KEY PENSION CHALLENGES AND FINDINGS FROM THE PENSION REVIEWS

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OECD pension reviews in Europe

- Ireland (2014)
- Latvia (2018)
- Portugal (2019)
Outline

• Mandatory pensions
  – Structure of mandatory pensions
  – First-tier benefits
  – Demographics and pensions
  – Pension incentives to work longer (beside retirement age)

• Funded pensions
  – Importance of funded systems
  – Investment regime, fees and competition, benefit security of DB schemes
  – Pay-out phase

• Conclusions
MANDATORY PENSIONS
Mandatory pensions

• Ireland: contributory-based basic pension.

• Latvia: notional defined contribution (NDC) and financial defined contribution (FDC) schemes + minimum pension.

• Portugal: defined-benefit scheme + minimum pension.
Mandatory contributions rates vary among countries

Effective contribution rates for average earner, 2018

Old-age relative poverty is very high in Latvia

Income poverty rates % of the population subgroup, 2015

Source: OECD Reviews of Pension System: Portugal, Figure 2.1.
First-tier benefits are low in Latvia compared to OECD countries, as a percentage of average earnings, 2016

Source: OECD Reviews of Pension System: Latvia, Figure 3.8.
Issues related to first-tier benefits

• Benefit amounts
  – In Latvia, full minimum pensions equals 14% of average wage vs 25% on average in the OECD. The basic and minimum pension levels have not increased in nominal terms since 2006 despite the almost doubling of average wages.
  – In Latvia and Portugal, contributing longer increases minimum pensions only at specific knots.
  – In Ireland, basic pensions is the only mandatory scheme.

• Coordination among different benefits
  – In Portugal, two old-age safety-net benefits largely overlap and one of them is means-tested against income of all decedents.
  – In Ireland, differences between the contributory and non-contributory schemes and not transparent.
Demographic pressure: old-age vs working population

Projected changes in population size between 2015 and 2035

- **Latvia**
- **Portugal**
- **OECD**
- **Ireland**

Source: OECD Reviews of Pension System: Latvia, Figure 2.3., based on the UN (2017)
• Latvia – statutory retirement age will reach 65 in 2025 and no further adjustments legislated so far.

• Portugal – 2/3 of life-expectancy gains at age 65 have been transmitted to the statutory retirement age since 2015. NRA rises slower and will start to increase above 65 (currently) from 2022.

• Ireland – retirement age set to increase to 68 in 2028 and no further adjustments legislated so far.
Automatic adjustments of benefits to demographic shift

- Latvia: NDC and FDC provide approximately actuarial adjustments of benefits.

- In Ireland and Portugal, benefit calculations from mandatory schemes at statutory retirement ages are not directly affected by aggregate demographics.
Future benefits

Future gross replacement rates for full-career workers

Average wage
Half average wage

Source: OECD Reviews of Pension System: Portugal, Figure 3.17.
Public pension expenditure in GDP are projected to be broadly stable

Source: OECD Reviews of Pension System: Portugal, Figure 3.4., based on the EC (2018)
Incentives to work longer (beside retirement age)

- Minimum contribution requirements to receive pensions:
  - 15 years in Latvia and Portugal for earnings-related and minimum pensions;
  - 10 years in Ireland.

- Substantial penalties for early retirement in Latvia and Portugal.

- In Portugal, very low bonuses for working more than a year beyond statutory retirement age for those with long careers.

- No early retirement option and very low bonuses for late retirement in Ireland.
Employment outcomes: employment rates are around OECD averages

Employment rates of workers aged 55-59, 60-64 and 65-69 in 2018

FUNDED PRIVATE PENSIONS
Importance of the funded pension system

Total assets as a % of GDP in OECD countries, 2018
Low coverage in voluntary systems

- Insufficient coverage in Ireland given low RR from public system
- Under-development of occupational plans in Portugal and Latvia
- Inappropriate (tax) incentives
- Low contribution levels
• Latvia below the OECD average most of the time
• Over the last 15 years, on average, real returns of -1.0% in Latvia and 2.2% in Portugal
• Conservative investment in Latvia and Portugal

• Conservative default investment strategy in Latvia not appropriate

• No legal requirements for defaults in Ireland and Portugal
Fees and competition

- Ireland - High fees for small occupational and personal plans
- Latvia - High fees (2016) in international comparison
- Portugal - Costs declining faster than fees in Portugal
- No standardised fee structure and no cap in Portugal and Latvia (voluntary plans)
- Latvia - Barriers to entry in the market
Benefit security in DB schemes

- Ireland - Large impact of the 2008 crisis on DB schemes
  - The guarantee schemes only provide a partial protection to DB plan members’ benefits in case of sponsor insolvency
  - The priority given to pensioners before other members if a scheme winds up creates large inequalities
  - Healthy plan sponsors can “walk away” from DB plans

- Portugal - The minimum funding scenario, which establishes a minimum safety net, is not appropriate, calculated using
  - An accumulated benefit obligation (i.e. no salary projection)
  - A fixed discount rate of 4.5%
  - Old mortality tables representing the French population
Structure of the pay-out phase

• Ireland - Mandatory annuity removed in occupational DC plans in 2011
• Latvia - Members of the FDC in Latvia can transfer assets to the NDC instead of buying a life annuity
• Latvia - Confusion in product design between annuity and drawdown
• Portugal - Withdrawal rules from personal pension plans (PPR schemes) are too lenient
CONCLUSIONS
Main pension challenges will be amplified by population ageing

• Ireland targets public pensions at providing basic old-age income while income smoothing is left to voluntary pensions, whose coverage remains insufficient.

• In Latvia, mandatory pensions – PAYGO (NDC) and funded DC schemes – provide a close link between earnings and pension entitlements with less focus on securing minimum level of income.

• Portugal balances the two objectives in a complex way and spends more on public pensions while private pensions are of lesser importance.
Thank you for your attention

Further information:

https://www.oecd.org/els/public-pensions/

http://www.oecd.org/finance/private-pensions/