Improving the pension income prospects of EU Member States: Lessons from the Pension Reviews
06.11.2019

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

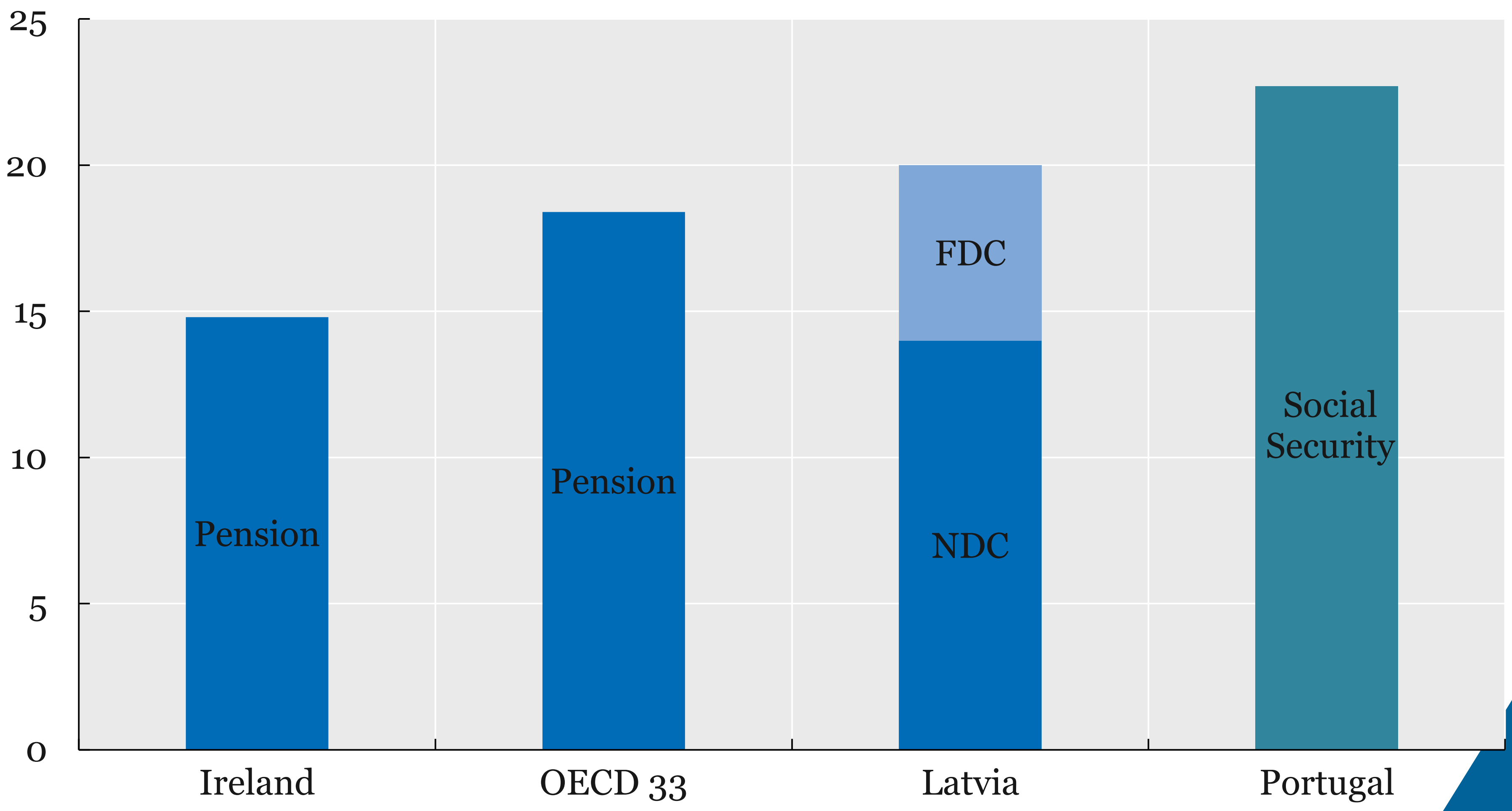
MANDATORY PENSIONS

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

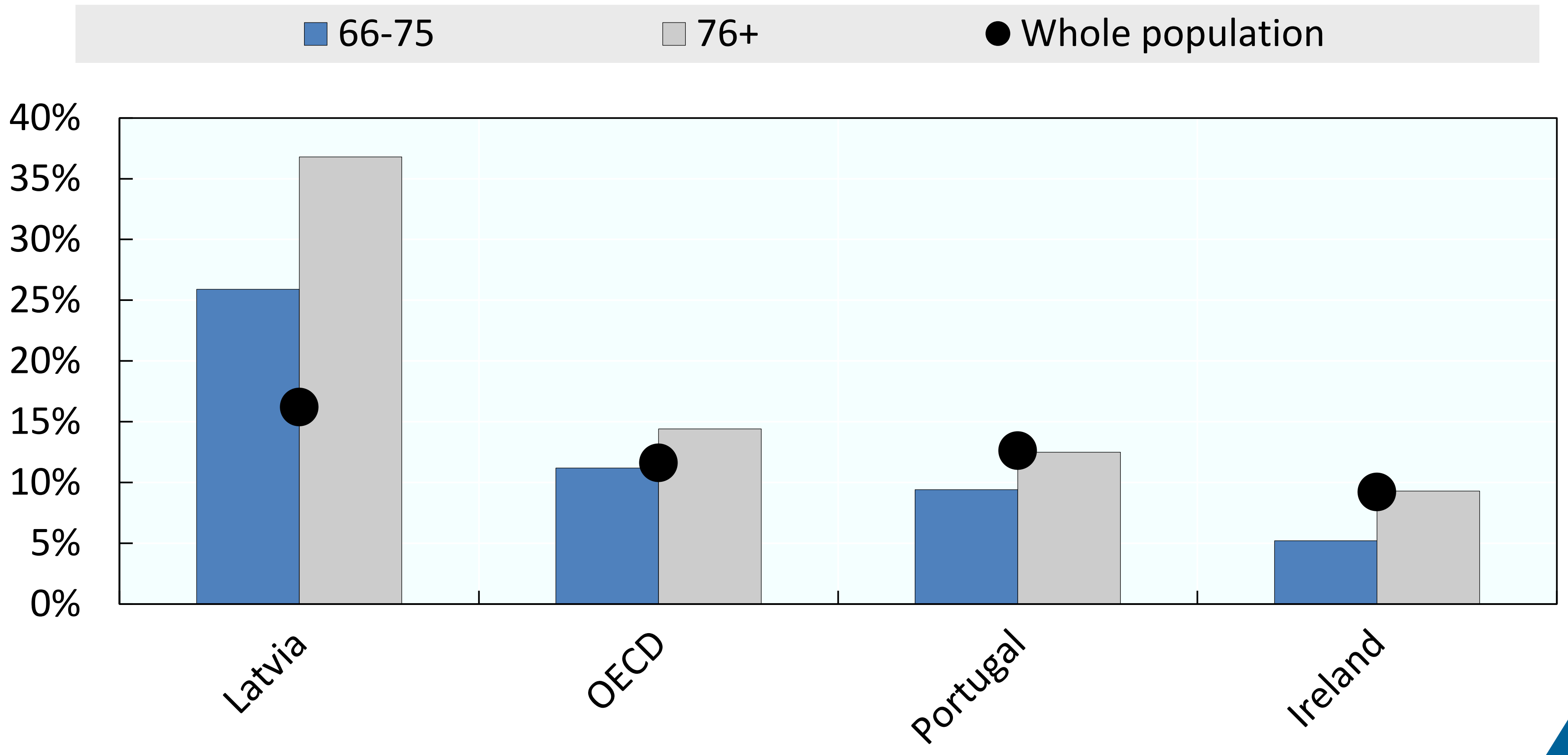
Effective contribution rates for average earner, 2018



Source: 2019 Pensions at a Glance, forthcoming.

Old-age relative poverty is very high in Latvia

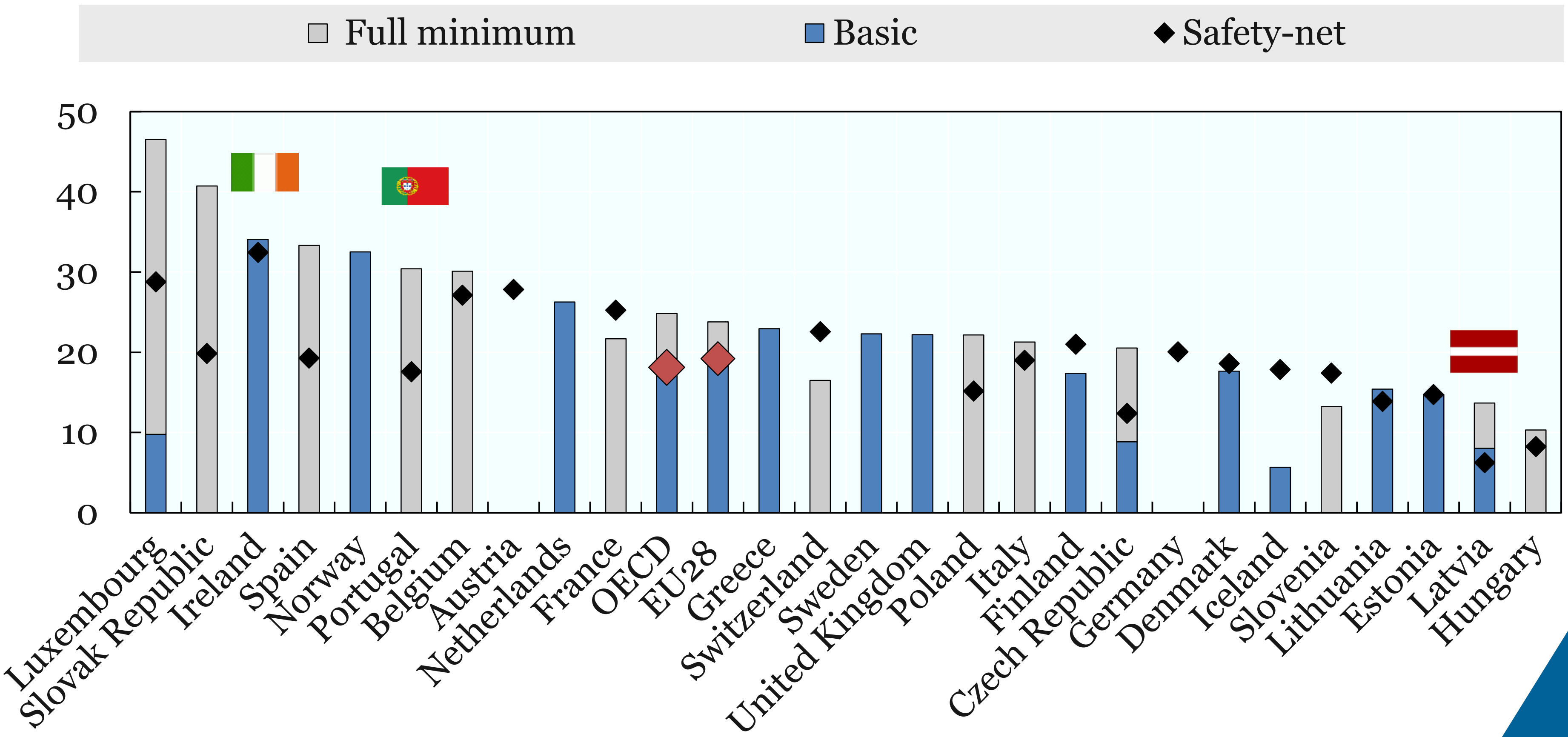
Income poverty rates % of the population subgroup, 2015



Source: OECD Reviews of Pension System: Portugal, Figure 2.1.

First-tier benefits are low in Latvia

First-tier benefits are low in Latvia compared to OECD countries, as a percentage of average earnings, 2016



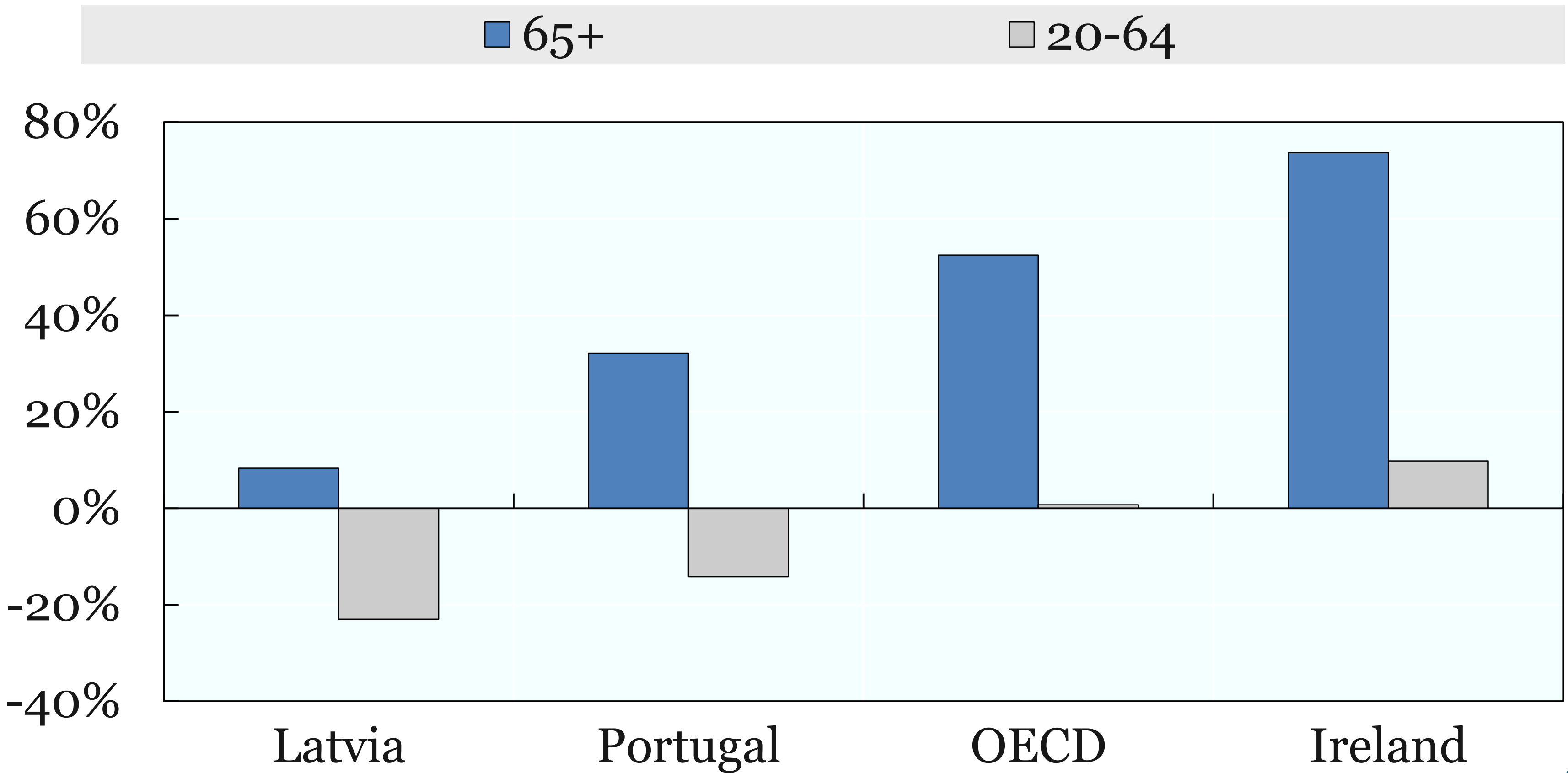
Source: OECD Reviews of Pension System: Latvia, Figure 3.8.

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



Source: OECD Reviews of Pension System: Latvia, Figure 2.3., based on the UN (2017)

Retirement ages and longevity increases

- 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.

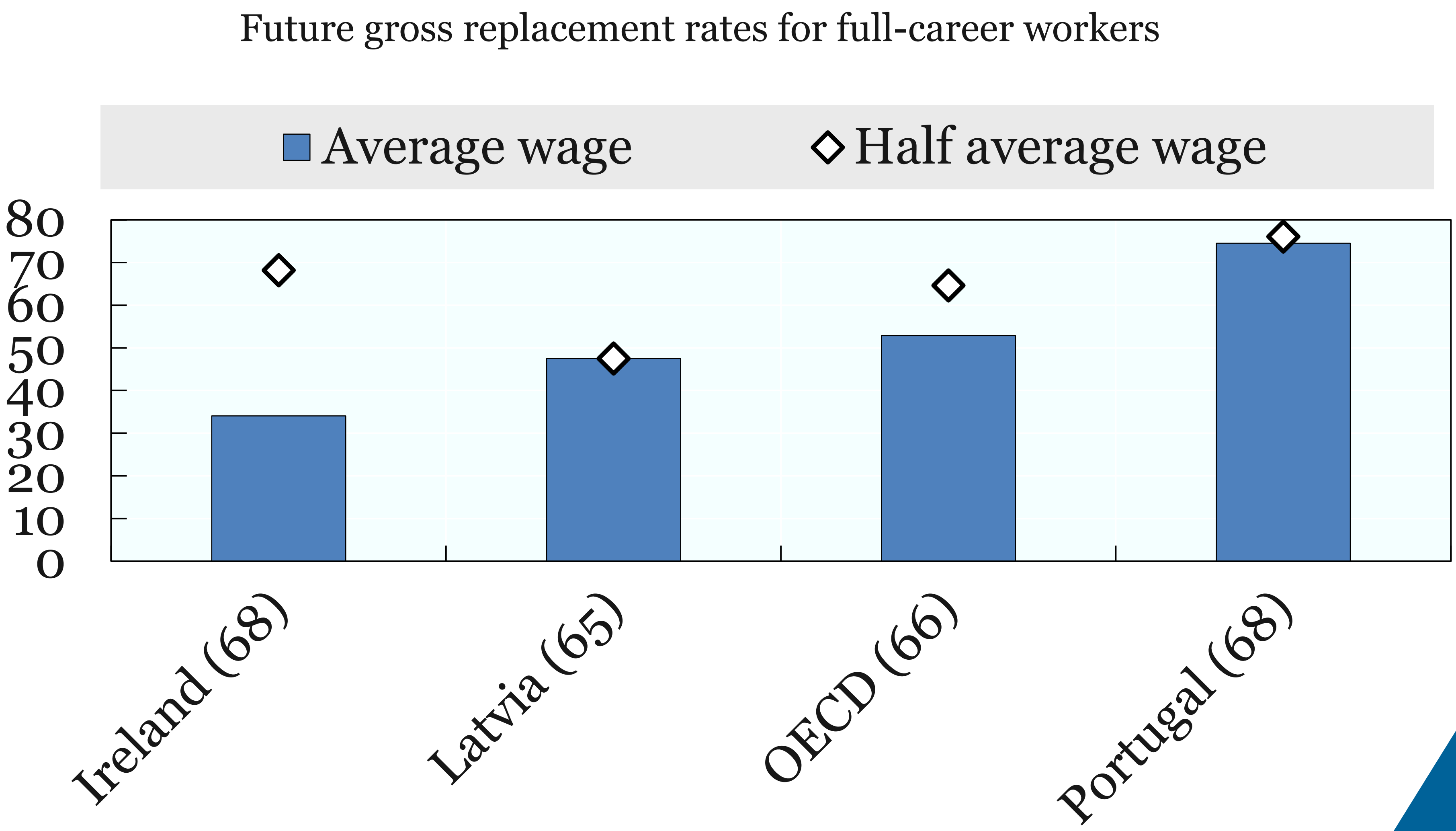
- Ireland – retirement age set to increase to 68 in 2028 and no further adjustments legislated so far.

Automatic adjustments of benefits to demographic shift

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

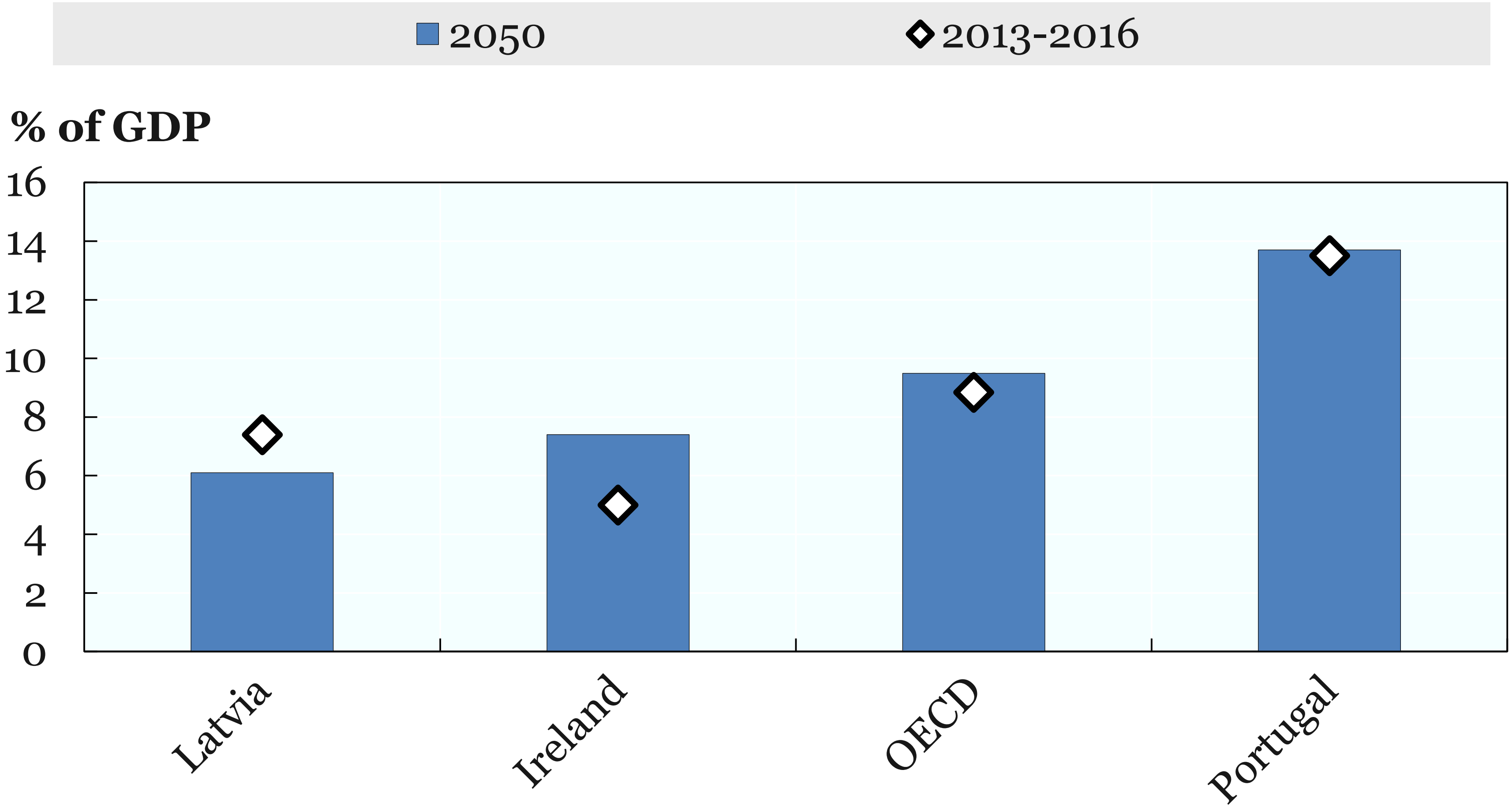
- In Ireland and Portugal, benefit calculations from mandatory schemes at statutory retirements ages are not directly affected by aggregate demographics.

Future benefits



Source: OECD Reviews of Pension System: Portugal, Figure 3.17.

Public pension expenditure in GDP are projected to be broadly stable



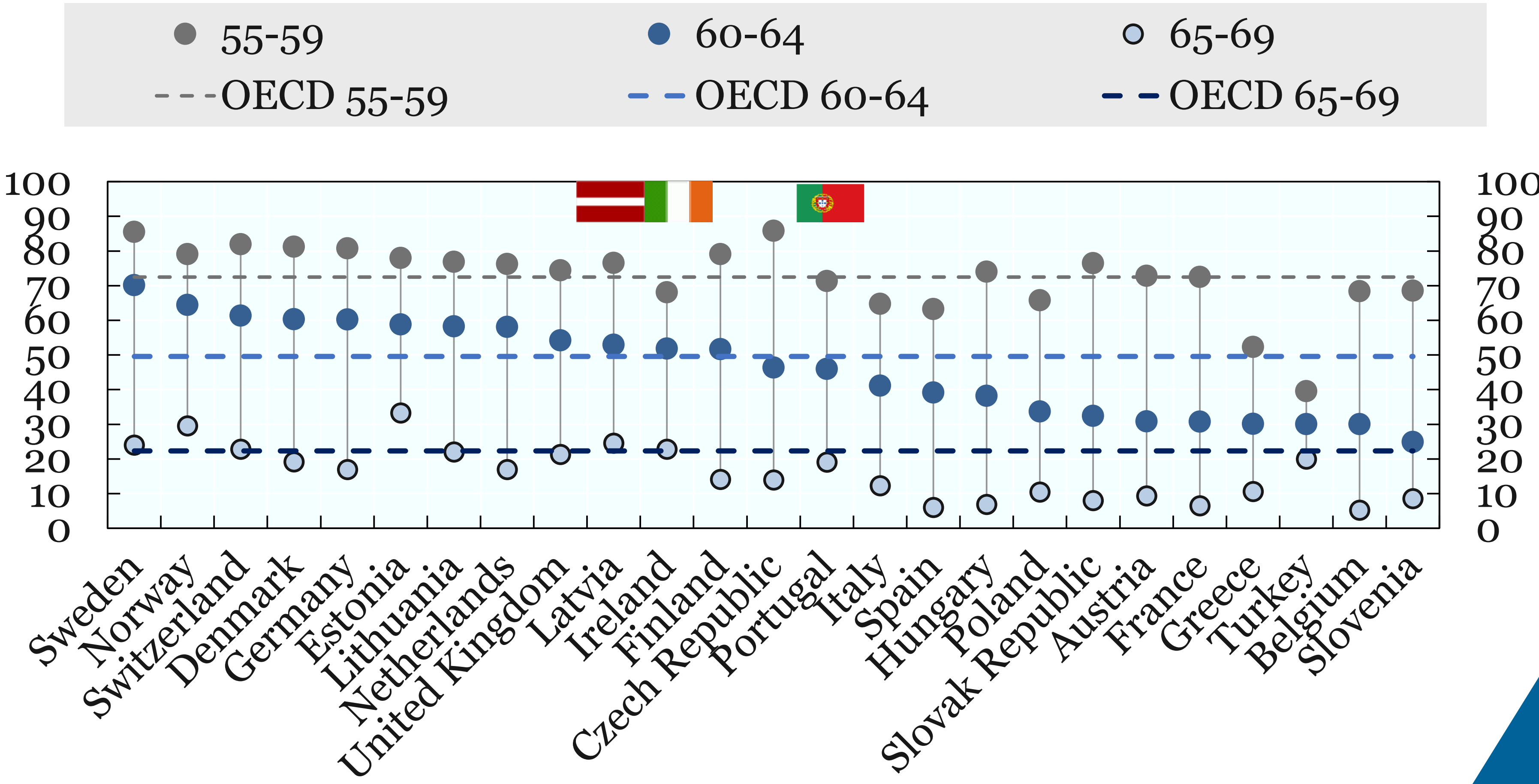
Source: OECD Reviews of Pension System: Portugal, Figure 3.4., based on the EC (2018)

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

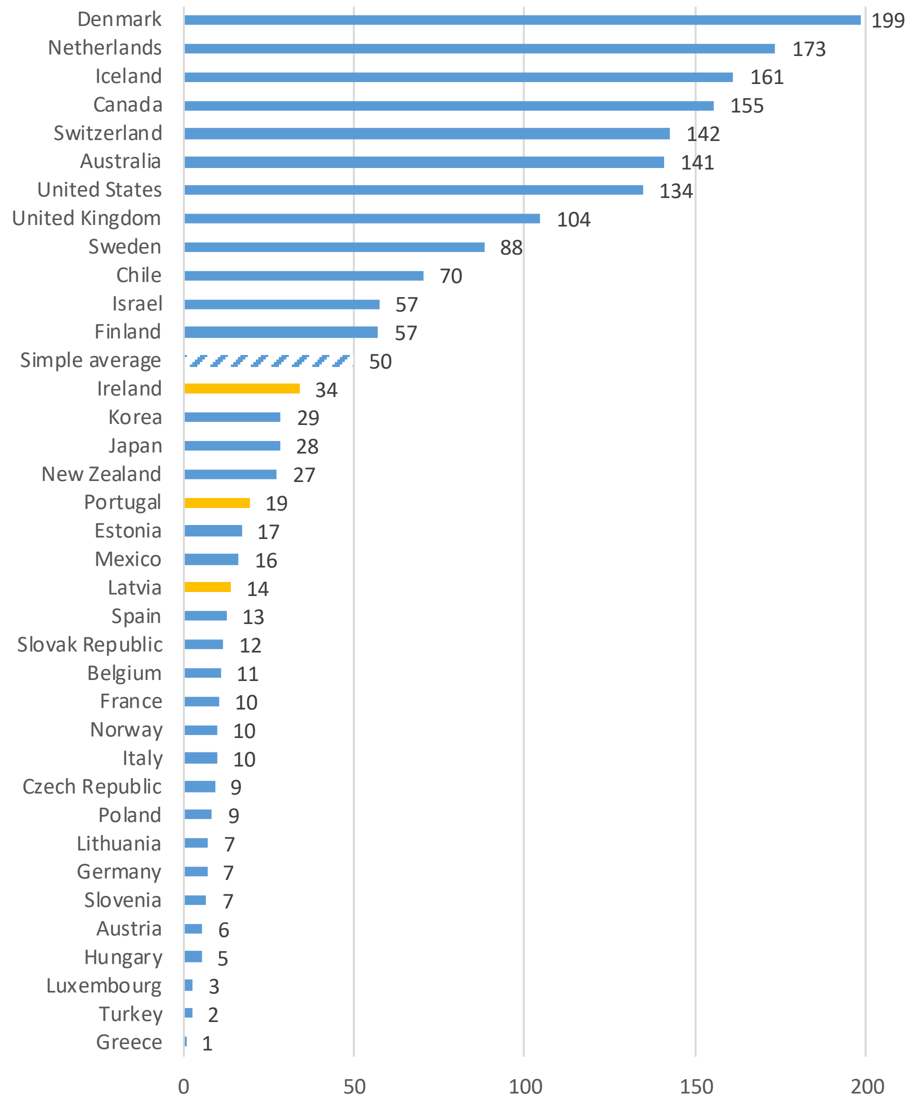


Source: 2019 Pensions at a Glance, forthcoming.

FUNDED PRIVATE PENSIONS

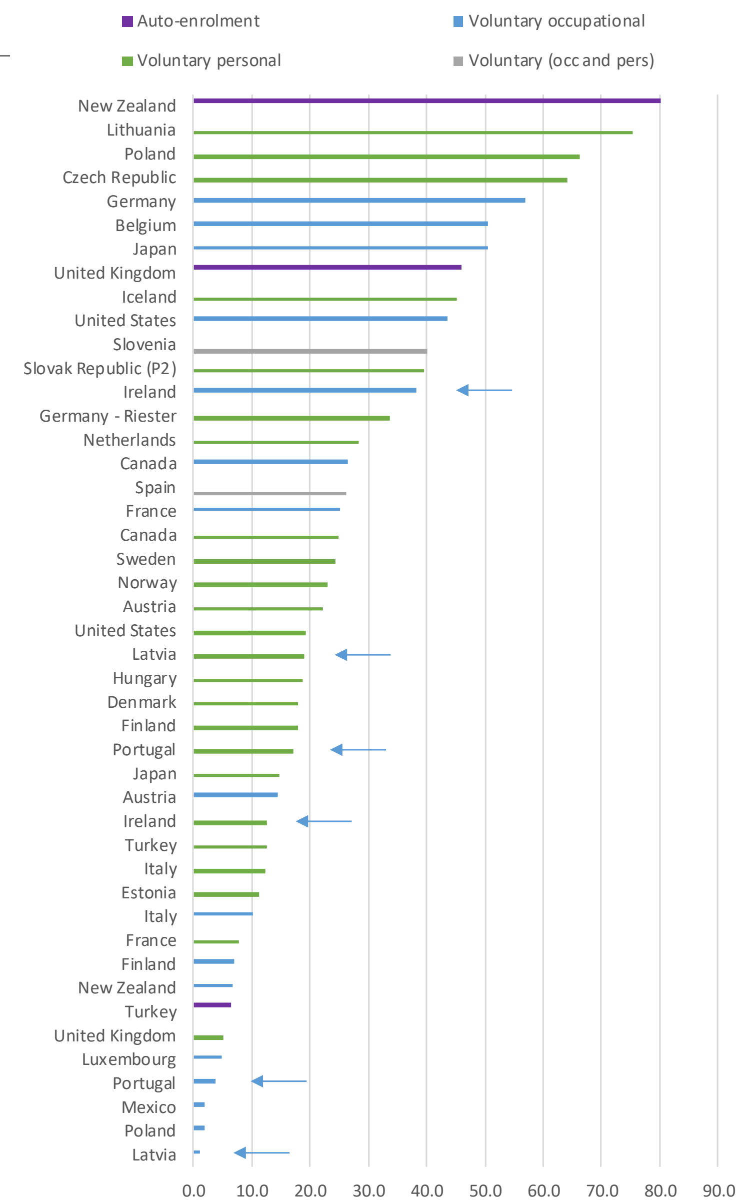
Importance of the funded pension system

Total assets as a % of GDP in OECD countries, 2018

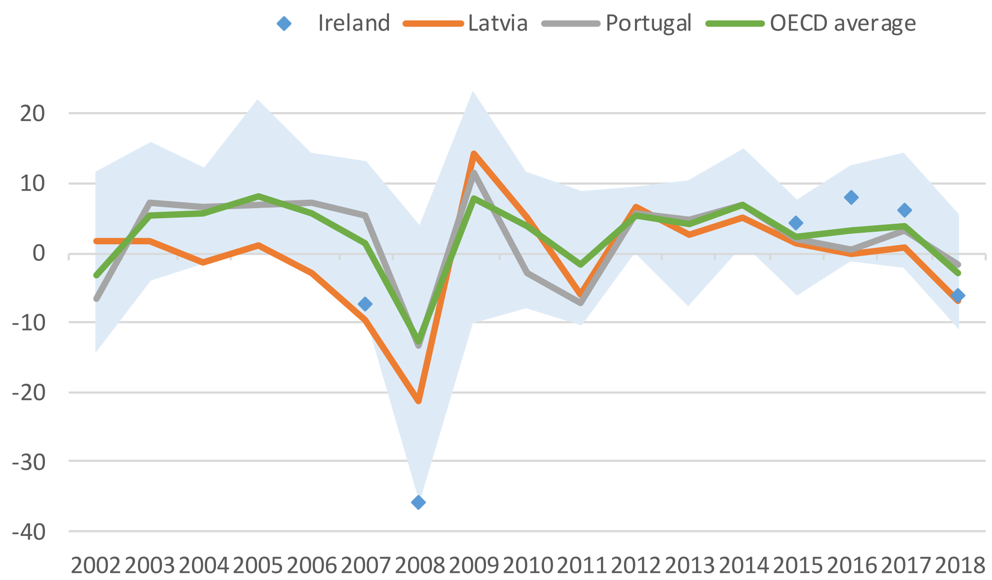


Low coverage in voluntary systems

- 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



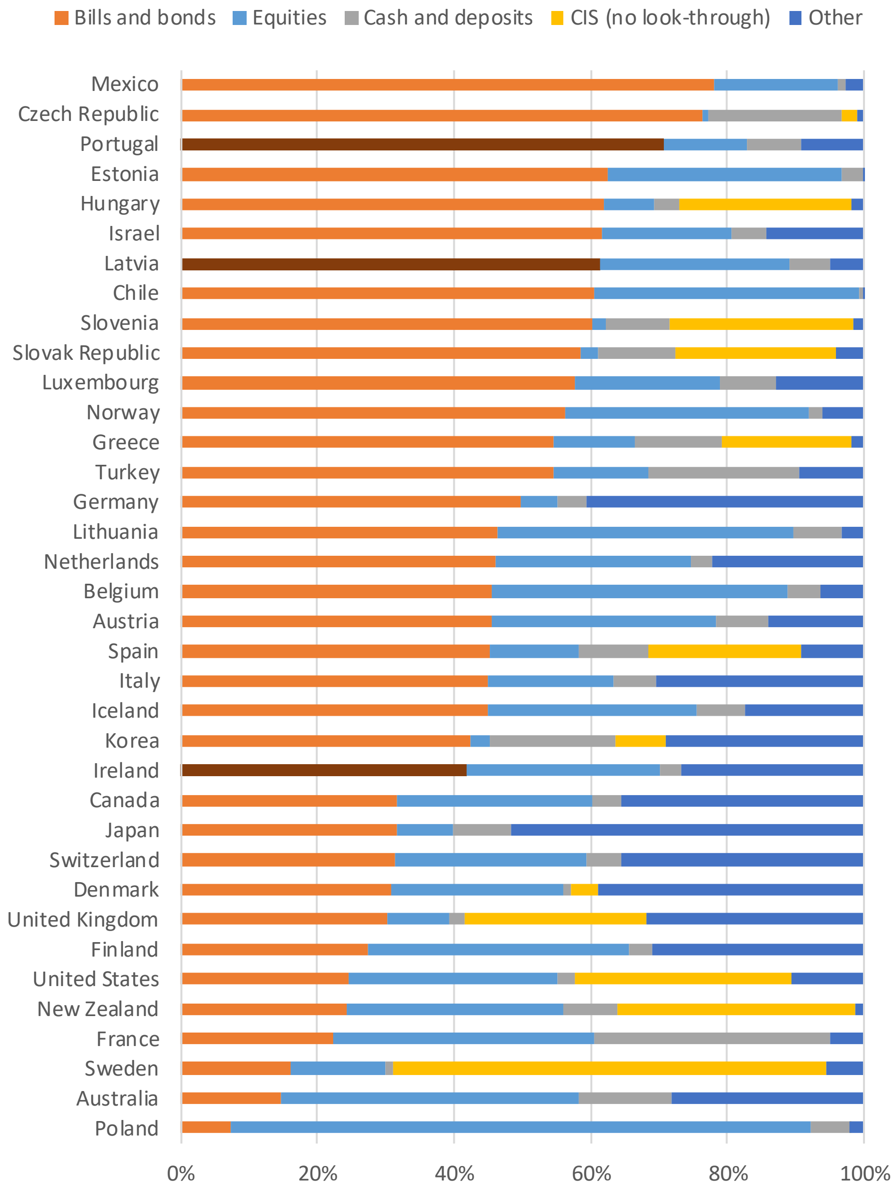
Real rates of return, net of investment expenses



- 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

Investment regime

- 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/