IS THE SUPPLY OF SECOND PILLAR PENSION FUNDS AND INVESTMENT STRATEGIES SUFFICIENT IN LITHUANIA?

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Summary

- Lithuanian pension system in brief.
- Performance of the funded part and current discussions on funded system.

- Statistical analysis of average returns achieved by different pension funds in Lithuania and other Baltic States.
- Results of analysis.

Lithuanian pension system: pillars

- First pillar: traditional public pay-as-you-go system (from 1995).
- Second pillar: funded part designed as partial replacement of traditional pay-as-you-go pensions system (from 2004).
- Third pillar: fully funded defined contribution system (from 2004).

Similar approach to the pension systems was introduced in most post communist European countries in last decade of 20th century and first decade of 21st century.

Second pillar: reasons

- Adaptation of pension system to the ageing of population: make reserves in "good times" waiting for "bad times".
- Diversifying of old age protection between public and private, *payg* and funded, defined benefit and defined contributions.
- Expectation of better performance of private sector versus public.

Second pillar performance: return

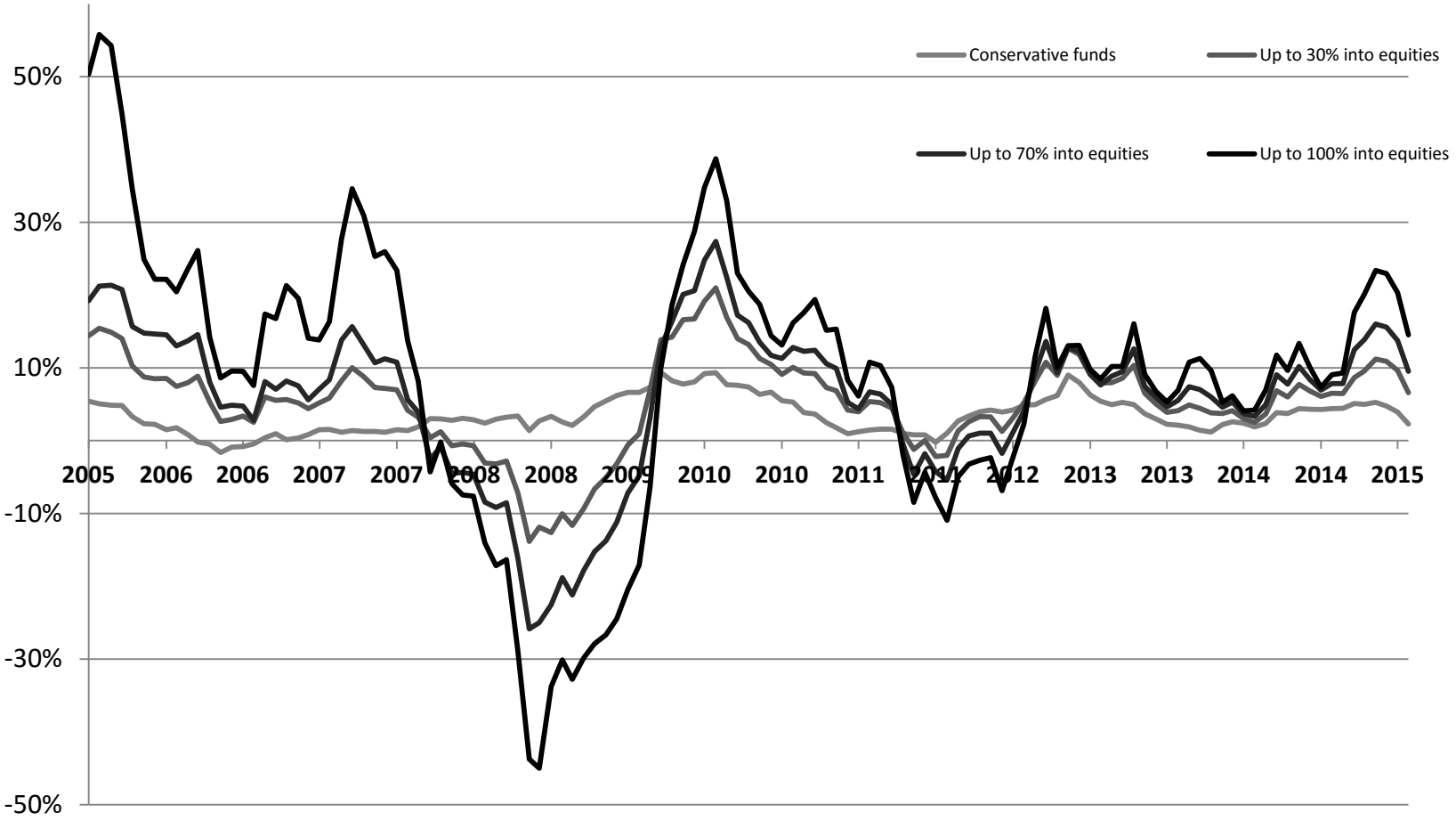
12-month rolling returns of pension funds categories (%)

	2004	2005	2008	2009	2010	2011	2012	2013	2014	2015
Conservative	4,58	2,21	2,94	8,01	3,12	1,41	6,47	0,58	4,02	1,24
Small part of equities (30%)	9,05	7,52	-12,00	13,36	6,17	-0,41	10,94	3,37	8,20	3,08
Average part equities (70%)	11,88	15,10	-27,47	21,60	10,60	-4,15	12,24	4,61	7,95	3,63
Pure equities	76,00	21,31	-54,91	27,56	18,82	-10,82	13,06	9,38	9,73	6,64
Average	11,60	10,59	-19,71	17,31	9,05	-2,88	11,21	4,28	7,78	3,61

Nevertheless average return rate is reported around 5 per cent per year.

Second pillar performance: return

12-month rolling returns of pension funds categories



Second pillar performance: amount paid

From the point of view of II pillar participant – average wage earner:

in the years 2004 - 2013 a person accumulated around €2000, but had lost about €10 per month of I pillar pension.

"Basic" annuity calculated from €2000 is bigger than €10, but commercial one (available in Lithuania) is smaller.

Second pillar performance: public finance

The amount transferred in the years 2004 – 2015 from I to II pillar was €1767 million. Current assets are € 2118 million.

I pillar pensions because of transfer were smaller, but we enter to the ageing future with accordingly smaller obligations. Was it good or wrong policy?

Second pillar: policy response to the crisis

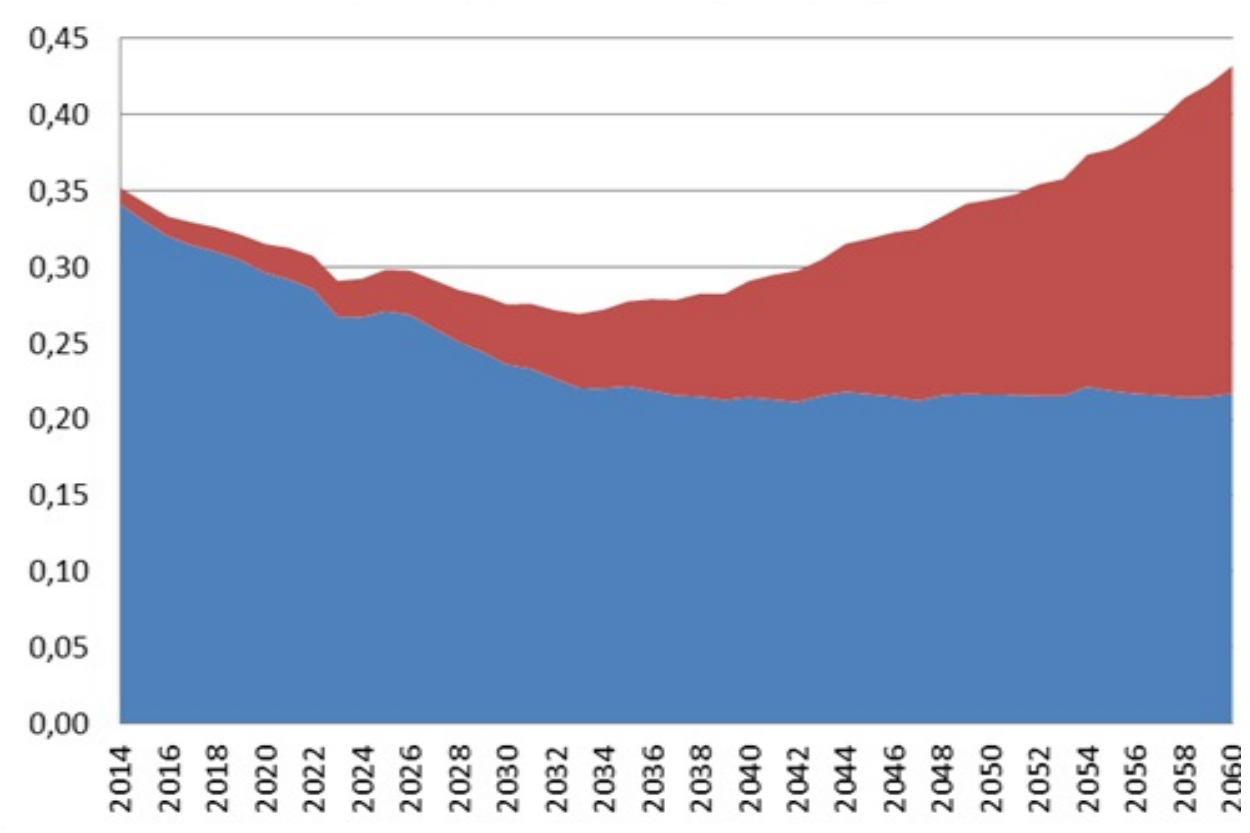
Lithuania: reduced contributions rate in 2009 from 5.5% to 2% and later (2014) reformed system into so called "2+2+2" approach.

Latvia: reduced the contribution rate for second pension pillar from 8% to 2%. Only in 2016 the contribution rate was restored to 6%.

Estonia: suspended state contributions to funded pensions from June 2009 until 2011, but retained a possibility to make private contributions of 2%. In 2011 the contribution system was partly resumed and from the beginning of 2012 the initial system (2% as personal contribution and 4% as State transfer) was restored.

How to continue with II pillar?

As the more and more important part of pension will be paid from II pillar (red part on the graph) more attention should be paid for II pillar performance.



How to continue with II pillar?

- High volatility of returns requires the rule that older the participant – into less risky instruments are his/her assets invested (life cycle approach).
- But are the average annual returns, achieved by different pension fund categories during the last 10 years, statistically different, taking into account their variability during different periods?
- In order to answer this question we performed the statistical analysis to test the hypothesis about the equality of average returns achieved by different pension fund groups in three Baltic countries during the last 10-12 years.

Groups of pension funds investigated

- Conservative pension funds (assets are not invested into equities);
- pension funds investing a small part into equities (up to 30 per cent of assets invested into equities);
- pension funds investing a medium part into equities (up to70 per cent of assets are invested into equities);
- pure equity pension funds (up to 100 per cent of assets are invested into equities).

Results of statistical test

- Despite the fact that quite a big number of second pillar pension funds are offered, the possibilities to select different investment strategy (investment risk level) are limited, due to the number of pension funds offer in specific risk categories.
- Testing results indicate that the hypothesis about the equality of mean returns cannot be rejected at all (Latvia) or is rejected only when comparing conservative category with riskier funds (Lithuania and Estonia),

Results and suggestions

- A similar conclusion comes from comparison of returns among individual funds – the share of individual pairs of funds, for which the hypothesis about equal mean returns is rejected, varies only between around 13 and 25 percent. The diversity of funds in terms of their mean returns in Estonia seems to be relatively higher than in Latvia and Lithuania.
- These findings from statistical analysis possibly suggest that

  (1) the traditional classification of pension funds not necessarily can be meaningful: even if two funds belong to different categories by their risk, this not necessarily means that their investment strategies and actual returns will differ significantly.

  (2) possibly there is a need for stricter rules in terms of pension funds' investment strategies and their linkage to fund participants' age, in order to increase the compatibility between the pension funds supply side and pension system participants needs over their entire life-cycle.

Thank you for attention