

# INDIVIDUAL PENSION SYSTEM 2022

## RISK INVENTORY





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# Message from Senior Management

**W**e are delighted to share our second report on the Individual Pension System Risk Inventory Project conducted with active participation by our esteemed stakeholders.

In 2021, we continued to fight the effects of the COVID-19 pandemic that was declared in 2020, and foresaw that these effects would continue well into the future. One of the greatest challenges stemming from the pandemic is undoubtedly the economic recession experienced around the world. According to the Global Risks Report 2022 published by the World Economic Forum, the global economy is expected to shrink 2.3 percent by 2024 due to the pandemic. Private pension developments throughout the year included easing the rules of “access” to global fund savings, introducing certain “exceptions” for the pandemic, and meeting the needs of people with financial difficulties.

Identified with surveys conducted around the world, the prominent risks for 2022 included financial difficulties, rising commodity prices, high inflation and problems in the labor market as well as cyber risks arising due to the increase in digital dependency caused by the pandemic.

Similar developments are observed in Türkiye, as 2021 has been a year of change in terms of our country's individual pension system. The Individual Pension Fund Trading Platform (BEFAS), which was

established during the year with the efforts of industry stakeholders, has paved the way for the participants to choose funds regardless of their pension company. With the amendment made at the beginning of 2022, the rate of state contributions, which is the most important tool for the industry's growth, was increased from 25 percent to 30 percent. Additionally, participants who make collective contribution payments can now receive state contributions over the following years. The savings can be paid partially, and can also be used for loan processes through the assignment of claims. This has created significant growth opportunities for the industry.

As part of our project, we identified the relevant risks and completed our technical studies for generating data-based risk warnings through digital processes and for communicating these risk warnings to the senior managers of companies.

Our efforts for improvement will continue in 2022, as we will be focusing on improving the scope and quality of the services covered in the project.

We would like to take this opportunity to thank all our stakeholders who participated in our surveys and supported our workshops.

Sincerely,

**MUSTAFA AKMAZ**

CEO

**ULUÇ İÇÖZ**

CHAIRMAN





# Executive Summary

As in the previous year, we identified the relevant risks at workshops held with the participation of our stakeholders. To serve this end, we organized five workshops with the participation of 115 stakeholders. The final versions of the risk definitions suggested by PMC were discussed and approved at these workshops, as “11 new risk definitions” were added to the inventory.

The new risks consisted of the issues arising from the economic effects of COVID-19, the impact of the changing set of competency requirements on the industry, climate change, business continuity risks in inter-company processes, and the Individual Pension Fund Trading Platform established during the year.

The electronic survey designed by the PMC was distributed to the target audience of 495 people consisting of relevant specialists and managers in stakeholder institutions, and 42 percent completed the survey. The summary profile of survey respondents is presented in Appendix 2.

The respondents received 65 risk definitions and sorted them based on risk severity, calculated by multiplying impact and probability. The top 10 risks listed in the responses are provided on Pages 6, 7 and 8 of the report.

In parallel with the results of the global-scale risk surveys, the external environmental risks arising from the prolonged economic and social effects of COVID-19 were among the first ones. This year, two new risks related to the external environment took their place among the top three risks. With the relative significance of “trust in the system” in the private pension system, which focuses on long-term savings and investments, and the sector’s sensitivity to the issue, the relevant risks were once again at the top.

It is observed that many of the operational risks are now better managed in line with the increase in digitalization incurred by the pandemic, and cyber risks ranking higher is considered to be a natural result of the increase in digital dependency.

# Substantial Risks According to Survey Respondents

The inventory focuses on the individual pension industry.

Risks discussed and approved by stakeholders during workshops were sent to survey respondents to be sorted based on impact and probability on a scale from 1 to 10.

## Risks by Severity (Impact\*Probability)

The risks included in the survey were sorted based on risk severity calculated by multiplying the impact and probability values provided by survey respondents. The resulting top 10 risks are listed below. The rankings of these risks in the previous year are provided in the table.

Rankings marked with “-” indicate new risk definitions that were not included in the previous year’s inventory.

**Table 1 – Top 10 Risks by Risk Severity (Impact\*Probability)**

2022 Rankings	2021 Rankings	Risk Definition	Risk Type
1	2	Impact of potential fluctuations in the economy on new contract entries	EXTERNAL
2	-	Exchange rate risk	EXTERNAL
3	-	Risk of widespread poverty	EXTERNAL
4	1	Potential improvements and changes in state incentives to the system	STRATEGIC
5	4	Perception of lower returns compared to alternatives	PORTFOLIO MANAGEMENT
6	8	Natural hazard risk	EXTERNAL
7	10	Risk of damage to system infrastructures as a result of cyber attacks	INFORMATION TECHNOLOGIES
8	3	Relative insufficiency of retirement income from the system and negative perceptions of the system	PORTFOLIO MANAGEMENT
9	6	Risk of customer dissatisfaction	STRATEGIC
10	12	Risk of perception of the system fulfilling an individual’s short-term needs versus the system’s actual basis on long-term savings	STRATEGIC

## Risks by Impact Level

Risk definitions were sorted based on respondent evaluations of the impact level on a scale of 1 to 10. The top 10 risks are presented in Table 2. The rankings of these risks in the previous year are provided in the table.

Rankings marked with “-” indicate new risk definitions that were not included in the previous year’s inventory.

**Table 2 – Top 10 Risks by Impact Level**

2022 Rankings	2021 Rankings	Risk Definition	Risk Type
1	8	Impact of potential fluctuations in the economy on new contract entries	EXTERNAL
2	1	Potential improvements and changes in state incentives to the system	STRATEGIC
3	2	Perception of lower returns compared to alternatives	PORTFOLIO MANAGEMENT
4	9	Natural hazard risk	EXTERNAL
5	4	Risk of customer dissatisfaction	STRATEGIC
6	6	Risk of operating license revocation or bankruptcy for pension companies	STRATEGIC
7	3	Risks concerning the perception of system reliability	STRATEGIC
8	10	Risk of damage to system infrastructures as a result of cyber attacks	INFORMATION TECHNOLOGIES
9	11	Reputational risk for companies and the system	STRATEGIC
9	-	Exchange rate risk	EXTERNAL
10	-	Risk of widespread poverty	EXTERNAL

## Risks by Degree of Probability

Risk definitions were sorted based on respondent evaluations of the degree of probability on a scale of 1 to 10. The top 10 risks are presented in Table 3. The rankings of these risks in the previous year are provided in the table.

Rankings marked with “-” indicate new risk definitions that were not included in the previous year’s inventory.

**Table 3 – Top 10 Risks by Degree of Probability**

2022 Rankings	2021 Rankings	Risk Definition	Risk Type
1	1	Impact of potential fluctuations in the economy on new contract entries	EXTERNAL
2	-	Exchange rate risk	EXTERNAL
3	-	Risk of widespread poverty	EXTERNAL
4	10	Risk of perception of the system fulfilling an individual's short-term needs versus the system's actual basis on long-term savings	STRATEGIC
5	11	Pandemic and epidemic risks	EXTERNAL
6	3	Relative insufficiency of retirement income from the system and negative perceptions of the system	PORTFOLIO MANAGEMENT
7	2	Potential improvements and changes in state incentives to the system	STRATEGIC
8	7	Perception of lower returns compared to alternatives	PORTFOLIO MANAGEMENT
9	-	Talent management – brain drain risk	STRATEGIC
10	-	The risk of being unable to access the competent workforce needed in information technologies	INFORMATION TECHNOLOGIES



## Notes on Risk Definitions in Tables

### Impact of potential fluctuations in the economy on new contract entries

This refers to the risks of lower amounts of funds available for savings and withdrawal of current individual pension system savings to fulfill urgent cash needs against high inflation, rising commodity prices and other effects observed in Türkiye and all around the world due to the pandemic.

### Exchange rate risk

This refers to the risks of people choosing foreign currency over the individual pension system for investment purposes as well as for loss of savings caused by fluctuations that have been observed in the exchange rate since the end of 2021.

### Risk of widespread poverty

This refers to the risks of financial difficulties reducing the amounts that can be put aside by individuals as savings and the use of current savings for primary needs in line with the global trend that is expected to continue to gain momentum.

### Potential improvements and changes in state incentives to the system

This refers to the impact of the improvement in the state incentives provided to the system on the industry's growth, collection rates and the system reaching a wider audience. It is possible that the amendment to increase the state contributions from 25 percent to 30 percent, which was on the agenda at the time of the survey, may have influenced the expectations of the respondents for the future. Just like last year, the industry views potential improvements and changes in state incentives as major leverages.

### Perception of lower returns compared to alternatives

It is known that returns obtained in the system are often compared to widely used investment tools such as deposits, gold and foreign exchange without consideration of factors such as risk level, risk appetite and differing payments.

This comparison feeds the perception that returns in the system are lower than other investment tools and, as financial literacy is substantially lower in Türkiye like it is in the rest of the world, this perception might discourage participation in the system while encouraging current participants to withdraw from the system.

### Natural hazard risk

Natural hazards directly affect business continuity, service provision capacity, income, and financial structure of all industries, including the individual pension system. Similarly, they may also impact the economy and human behavior, potentially reducing allocable savings amounts and prompting the early withdrawal of individual pension system savings.

### Pandemic and epidemic risks

This refers to the risks of devastating social and economic consequences created by a potential pandemic in line with the increased awareness and experience gained from the COVID-19 pandemic, which has affected the entire world for two years.

### Risk of damage to system infrastructures as a result of cyber attacks

This is a growing threat induced by process digitalization and remote working practices and is considered a substantial risk as it might impact service continuity in all industries, including the individual pension system, and damage industry reliability.

## **Relative insufficiency of retirement income from the system and negative perceptions of the system**

As the individual pension system is contribution-based, the retirement income from the system depends on the contribution amount and its returns. Participants may be dissatisfied if they made payments (widely) disproportionate to their expected pension income during their accumulation period and therefore could not receive the amount they expected in retirement. Their expression of this dissatisfaction through various communication channels might negatively impact others who lack basic information about the system.

## **Risk of customer dissatisfaction**

As is known, private pension systems rely on regular payments and continuity to provide the expected benefits. Therefore, longer periods in the system is a global performance criterion in terms of meeting participant expectations of pension and minimizing corporate costs reflected on participants. Dissatisfaction with the system has become an important risk that needs to be addressed as social media interaction increases, reaching wider audiences.

## **Risk of perception of the system fulfilling an individual's short-term needs versus the system's actual basis on long-term savings**

The individual pension system requires a long-term commitment to provide the expected benefits and to effectively implement appropriate investment strategies. This risk definition refers to the perception of the system as an ever-available investment tool to fulfill urgent short-term needs.

## **Risks concerning the perception of system reliability**

The growth and improvement of private pension systems require continued trust in the system as it is a long-term structure and offers commitments for later years in life. With this in mind, industry stakeholders consider the damage to the perception of reliability, a key and well-protected aspect of the system since its establishment, a substantial risk to system growth.

## **Reputational risk for companies and the system**

This refers to the risks of adverse events in pension companies or the industry affecting the reputation of companies and the entire industry, and the effects of this loss of reputation on growth expectations.

## **Risk of operating license revocation or bankruptcy for pension companies**

While lower in probability thanks to firm supervision and audit mechanisms, this risk focuses on the possible impact on industry growth and potential damage to the perception of reliability of other companies in the industry rather than on direct consequences to participants, as participant funds are kept separate from corporate assets in individual accounts at Istanbul Settlement and Custody Bank.

## **Talent management – brain drain risk**

This refers to the risks of facing challenges in acquiring human resources, as qualified people that meet the new competency requirements brought along by new technologies and needs may prefer to work abroad or in other industries.

## **The risk of being unable to access the competent workforce needed in information technologies**

With digitalization making its way into the priority targets of the industry and the companies, and competence in information technologies becoming a critical requirement in the acquisition of human resources, accessing and retaining this workforce has become a major issue for the pension industry, as it has for all other industries.

## Conclusion and Assessment

### The Top Three Risks in the Risk Inventory are External Risks.

While related to general economic indicators, widespread poverty and exchange rate risks were identified as separate risks at the relevant workshops. Potential fluctuations in the economy, exchange rates and poverty risks, which are in the top three in terms of impact and probability, are external risks that arise from the ongoing effects of COVID-19 and cannot be controlled by the industry.

### Operational Risks

There is no operational risk among the top 19 risks. Operational risks lag far behind in terms of impact and probability when compared to strategic risks, economic risks, and cyber risks.

### Cyber Risks Rank Higher in Senior Management and Internal Systems.

Compared to other respondents, members of the senior management and internal systems rank information security risks in the top three risks. In our industry, it will not be inaccurate to say that the cyber risk awareness of senior management is quite high.

### Changing Ways of Doing Business Have Brought Along Certain Risks for the Acquisition of Human Resources.

In line with the increasing digitalization in the industry and the subsequent setting of higher strategic goals, the set of competencies required by companies has also changed. The challenges faced in accessing human resources compatible with this changing skill set were ranked as a major risk in terms of achieving company and industry goals in the following periods.

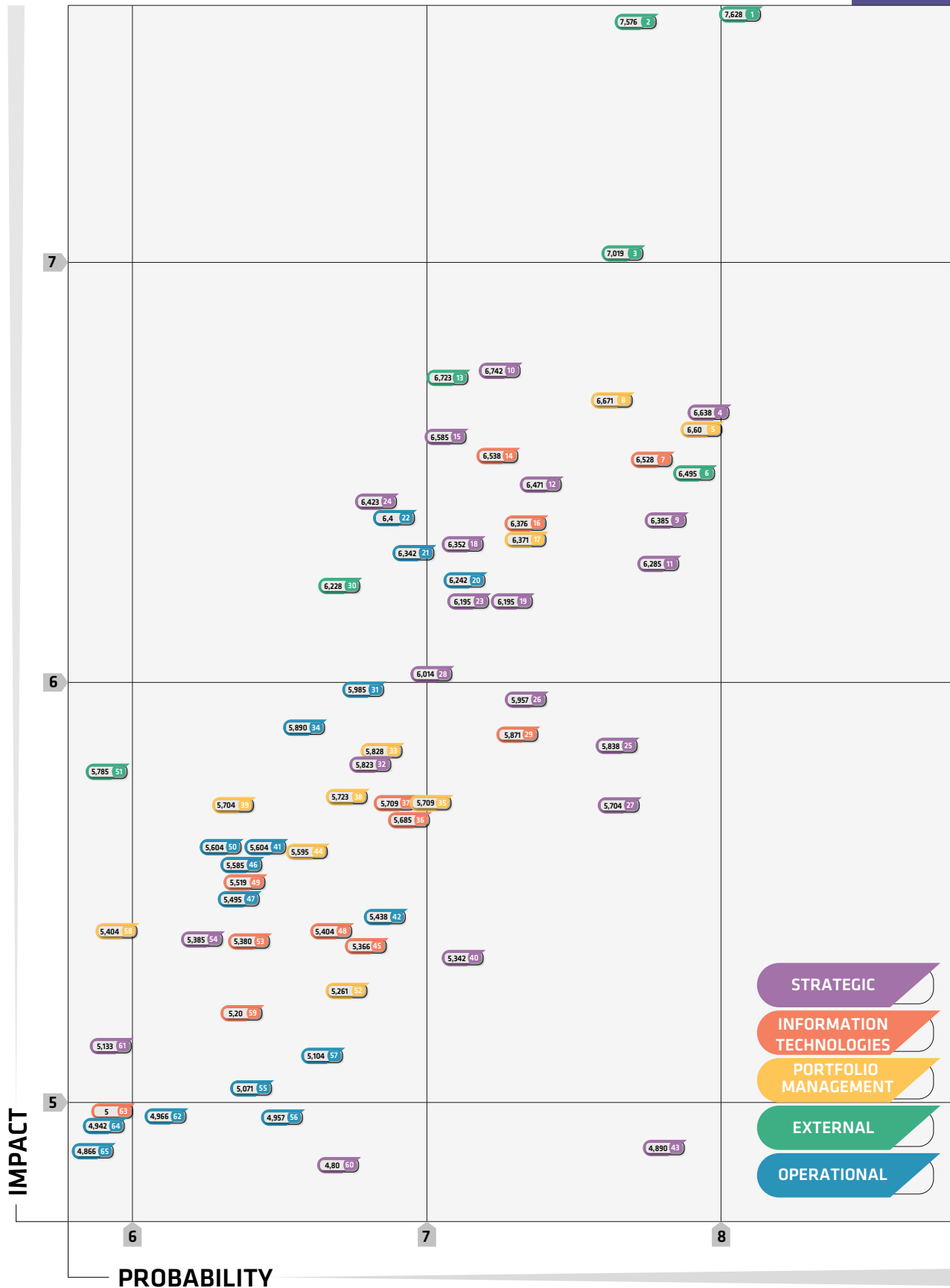
### Customer Satisfaction is Among the Priorities of the Industry Once Again.

The private pension system, where long-term relationships are established based on trust and risks related to improving customer experience and ensuring satisfaction emerge as some of the most critical focal points of pension companies, continues to put particular emphasis on the management of perception and reputational risks.

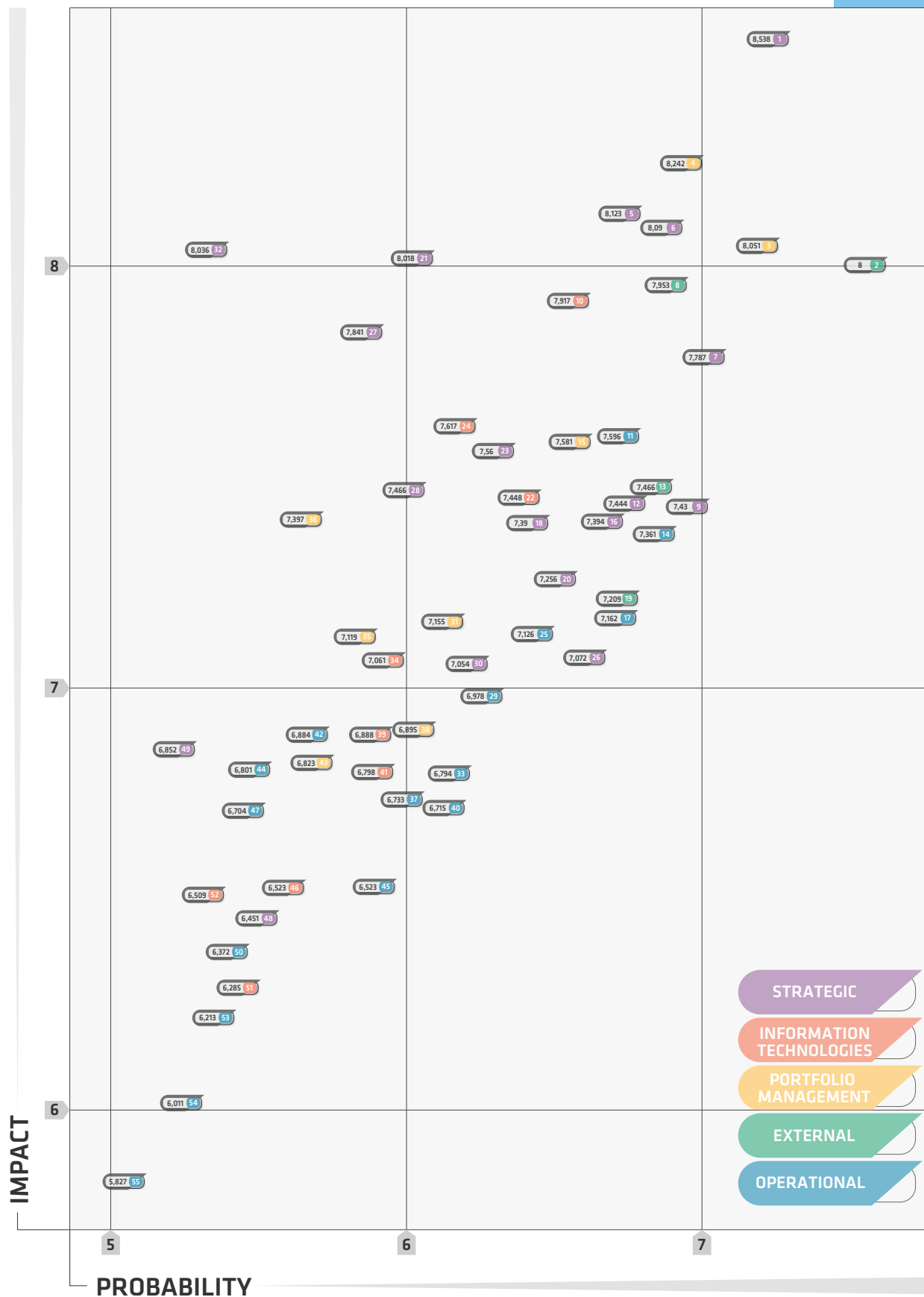


APPENDIX 1. RISK MAP

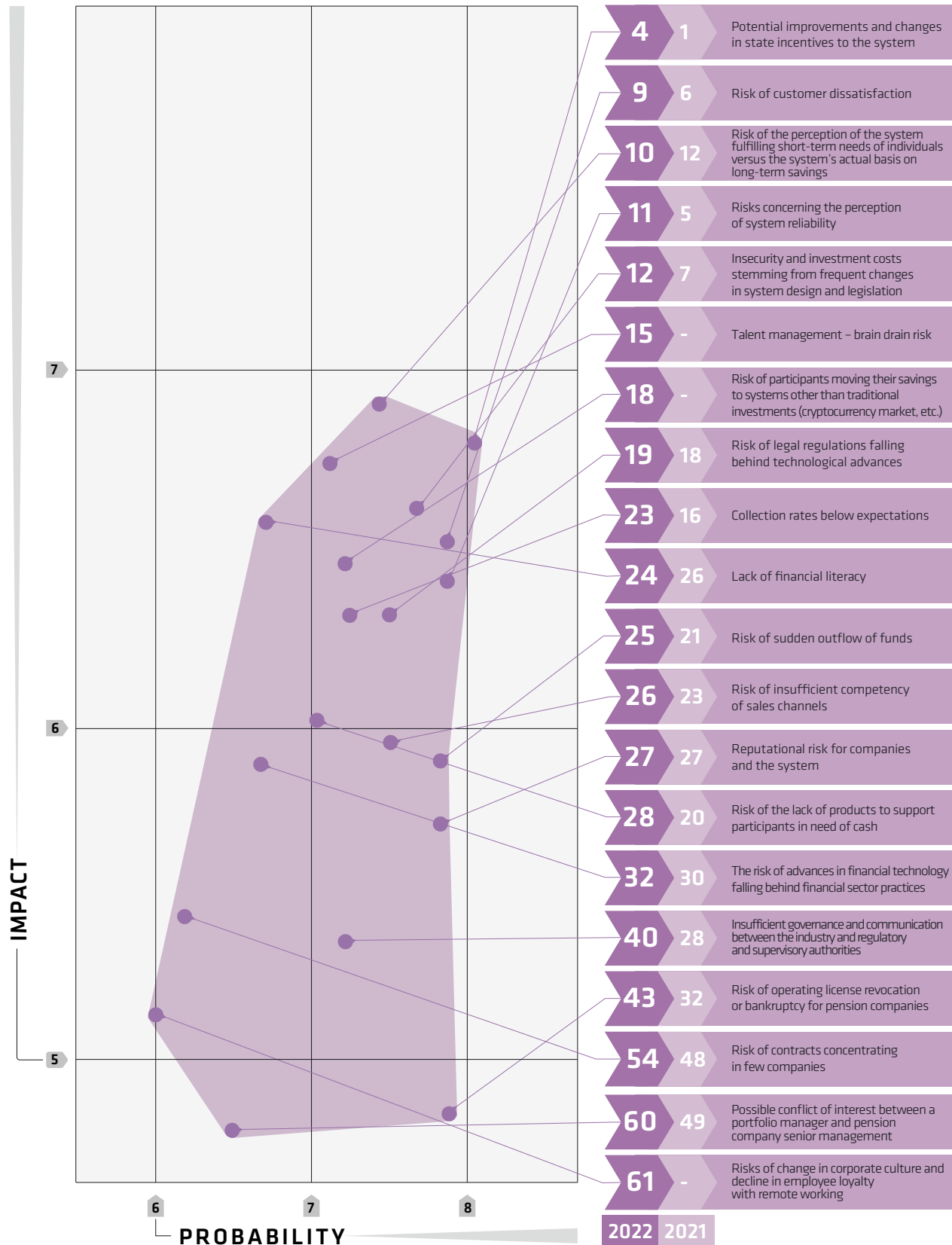
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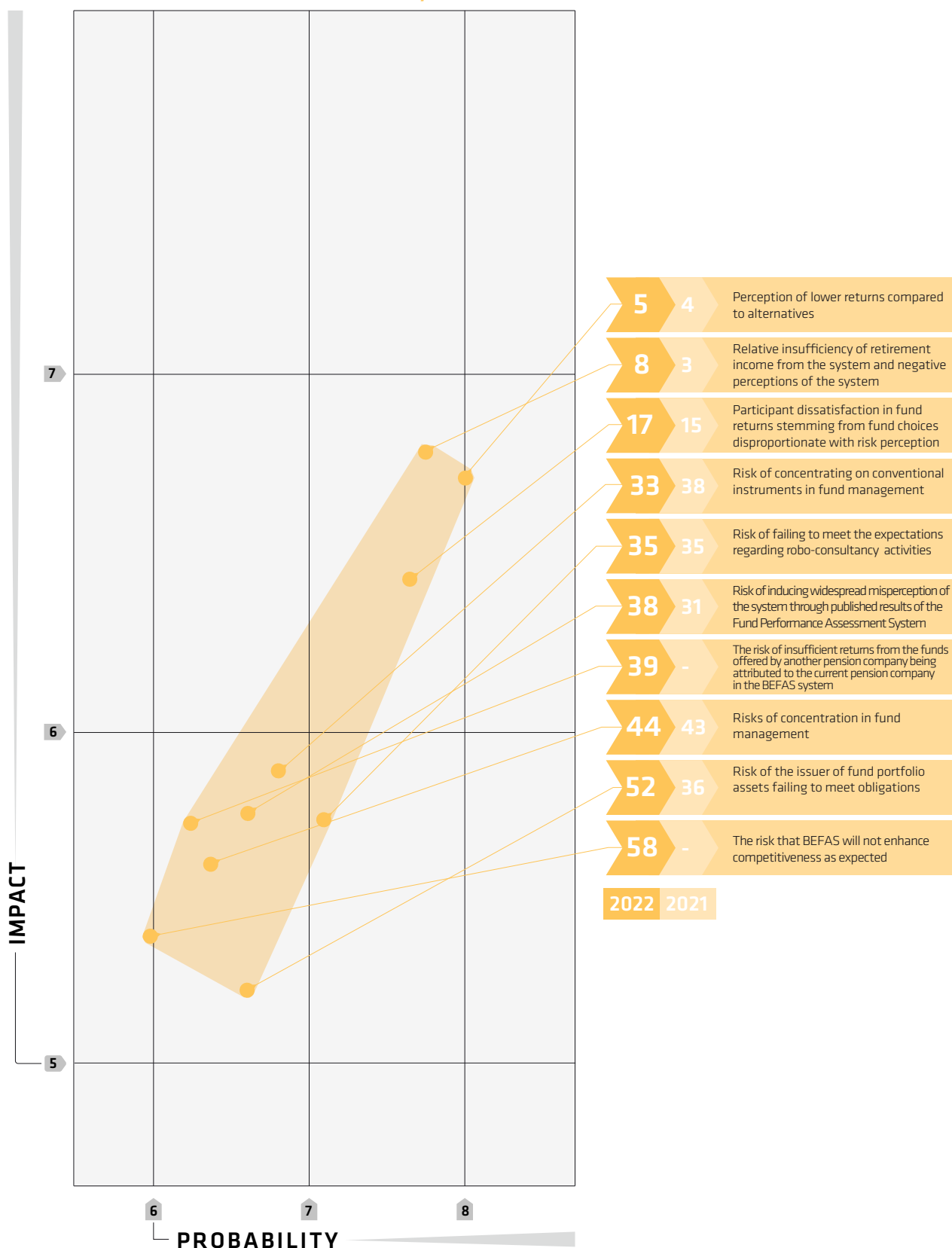
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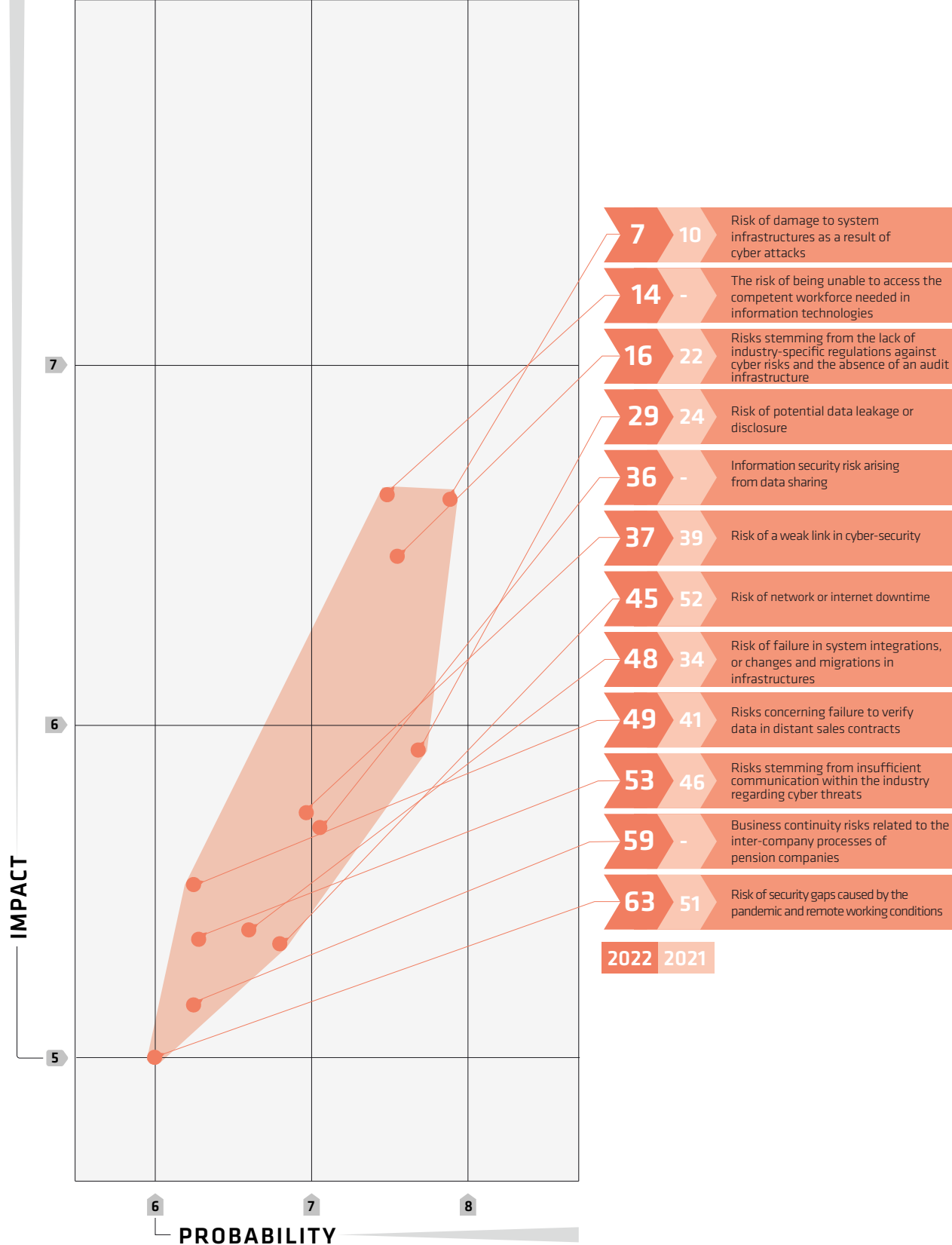
APPENDIX 1. RISK MAP/ STRATEGIC RISKS



## APPENDIX 1. RISK MAP / PORTFOLIO MANAGEMENT RISKS

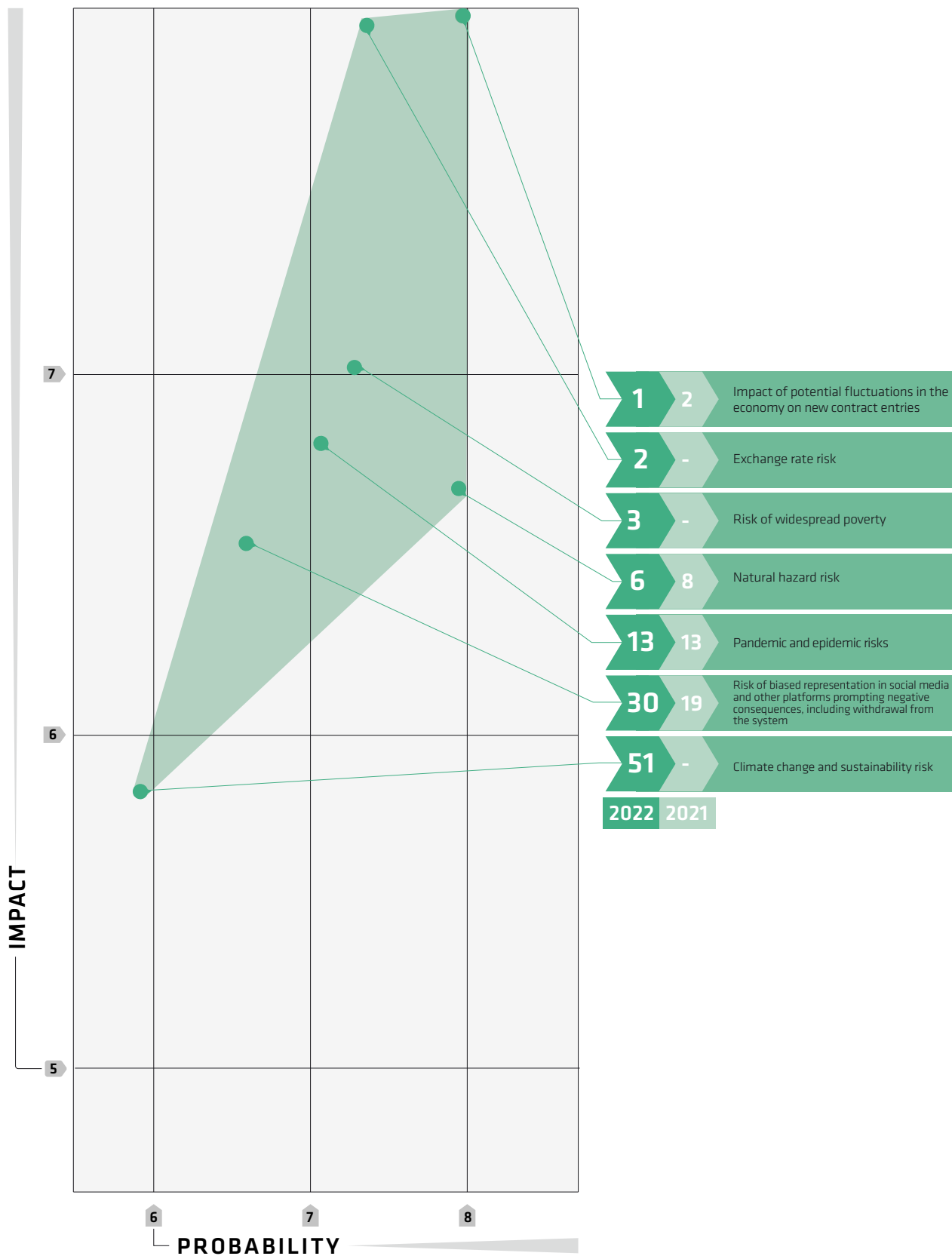


APPENDIX 1. RISK MAP / INFORMATION TECHNOLOGIES RISKS

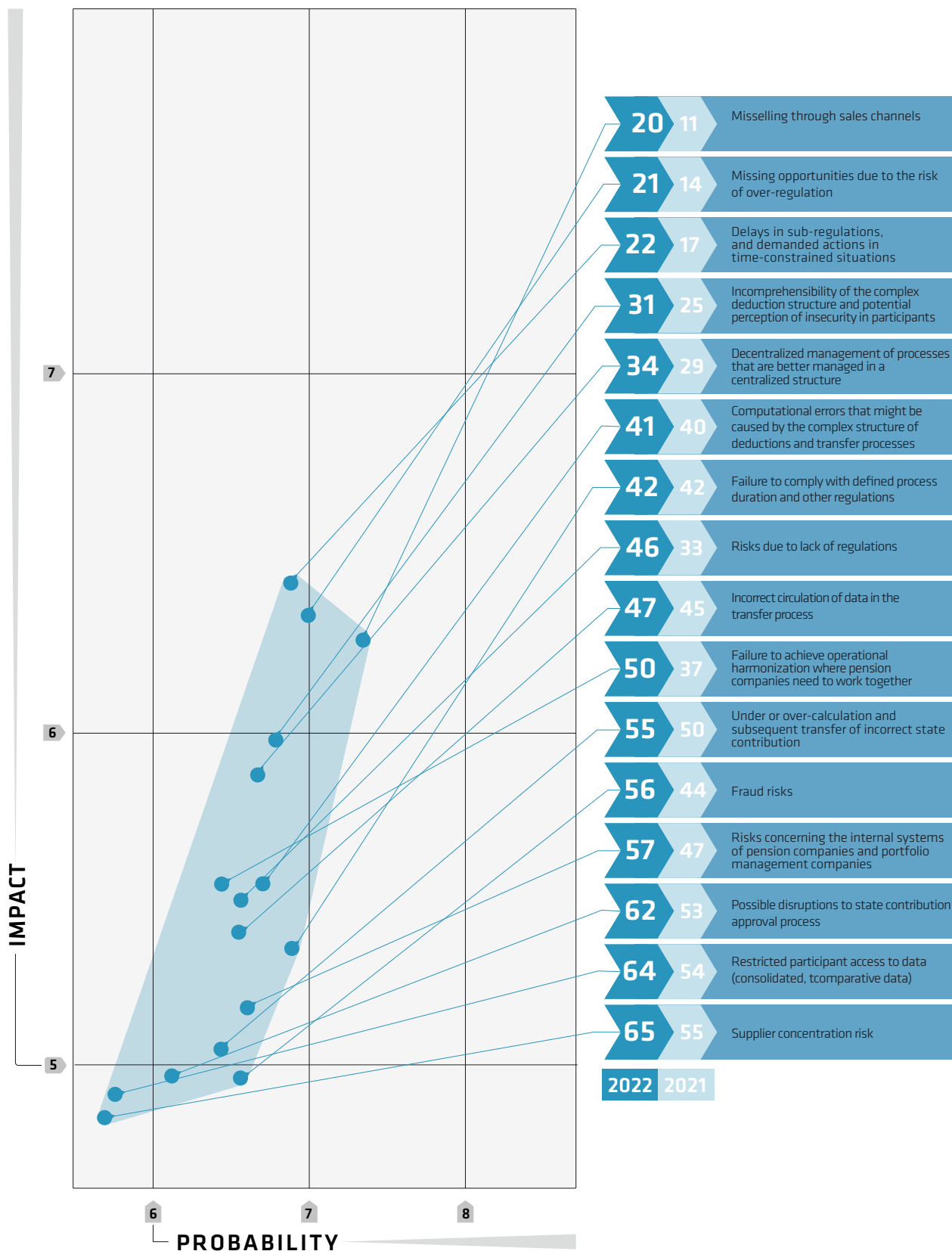




## APPENDIX 1. RISK MAP / EXTERNAL RISKS



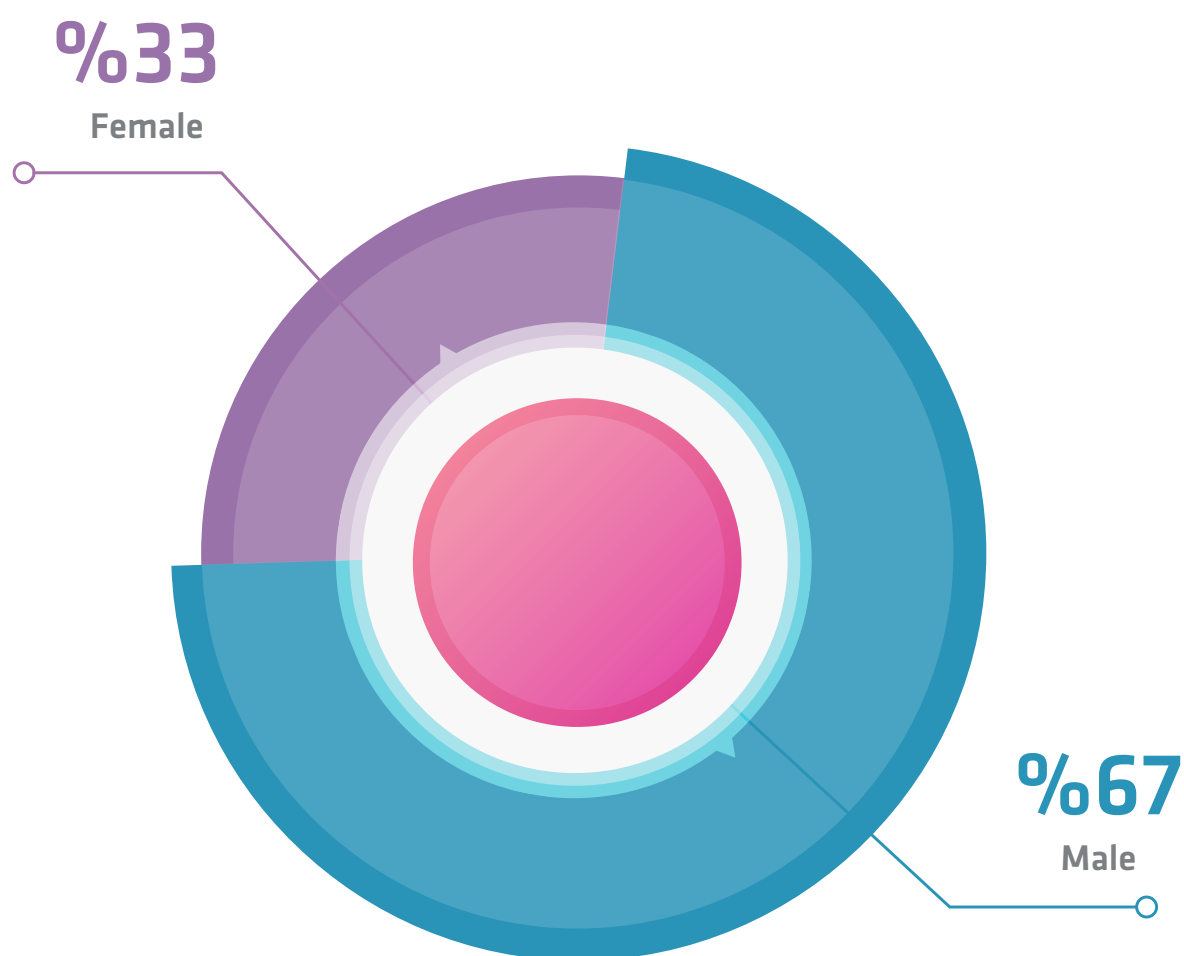
## APPENDIX 1. RISK MAP / OPERATIONAL RISKS



## Appendix 2. Profile of Survey Respondents

### Distribution of Survey Respondents By Gender

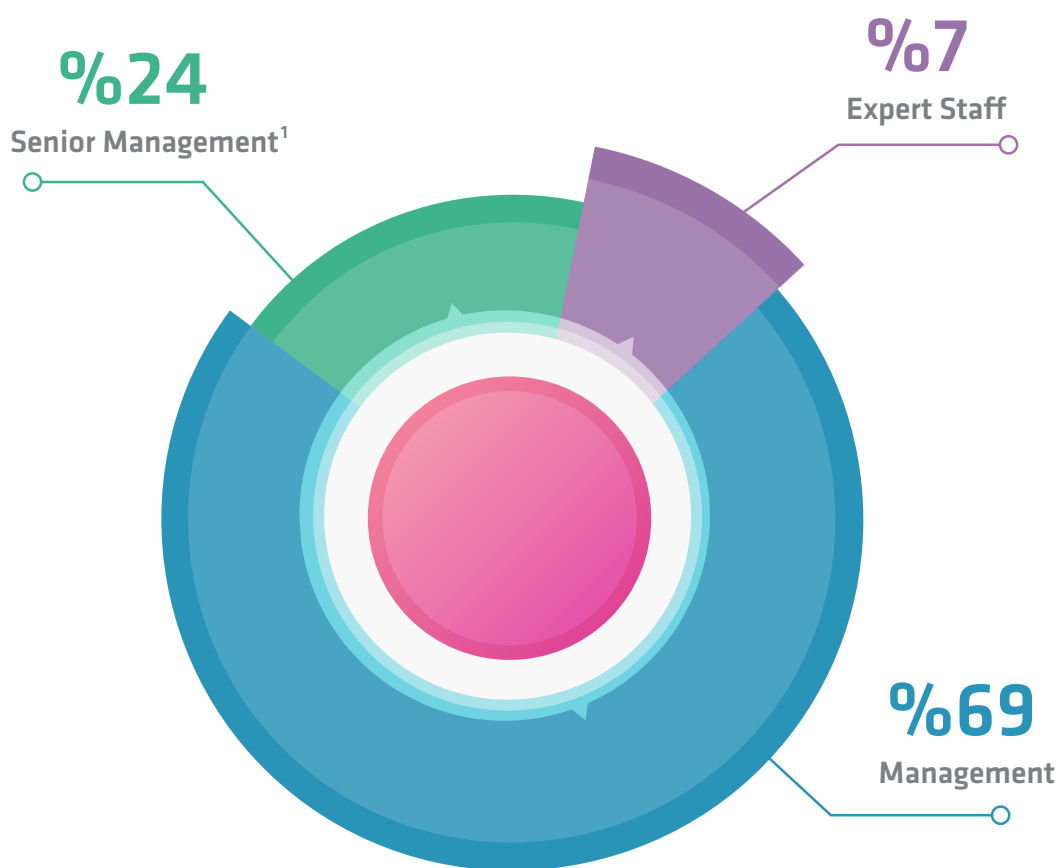
Of the 210 survey respondents, 69 are female, and 141 are male.



## Appendix 2. Profile of Survey Respondents

### Distribution of Survey Respondents By Management Level

Of the survey respondents, 69 percent are in management while 24 percent are in senior management.

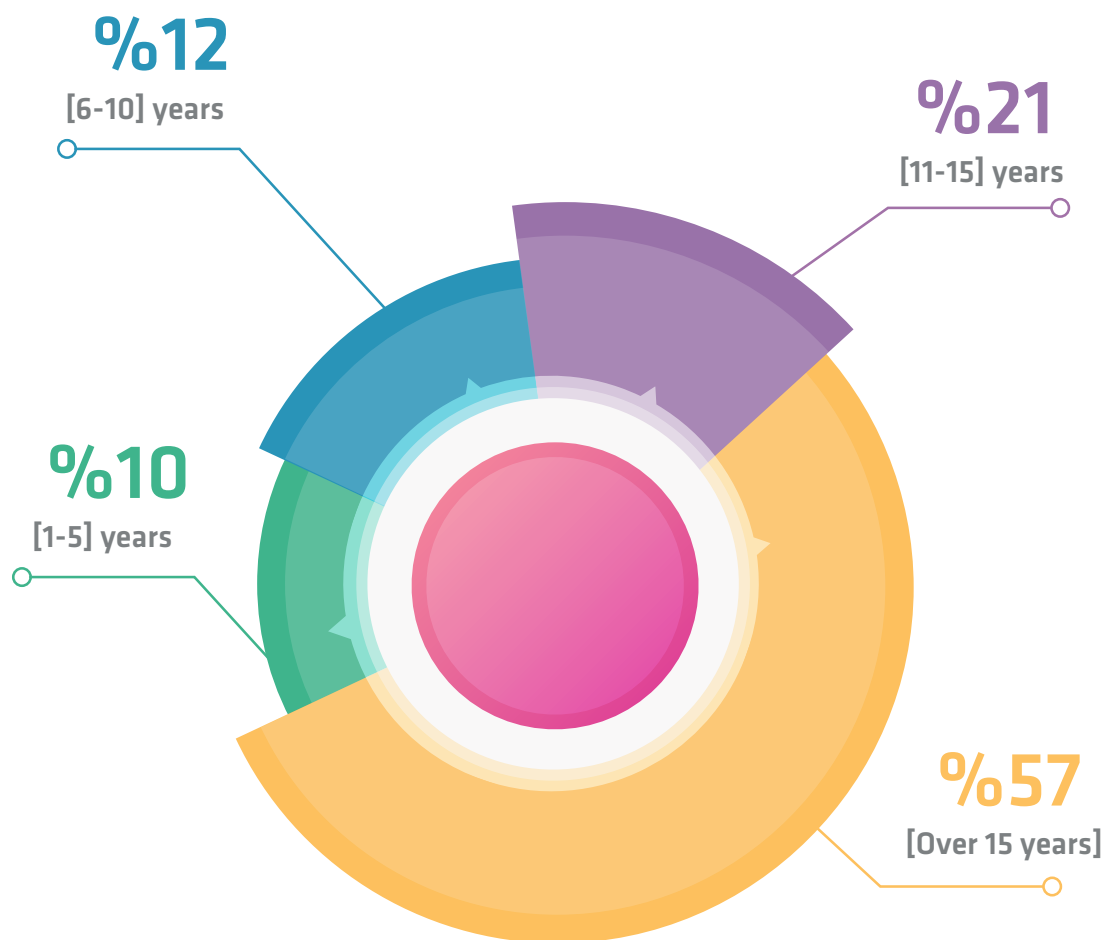


(1) Senior Management level refers to the General Manager, CEO, CFO, CIO, CRO, Deputy General Manager, Director, Coordinator, Legal Consultancy, and senior management of Regulatory and Supervisory Authority.

## Appendix 2. Profile of Survey Respondents

### Distribution of Survey Respondents By Industry Experience

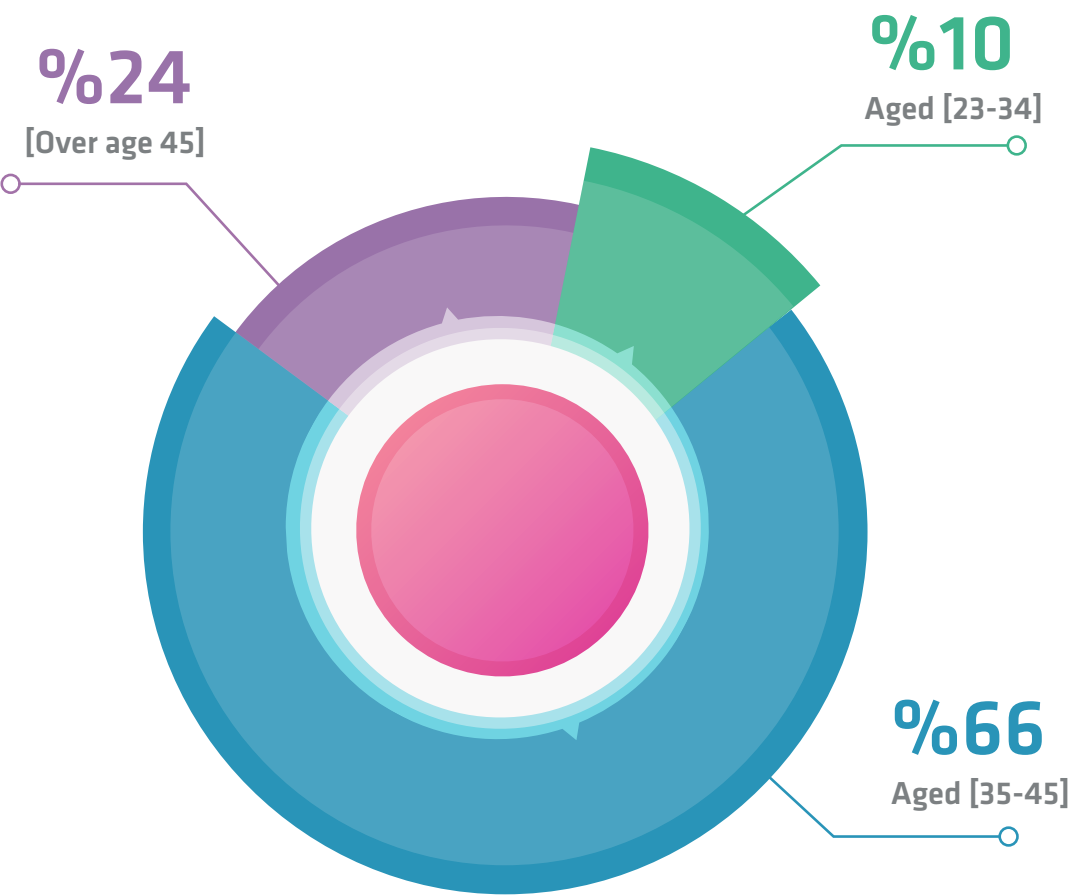
Of the survey respondents, 78 percent have over 11 years of industry experience.



## Appendix 2. Profile of Survey Respondents

### Distribution of Survey Respondents By Age

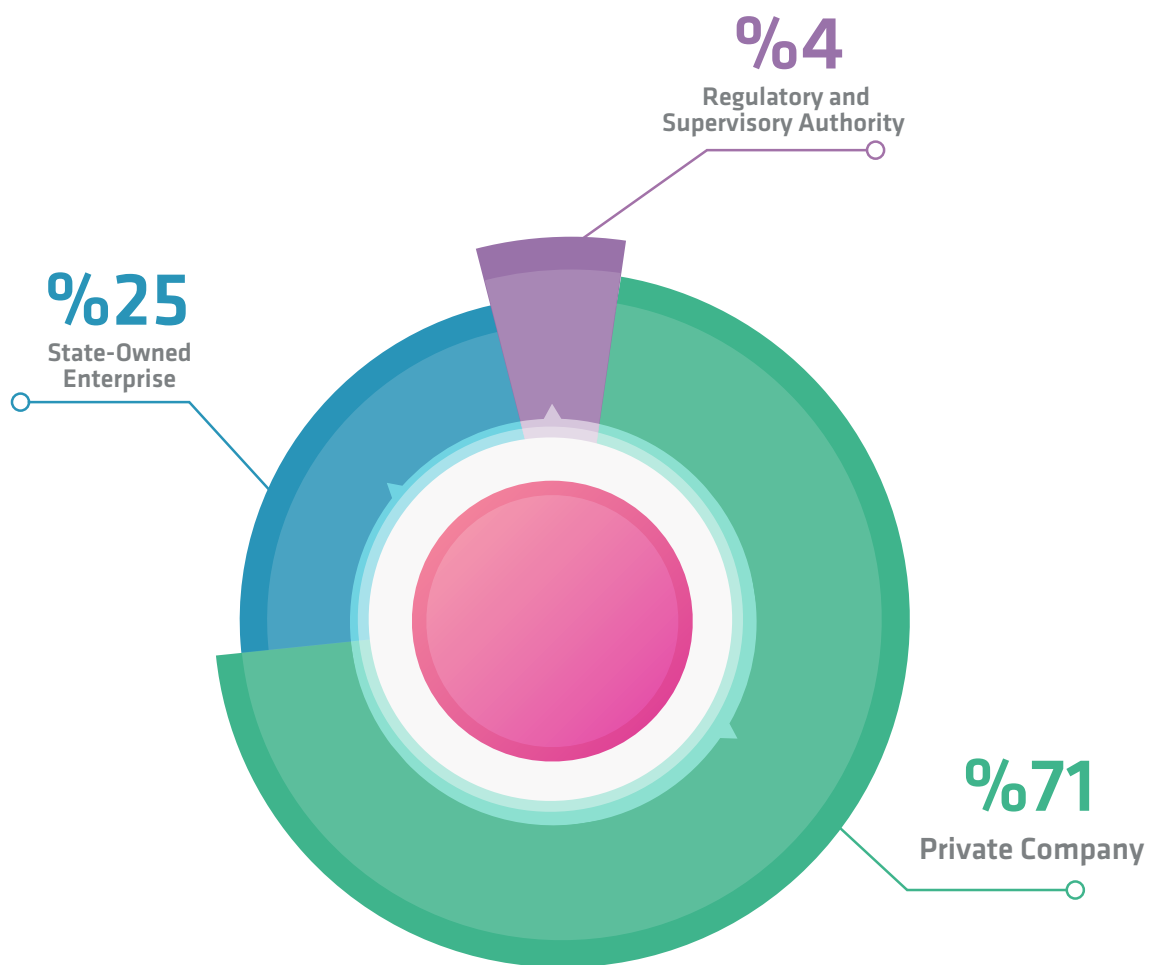
Of the survey participants, 90 percent are aged over 35.



## Appendix 2. Profile of Survey Respondents

### Distribution of Survey Respondents By Employment Institution

Of the survey respondents, 71 percent work for private companies; 25 percent, for state-owned enterprises, and 4 percent, for regulatory and supervisory authorities.

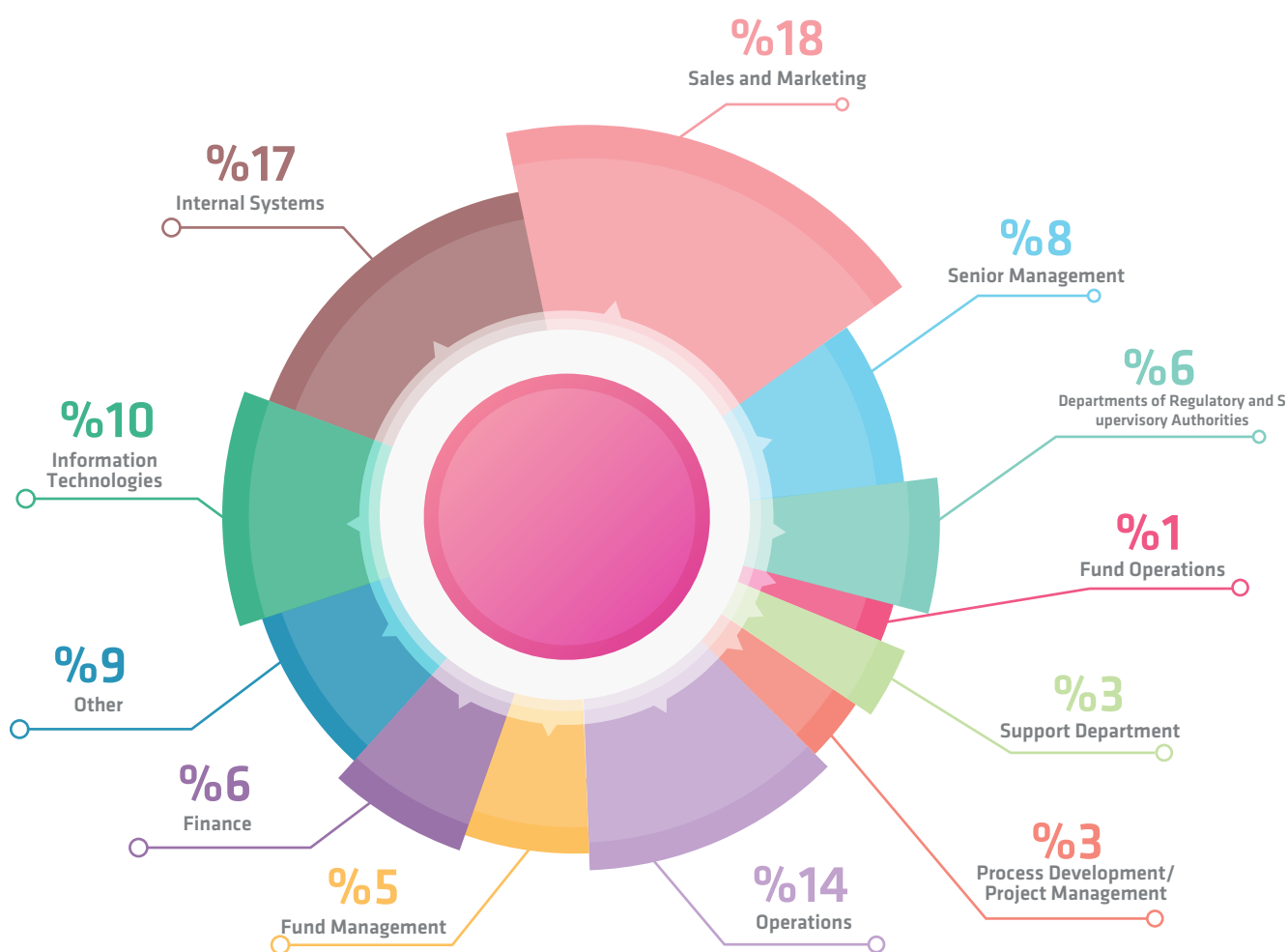


- Private Company (company subject to the provisions of private law, with capital distribution and control held by real persons or legal persons in the private sector)
- State-Owned Enterprise (A company with at least 50 percent of its capital owned or controlled by the public)
- Regulatory and Supervisory Authority

## Appendix 2. Profile of Survey Respondents

### Distribution of Survey Respondents By Work Department

Of the survey participants, 18 percent work in sales and marketing; 14 percent, in operations; 17 percent, in internal systems; and 10 percent, in information technologies department.







This report was prepared and reviewed by the Internal Control and Risk Management and Internal Audit Departments of the Pension Monitoring Center based on workshop outcomes and survey results and was approved by the General Directorate.

Contact us at <https://egm.org.tr/contact-us/contact-us/> for further inquiries or suggestions concerning the report.

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