Redistributing Risk – Tuleva as a Case Study

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(Based on a lecture for REALTY: STATECRAFT, at ExRotaprint, 17 November 2018)

“Imagine a world that moves from an extractive to a distributive model – in which Amazon is owned by its sellers, Uber is owned by its drivers, and Facebook is owned by the people who create its content,” wrote Douglas Rushkoff, then an editor of The Financial Times in 2016.

At this point, it is a little difficult. Could the world still hold tiny pockets of possibility for alternative, distributive models to germinate?

I

In Estonia, the user-owned fintech Tuleva has identified one such hidey-hole of opportunity: the pensions market.

II

Challenge: think of something less sexy than pensions.

Or something more confusing than your pension plan.

Mandated or strongly incentivised by law, people around Europe – the wealthy as well as the struggling – regularly invest in stock markets through pension funds. Many aren’t even aware that they are doing so. We lose money, playing a zero-sum game with fund managers – the middleman’s cut eating into slender returns.

For fund managers, the pensions market is a source of guaranteed income. The old players are guarded by a shield of boredom, and a web of complexity.

In a profitable slumber, financial institutions are slow and inert, giving a newcomer relatively ample time to sneak in. Even a tiny piece of this market can provide a sustainable revenue base. This is crucial if you tried to, say, build a foundation for a more collective, cooperative fintech company.

III

By now, financialization – the growing dominance of financial institutions in public and private domains – is a firm, default living condition. Kind of like the weather – you can moan about it, but you cannot avoid it.

In the West, the process of financialization took several decades, brought on by a series of contingent events. In post-Soviet Estonia it was a goal in and of itself, pushed forward with radical speed.

In the 90s, the new government felt it had one job: to leave the Soviet experiment behind, and to then accelerate and catch up with the globalised market economy. Under the IMF’s guidance, flows of finance would provide a safety net for Estonia’s fragile sovereignty. To attract foreign investment, the signaling must be simple and convincing: we offer great returns at minimal risk. Risk, therefore, had to be redistributed and underwritten by the local population.

The strategy, more aggressive than our neighbours’, worked: Estonia’s economy has been amongst the fastest-growing ones in the ex-Soviet camp. By today, most areas of our economic and social life are dominated by 3–4 mostly Scandinavian- and American-owned banks.

IV

Replacing defined benefit pensions (a state’s pledge to its citizens) with defined contributions (at every individual’s personal risk) is one manifestation of a state’s shifting focus from offering security to their citizens to pitching value to investors.

Until recently, the idea of a pension was simple: the retired would get a fixed allowance. In a financialized world, a promise of the sort becomes a

liability, a risk that states prefer to remove from their books.

With the provision of social security expected to decrease, or perhaps gradually disappear, the burden is now on every individual to not just "save responsibly", but navigate opportunities and risks in global capital markets.

For a country the size of Estonia, it would be more efficient to run a consolidated pension pool. Shuffling thousands of small contracts is costly. Individual accounts have no negotiating power. Yet capital prefers national balance sheets wiped clean of demographic risk.

V

Today, mandatory pension investment in Estonia is 16 years old. Salary earners invest 6% of their monthly income through a licensed pension fund. There's no opting out.

Pension funds have proved an excellent business for banks, but a shoddy proposition for the people.

According to a report published by OECD, Estonia's funds stand out for being the greediest in terms of fees (that's what the banks charge), and the worst in terms of returns (that is what the pension savers get). Considering that high fees and substandard returns are apparently a problem of retail investment funds everywhere, this is quite an achievement.

"Pensions and investments remain ranked at the bottom of all consumer products," states Betterfinance, a European advocacy body representing individual investors and financial services users (referring to EU consumer scoreboards).

The outcome is that most people deeply distrust the system. Overwhelmed and confused, many consider the monthly mandatory pension payments as money lost. ("I don't trust banks anyway. My children are my pension pillar.")

(Banks, for their part, really like the fact that we believe that money doesn't buy happiness.)

Frustration usually contains an opportunity to try something new.

What if we cut out the middleman and started our own pension fund? A fund whose owners don't play a zero-sum game with the users – and whose users are actually the owners?

VI

So, how do you start your own pension fund?

In finance, as is the case elsewhere, scale is power. Operating alone, my risk capability is low, my negotiating power weak.

Tuleva was emerged from a calculation on the back of a napkin about three years ago. My colleague Tõnu Pekk estimated that if about 3000 people pooled together their pension savings, a considerably cheaper, better fund would become viable. So we needed allies, a lot of allies.

A few friends were already on board, but to achieve wider traction, reputational capital had to be raised.

Tõnu pitched the idea to about 20 people who are well-known and trusted in Estonia, for a variety of different reasons. Almost every one of them were willing to offer a public face for the plan.

The profiles of the 22 founding members helped attract media attention and create widespread trust. When we went public, with a simple wordpress website, 1,000 people signed up within the first couple of weeks.

It wasn't about subscribing to a mailing list.
Every member contributed 100 euros for start-up costs: stuff like building the IT architecture, legal help for preparing license applications, etc.

We also needed to raise 3 million euros for a liquidity reserve – a legal requirement for any company aspiring to manage a mandatory pension fund.

Venture capital wasn't an option: involving a third-party investor would have only brought us back to the inevitable conflict of interest between owners and users, the zero-sum game that we aimed to overcome.

So we offered the first 3,000 members a voluntary option to contribute anywhere between 1,000 and 10,000 euros. As the law requires, the money was invested in the managed fund itself, so the contributing members could earn investment returns, in addition to the returns that their mandatory pension savings produce.

It was important that as many people participate as possible, so that both the risks and potential returns could be evenly distributed. Almost 2,000 members out of 3,000 chose to contribute – not ideal, but close enough.

All this took about a year. Tuleva received a license from the finance watchdog in March 2017. In the first three days, 3,000 members transferred their mandatory pension savings. Collectively, we were now officially

running our very own pension fund – a low cost, fully automated index fund.

Our money is invested in global stock and bond markets, so it is still exposed to market risks. In this sense, not much has changed. However, we now own possible returns as well as losses. Up until now, about half the returns had gone to the middle man.

VII

Two things make Tuleva radically different from most start-ups and fund managers.

1. Capital is separated from governance. The members have agreed that each of us has one vote, regardless of capital contribution. Your life savings matter as much to you as to the next person, regardless of how much or how little you have.

2. Membership, and hence votes, are not tradeable. This ensures that nobody can take disproportionate control over decision-making or profits. Under agreed conditions, the contributions can only be sold back to Tuleva at book value.

So there is no speculative exit strategy for any individual member, even though as a collective, we could of course decide to sell any given part of our enterprise, and divide the gains.

By the end of January 2019, this people's pension fund was managing the savings of over 9,000 pension savers, 4,000 of whom are Tuleva members – in other words, co-owners. (Anyone who doesn't want to become a member, or cannot afford the 100 euro membership fee, is free to transfer their pension savings to Tuleva at no cost). In total, the fund had over 80 million euros under management.

With the population barely exceeding a million, Estonia is a good testing ground, where change can happen relatively fast.

Tuleva has more active members than most political parties. We work with government bodies and expert groups, to push legislation to make the pension system fairer, simpler and more efficient. For now, these are small, technical changes, yet they save every working person real money.

The questions raised by Tuleva have developed wider resonance and awareness, which in turn has resulted in pensions becoming one of the central issues of political debate in the forthcoming elections.

The old bank-owned fund managers have also been forced to react, and to lower their fees (though only marginally so far) – bringing small again even to those users who aren't with Tuleva yet.

VIII

Clearly, our relationships with financial institutions reflect a huge power asymmetry. But there's also a relational discontinuity.

Dealing with the bank is at best an annoying experience. I cannot do much about it, so I assume a passive, though critical, victim position. Don't we all love to slag them off?

For the financial sector, our names don't signify our weary faces, but markers in portfolios, markers of assets and liabilities. We are creditors and probably credit seekers. Our pension plans, however humble, make us investors. Financial crisis bailouts foregrounded our burden of risk-underwriting. As voters, we warrant the regulator.

The financialized world makes portfolio managers out of each and every one of us. Our selves smash into self-similar fractals that converge into multiple user profiles, only to diverge again.

Here, the risk-averse pay a premium to secure near-certain loss. When potential returns are diluted between multiple agents, or seem unquantifiable altogether, profits are often left unattended, for third parties to seize.

As a portfolio of assets, we have a structural complicity with everything we love, but also everything we hate. Our hopes and fears merge with dynamic flows of capital.

Financialization is not a layer glued on to everyday life, it is everyday life.

IX

Tuleva's goal is to pool together our investment portfolios, but also to consolidate some of these relationships, so that we can shift from the position of a disgruntled user to that of a collective portfolio of roles-assets that can be leveraged for our own needs.

Here, pensions are not the end game, but a tactical move. The mandatory pension fund provides a sustainable income stream that not only gives us negotiating power, but could fund further developments.

In Tuleva, we already pay three times less in fees than the average person. Our common fund manager, though still relatively tiny, has reached break-even. As we grow, the running costs will increase only marginally – and our mutual business will start generating profit. It will be up to the members to decide if they prefer to lower the fees further, or put the surplus to work for new projects.

What could those projects be? Today, we honestly don't know what the long game might be.

For now, we are moving in small, functional steps. Over the course of 2019, we hope to launch two new, voluntary investment funds for additional savings. Further down the line, meanwhile, Tuleva will consider peer-to-peer insurance and low interest mortgages. Social impact bonds, strategic investments and partnerships – all these options will be up to the members themselves to decide upon.