part of the entrepreneurial risks of PKs since the introduction of PKs in 1990 and that PKs were obliged to take the appropriate measures (i.e. own funds corresponding to their risks § 7 PKG) accordingly.[56] Sophisticated financial institutions should have factored these risks into their business models, charged the related risk premiums, and built up reserves corresponding to these risks or applied the appropriate risk mitigating techniques available. The representatives of the beneficiaries maintained that the problems, which arose due to falling assets prices on financial markets, were aggravated by management errors. The parameters underlying the pension projections (i.e. Rechnungszins, rechnungstechnischer Überschuss, Sterbetafeln) were chosen incautiously, to result in higher expected returns for beneficiaries to boost demand.[57]

The shareholders' interest

There are no documents officially stating the shareholders' interest. The Banking and Insurance Division of the Chamber of Commerce did not issue on official expert opinion on the first draft of the amendment. From the implications of the amendment one can infer that the shareholders aimed at reducing their implicit obligations (from estimated € 400 mio. to estimated € 100 mio., which could be spread over several years) vis-à-vis beneficiaries by promoting the amendment. In a press conference on 13 June 2003 the chairperson of the Banking and Insurance Division of the Chamber of Commerce, which represents the largest shareholders of PKs, welcomed the 2003 PKG amendment. The shareholders argued that the (potential) solvency problems of the PK system constituted

[56] Verzetnitsch and Leutner (2003), Tumpel and Kubitschek (2003).

[57] In response to the management errors of PKs the supervisor FMA restricted the choice of technical parameters in 2003 (Austrian Press Agency APA0078 5 WI 0607 II 24 April 2003 and FMA Regulation of parameters http://www.fma.gv.at/de/pdf/rechnung.pdf, last visit: 4 November 2004). In response to the insufficiency of own funds the 2003 amendment requires PKs to allocate 0.45% of the premium reserve to a statutory "minimum yield"-reserve until it reaches 3% of the premium reserve (§ 7 (3) PKG). The PK association announced that the beneficiaries would have to bear the costs in terms of higher costs for the administration of investments (http://www.iwm.co.at/inflist.asp?p=3&sec=2&1=de&owner=-3&idl=de&inf=1601 last visit: 20 July 2004).

an unforeseeable, exogenous shock (namely falling international equity and bond prices). Consequently, neither the beneficiaries nor the government could expect them to bear the ensuing costs.

The institutional interest of the PK association

The PK association represented the shareholders' interest. "Cui bono"-considerations are indicative but not sufficient to demonstrate the link between the interests of the shareholders and the PKs. This in turn is necessary to demonstrate the politico-economic repercussions of governance of PKs at the micro and meso level and the governance of the PK system at the political level. In order to identify the interests of PKs, the press statements of the PK association are indicative. In two press conferences on 13 June and 24 June 2003 the PK association explicitly welcomed the 2003 amendment. It argued that the obligatory additional contributions from PKs' own funds would be reduced to EUR 100 mio. (from EUR 400 mio.) and that the obligation could be spread over several years (rather than being due in a lump-sum).[58]

The government's official considerations

The government's official considerations for the amendment reflect the PK associations' position. The first draft of the amendment was sent out for consultation by the Ministry of Finance on 28 March 2003.[59] The ministry argued that against all expectations prices on international capital markets had substantially decreased over the period 2000 to 2003. Without capital injections by the shareholders, the ministry expected that the PKs'

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[58] http://www.iwm.co.at/default.asp?p=3&sec=2&1=de&owner=3&inf=1167 (last visit: 15 April 2004), http://www.iwm.co.at/default.asp?p=3&sec=2&1=de&owner=3&inf=1168 (last visit: 15 April 2004), and Austrian Press Agency APA0375 5 WI 0597 13 June 2003. The PK association did not issue an expert opinion during the consultation process following the presentation of the draft amendment issued by the Ministry of Finance, which it usually does if it opposes an amendment.

[59] The draft was changed during parliamentary negotiations to yield the resulting minimum yield guarantee described above with the additional adaptations further benefiting the PKs' shareholders at the expense of the beneficiaries. The draft contained an averaging period for the guaranteed minimum yield of 84 month for pensioners and of the entire contribution period for beneficiaries. It stipulated an obligatory credit to the assets of beneficiaries and pensioners in cases of underperformance of the required minimum yield. The final amendment reduced the averaging period for pensioners from 84 to 60 months, but abolished the obligatory credit to the assets of beneficiaries and pensioners.

own funds would not correspond to their risks.[60] The situation emerged despite the legal obligation of PKs to hold own funds corresponding to their risks (§ 7 (1) PKG). Rather than enforcing the regulation to ensure that PKs would hold sufficient own funds to cover their legal obligations, the government decided to change the law to bail-out PKs.[61] The supervisor FMA defended the draft amendment, as shareholders would otherwise face the burden of additional contributions to own funds of up to EUR 400 mio. According to FMA these would by far exceed the PKs' own funds (about EUR 60 mio. at the time), thus, pointing out the inadequacy of own funds.[62]

What role did the PK association play in the political process?

Members of parliament, their staff, representatives of the institutions representing beneficiaries and the PK association and civil servants involved in drafting the 2003 amendment were interviewed in September, October and November 2004.[63] All but one of them stated, that the draft compiled by the Ministry of Finance as well as the changes during the ensuing parliamentary debate can be traced back to the initiative of the PK association and the shareholders of PKs.[64] According to all of the interviewees the

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[60] "Therefore one has to assume that in the following years [after 2003] PKs might have to credit the accounts of a number of investment and risk sharing groups according to the minimum yield guarantee. This obligation will pose a substantial financial burden for PKs, which will presumably not be covered by their own funds." Begutachtungsentwurf „Bundesgesetz, mit dem das Pensionskassengesetz geändert wird", GZ. 040010/7-Pr.4/03, 28. März 2003, Wien, explanatory notes, General Part, (my own translation).

[61] "Thereby [by the initial lengthening of the averaging period for recipients from five to seven years], the stabilisation of the system will be supported taking due regard to the enormous volatility of capital markets." (Begutachtungsentwurf „Bundesgesetz, mit dem das Pensionskassengesetz geändert wird", GZ. 040010/7-Pr.4/03, 28. März 2003, Wien, explanatory notes to § 2 (2) PKG, (my own translation)).

[62] Austrian Press Agency APA0078 5 WI 0607 II 24 April 2003.

[63] Interviews with Abg. z. NR Sigisbert Dolinschek, FPÖ, sponsor of the amendment in the Social Committee and of the final motion in the plenary (face to face-interview 8 September 2004), Oberrat Friessnegg, Ministry of Finance (telephone interview 8 September 2004), Ministerialrat Abteilungsleiter Dr. Peter Erlacher, Ministry of Finance (telephone interview 29 September 2004), Dr. Otto Farny, Chamber of Labour (telephone interview 29 September 2004), Dr. Fritz Janda, managing director of the PK association (telephone interview 29 October 2004), Mag. Holnsteiner, expert at the SPÖ Club in Parliament (face-to-face interview 5 November 2004). The main promoter of the amendment for the ÖVP in the Finance Committee, Dr. Günter Stummvoll, declined to give an interview. Representatives of the Green Party were not available for interviews.

[64] The representative of the PK association argued that the PK association was involved in the negotiations to change the draft and achieved improvements for the beneficiaries. He refused to

shareholders argued that they would not be willing to inject further capital to maintain PKs operational, in case that the obligations according to the guaranteed minimum yield would become effective.

How did the PK association and the PKs' shareholders manage to convince the government to endorse the shareholders' interests?

The drafters of the bill in the Ministry of Finance and the sponsors of the motion in parliament presented it as public interest initiative. The amendments to the guaranteed minimum yield were motivated by the necessity to stabilise the PK system. This is in accordance with the PK association interpretation of the main objectives of the amendment. The State Secretary of the Ministry of Finance argued that the objectives of the amendment were "… the long-term security of occupational pensions and the long-term security of the PK system".[65] He made the statement during a press conference on 13 June 2003, which he attended together with the chairperson of the Banking and Insurance Division of the Chamber of Commerce and the chairperson of the PK association.[66] This evidence shows how effective and convincing the PK association was in presenting its institutional interest as public interest and in convincing the government to side with the PKs' shareholders in the conflict of interest concerning the guaranteed minimum yield.[67]

The powerful position of the PK association and the PKs' shareholders stemmed from the threat of the shareholders to allow PKs to become insolvent, such that the amendment could be postulated as the only means to secure the stability of the PK system – a public interest motive. The control over financial capital of PKs leverages the PK association's and the shareholders' politico-economic power at the political level. The power in public

comment on the motives of the Ministry of Finance and the initiative of the shareholders and the PK association in preparing the draft amendment.

[65] Press statement of the PK Association on 13 June 2003 http://www.iwm.co.at/default.asp?p=3&sec=2&1=de&owner=3&inf=1167 (last visit: 15 April 2004) http://www.iwm.co.at/default.asp?p=3&sec=2&1=de&owner=3&inf=1168 (last visit: 15 April 2004).

[66] The PK association is a subsection of the Banking and Insurance Division as most of the shareholders of PKs are banks and insurance companies and PKs are themselves incorporated as credit institutions.

[67] That, however, does not imply that the structural dominance of shareholders is the unique cause for the amendment.

discourse stems from constraining the public perception of the nature of the problem and the set of available policy alternatives[68]. In particular, the PKs and their shareholders managed to posit the potential collapse of the PK system as an exogenously determined objective fact, i.e. independent of PKs' and their shareholders' actions (i.e. management errors, i.e. the wrong parameters employed in the past and insufficient own funds relative to risk), and as a consequence of unforeseeable financial market developments. Consequently, neither the beneficiaries nor the government should expect the shareholders to bear the costs of the shock. The PK association managed to reframe the distributional (political) conflict as a technical (non-political) problem of financial stability.

How did the electoral dimension influence the decision of the government to promote the amendment, given the fact that beneficiaries dominate PKs' shareholders in terms of voting power? The final motion was tabled as part of the Budgetbegleitgesetze 2003, a substantial package of legislation that covered budgetary issues as well as a large public pension reform and the purchase of the Eurofighter jets. These issues attracted substantially more attention in public debate than the highly technical changes of § 2 PKG, such that the electoral dimension would pose very limited disincentives for the government to endorse the shareholders' position.

The incorporation of PKs as credit institutions has repercussions for governance at the political level beyond the structural dominance of shareholders in the governance of PKs. According to one of the sponsors of the bill, the changes to the guaranteed minimum yield were not negotiated in the Social but in the Finance Committee of the Austrian parliament. The logic and the policy network of the Finance Committee further strengthen the influence of the PK association and the shareholders of PKs. These are mostly banks and insurance companies, which are quite influential the policy network of the Finance Committee. This further increases the PKs' and their shareholders' power

[68] According to one interviewee, the PK association opposed alternative solutions, which would have decreased the immediate costs to shareholders, spread the costs arising from the guaranteed minimum yield over up to 20 years, and preserved the rights of the beneficiaries as well as prevented the damage to the credibility of financial market legislation.

resources at the expense of those of the representatives of the beneficiaries, which are more influential actors in the policy network surrounding the Social Committee.[69]

To sum up the results of the second section, the evidence indicates that the PK association and the PKs did not represent the interests of the beneficiaries, namely to prevent the effective dismantling of the guaranteed minimum yield, but much rather that it actively promoted the amendment in the interest of its shareholders. It corroborates the evidence of the first section of a structural dominance of the shareholders' interests in the governance structure of PKs and of the likely prevalence of the shareholders' interests in actual conflicts of interests with beneficiaries. It further demonstrates that shareholders employ this dominance at the micro and meso level also at the politico-economic level to further strengthen their position in the governance structure of PKs and that both levels of governance are mutually interdependent.

3. Conclusion

The central results of the paper are: (*i*) neither the internal governance structure of PKs not market competition provide an incentive structure that effectively addresses the structural dominance of shareholders' interests in PKs at the expense of beneficiaries; the shareholders' interests are likely to prevail in a conflict of interest with the beneficiaries; and (*ii*) in an actual conflict of interests concerning the governance structure of PKs the PK association and the PKs acted in the interest of the shareholders, as predicted in the first section; consequently, the governance structure at the micro and meso level has considerable politico-economic consequences at the political level, which can result in a vicious circle for beneficiaries: it subjects the governance arrangements in place to protect beneficiaries in conflicts of interests with shareholders to substantial political risk, which in turn is aggravated by the structural dominance of shareholders in the governance

[69] Talos and Kittel (2001) provide an analysis of the policy networks in Austria. They demonstrate that the banks are influential actors in the policy network in the area of financial legislation, while the Trade Union Association and the Chamber of Commerce as well as the Chamber of Commerce and the Association of Industrialists are influential actors in the policy network in the area of social policy.

of PKs. Asymmetries of power at the political level have substantial repercussions on the governance structure at the micro and meso level.

The structural dominance of shareholders in PKs is a consequence of the fact that PKs are credit institutions and must to be incorporated as joint stock companies. This, in turn, is motivated by the institutional interests of previous and current governments to promote the Austrian capital market by strengthening institutional investors.

The PK association played an important and effective role in initiating the 2003 PKG amendment and in shaping public discourse about the 2003 PKG amendment. It managed to construct the public perception of the problem of insufficient own funds, so that it was interpreted as an exogenously determined objective fact and as a consequence of unforeseeable financial market developments independent of PKs' management errors. The amendment was postulated to be the only means to secure the stability of the PK system and, therefore, as reform in the public interest.

In the short run, the policy options are limited. In order to increase the transparency of processes at the political level and to ensure the participation of beneficiaries an instrument of meta-governance[70] should be re-introduced. In 1990 the PKG instituted a Pensionskassenbeirat as expert committee to advise the Minister of Finance in all matters relating to PKs (§ 35 (1) PKG 1990). The committee consisted of five members nominated by the Chamber of Commerce (of which the PK association is a part), five members of the Chamber of Labour (which represents the interests of the beneficiaries) and one member nominated by the Ministry of Labour and Social Affairs and one nominated by the Ministry of Finance. The equal representation of the representatives of shareholders and of beneficiaries would at least ensure that the advice provided for the Minister of Finance also reflected the interests of the beneficiaries. A comparison of pension fund governance in OECD countries seems to indicate that the organisational forms of trusts and foundations provide for better formal representation of

[70] Jessop (1999, 16) defines meta-governance as mechanism to "… conform and coordinate several sites and objectives of governance".

beneficiaries.[71] The comparative analysis is restricted to a comparison of formal representation, but does not analyse the efficacy of specific arrangements and is rather narrow in its scope on internal governance structures. And an analysis of the efficacy of the formal arrangements in the UK suggests that beneficiaries have little influence in UK pension trusts as well.[72] This area warrants further comparative institutional research.

In the long run, the structural dominance of shareholders in PKs calls into question, whether the privatisation of old-age provision to credit institutions and its coupling with the promotion of capital markets optimally serves the beneficiaries' interests.

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