

OECD Reviews of Pension Systems Latvia

Riga, 07.03.2018



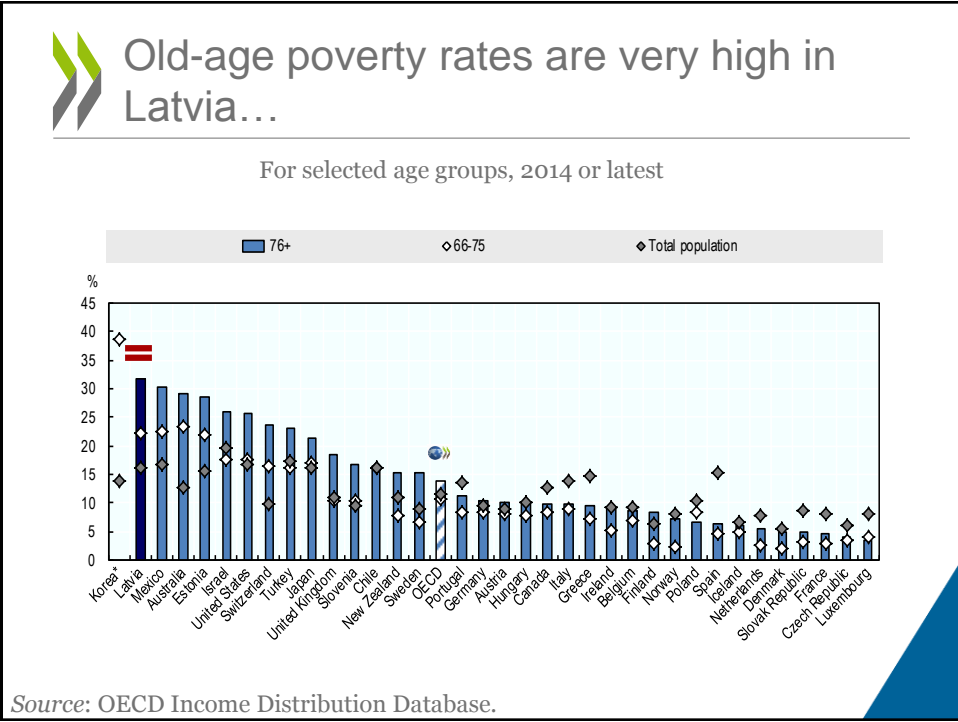
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Outline

- How to reduce old-age poverty?
- How to improve the notional defined contribution (NDC) scheme?
- How to improve separate schemes for selected occupations?
- How to improve the funded defined contribution (FDC) scheme?

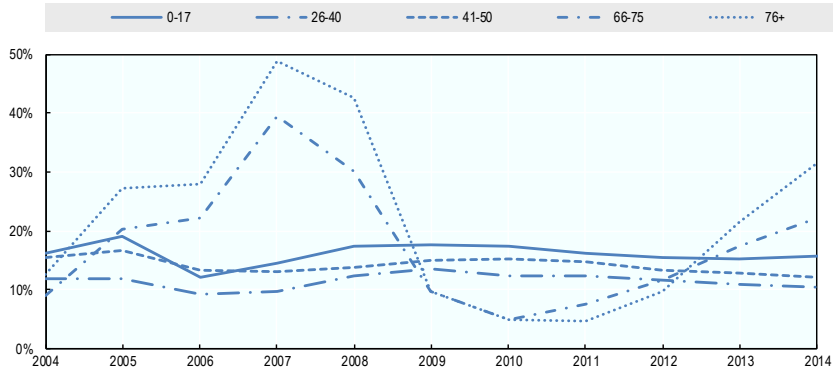
OLD-AGE POVERTY





.. even though old-age poverty rates declined strongly during the crisis

Poverty rates among selected age groups in Latvia in 2004-2014

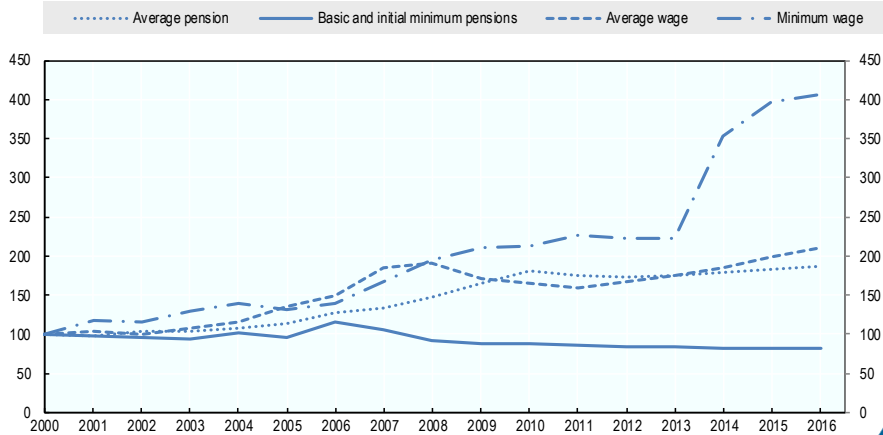


Source: OECD Income Distribution Database.



Basic and minimum pensions have lagged behind wages and average pension

Real term trends since 2000



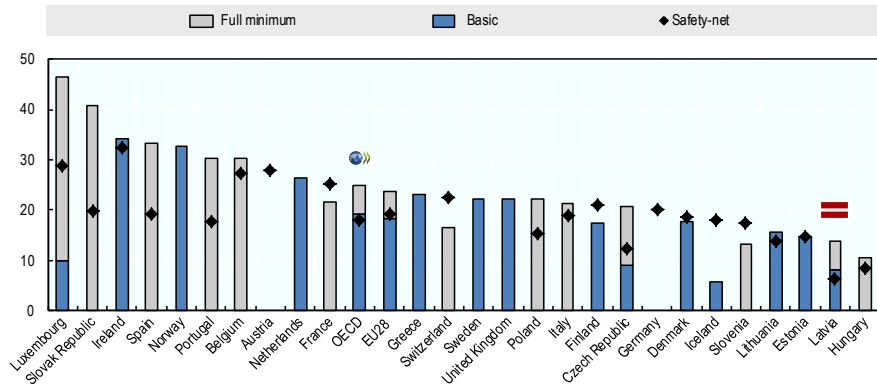
Note: Numbers are normalised at their 2000 real value (=100).

Source: OECD calculations based on data provided by the Latvian Ministry of Welfare and the OECD Labour Statistics.



First-tier benefits are substantially below the OECD averages

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

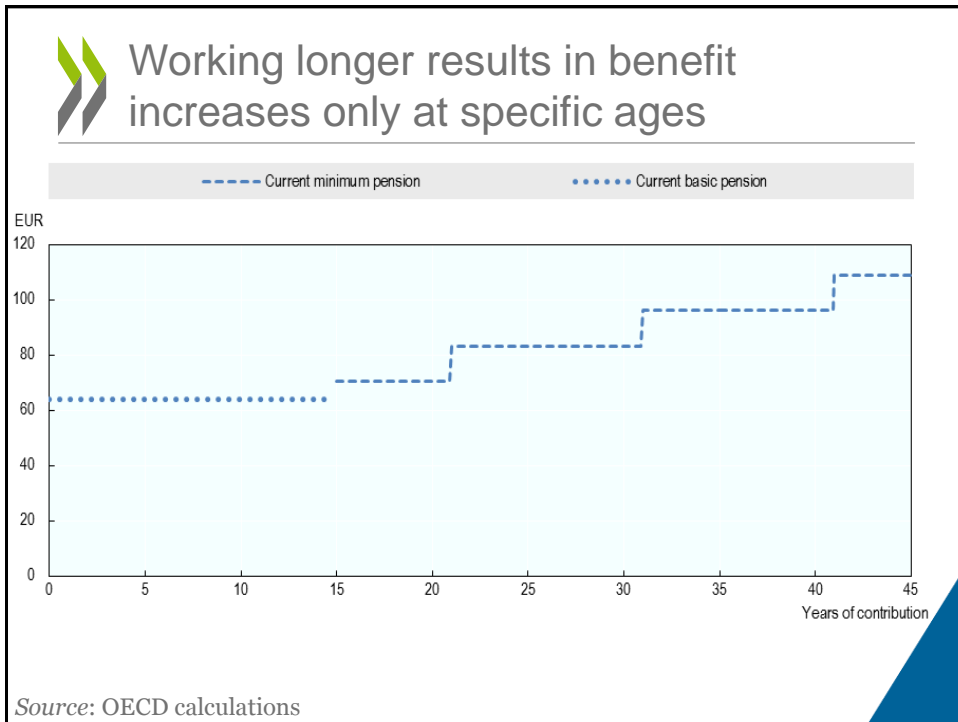



Source: OECD, 2017b and information provided by countries.



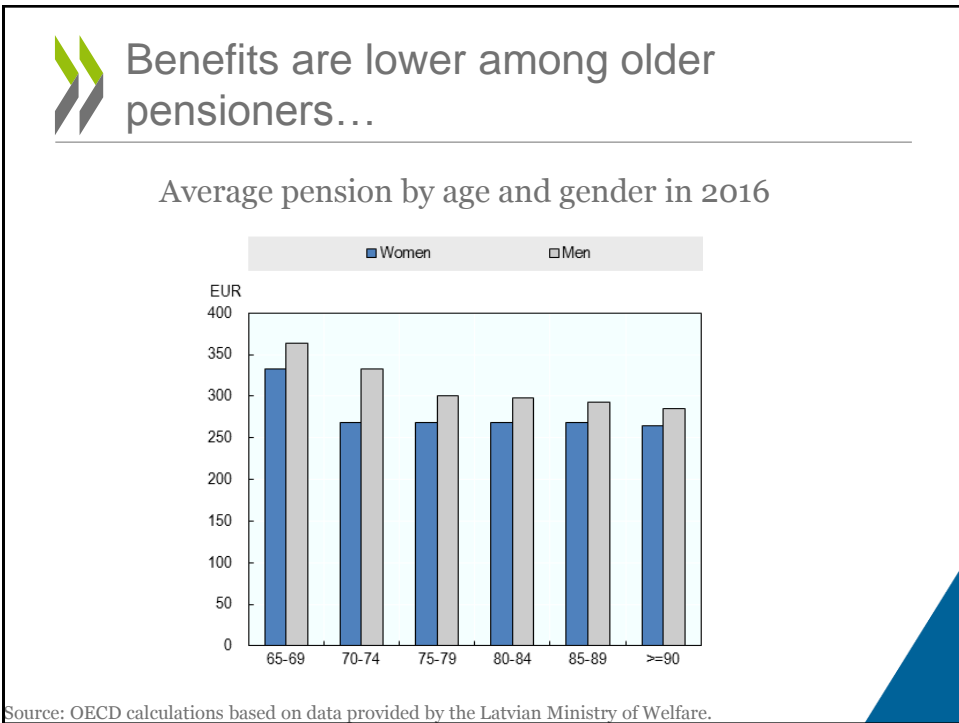
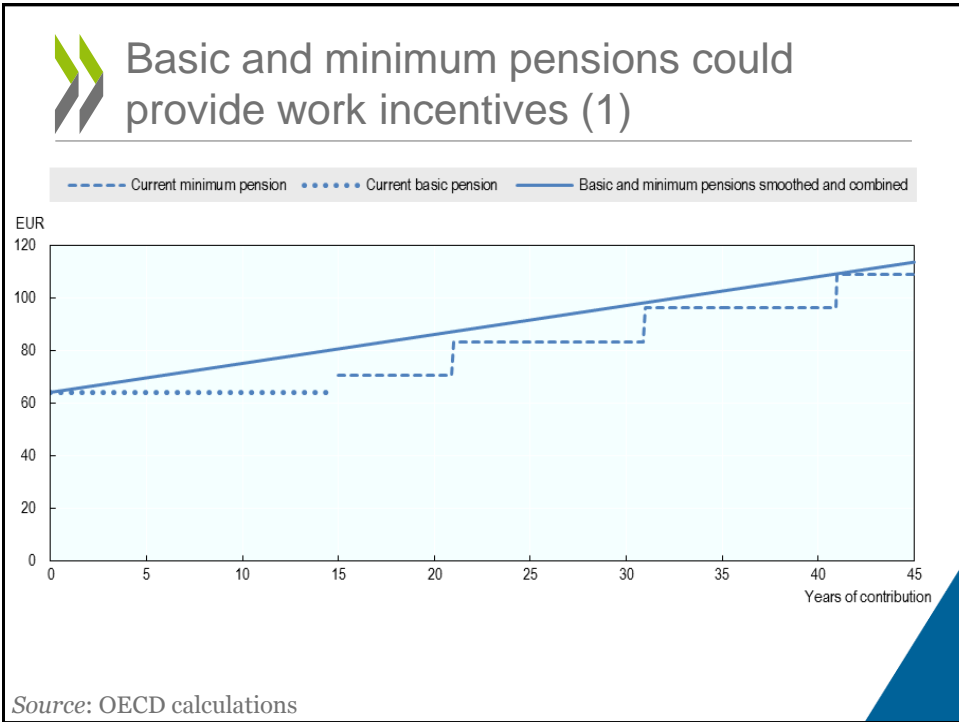
Basic and minimum pensions should prevent old-age poverty

- Increase substantially the levels of basic and minimum pensions.
- Use the same indexation rule for the level of basic and minimum pensions as the one for NDC pensions.



 Basic and minimum pensions could provide work incentives (1)

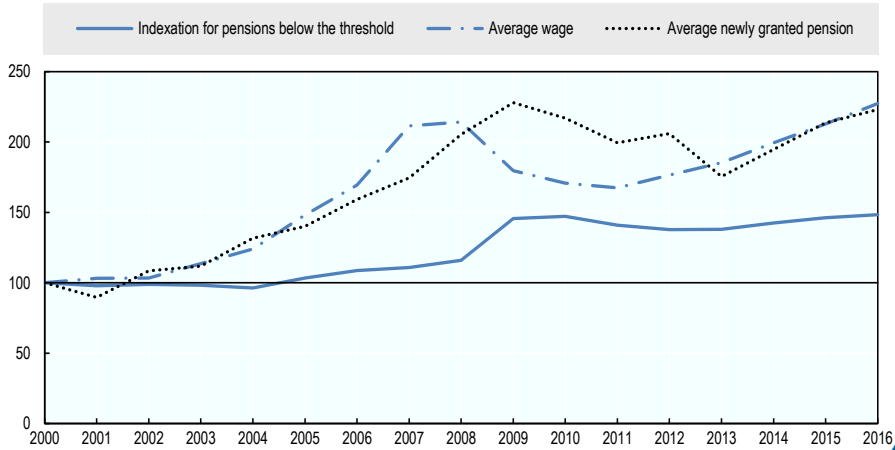
- Lower the minimum contribution period of 15 years required for the minimum pension.
- On top of the safety net available for someone who never contributed, ensure that each additional year of contribution results in a higher minimum pension benefit.





.. because pensions in payment have not kept pace with newly granted pensions

Real term trends since 2000



Note: Numbers are normalised at their 2000 real value (=100).

Source: OECD calculations based on data provided by the Latvian Ministry of Welfare and the OECD Labour Statistics.



How to reduce the pension gender gap and maintain the relative value of benefits with age?

- Index fully the NDC pensions in payment to the nominal growth of the contribution base.
- Introduce survivor pensions for spouses.



Survivor pensions

Reasons:

- They reduce the age and gender gradients in old-age poverty.
- They ensure income smoothing after the death of a partner.

Options:

- Joint annuity?
- Increased contributions?
- Additional age and income eligibility conditions?
- Mandatory, default or voluntary?

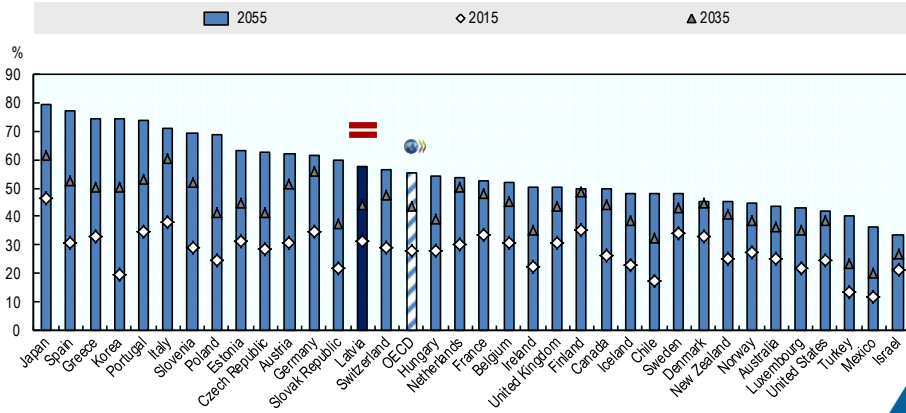
In-depth analysis of survivor pensions in the OECD countries to come in Pensions Outlook 2018

IMPROVING THE NDC
SCHEME



The Latvian population is ageing at the same pace as the OECD on average

Old-age dependency ratio
(population 65+ divided by the population 20-64)

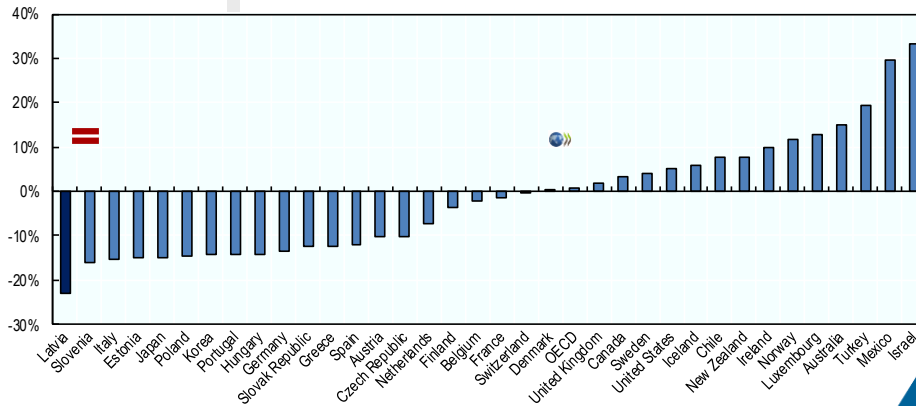


Source: OECD calculations based on data provided by Latvian Ministry of Welfare, Department of Social Insurance.



The working-age population is shrinking

Projected change in the population size by age groups in OECD countries between 2015 and 2035
Panel A: 20-64



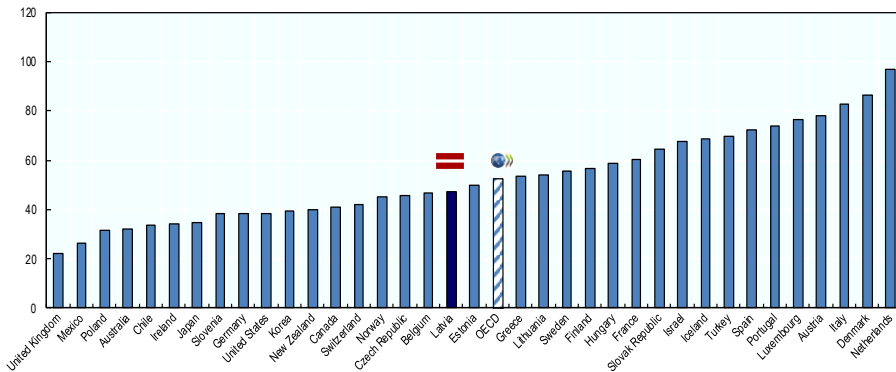
Source: UN 2017 population projections.

Automatic adjustment mechanisms transfer the demographic shift into pension levels

- Life expectancy gains lower NDC/FDC benefits.
- Decline in labour force lowers valorisation of notional accounts (NDC).

Future replacement rates

Gross theoretical replacement rates are below the OECD average
Mandatory pension schemes for an average-wage full-career worker from age 20 in 2016, %

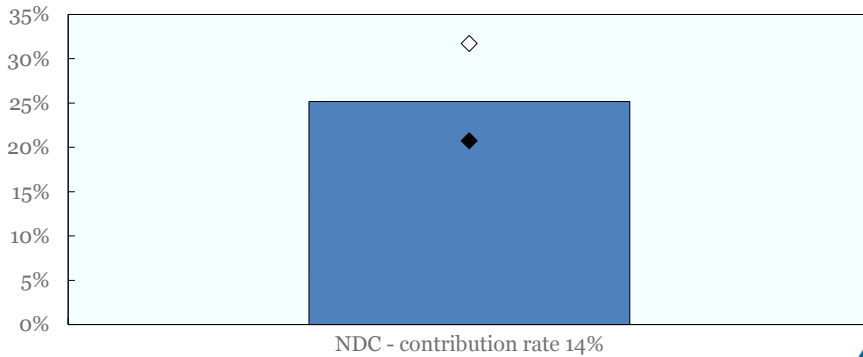


Source: OECD (2017).



Automatic adjustments have strong impact on future replacement rates

- Baseline (PAG 2017)
- ◇ Scenario 1: working-age population does not decline
- ◆ Scenario 2: life expectancy increases to the OECD average (+ 4 years)



Source: OECD calculations.



How to improve the adequacy of the NDC benefits?

- Steadily increase contributions paid by employees of micro-enterprises and align pension contributions paid by the self-employed to those of dependent employment.
- The retirement age will increase from 63 years and 3 months in 2018 to 65 years in 2025. Afterwards, the official retirement age should be linked to future life expectancy gains.



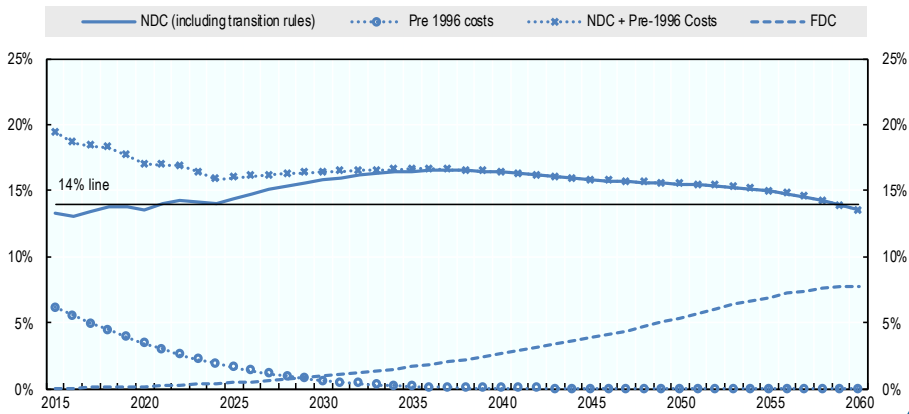
How to link retirement age with gains in life expectancy?

- 1:1?
- Keeping the proportion of working life in lifespan constant on average?
- In line with the increases of life expectancy in good health?



NDC expenditures are projected to exceed revenues

Pension expenditures by scheme



Source: OECD calculations based on data provided by Latvian Ministry of Welfare, Department of Social Insurance.



What are the reasons for the future NDC deficit?

- Calculation of initial notional capital was based on the 20% contribution rate
- Varying NDC contribution rate: on average at 17.4 between 1996 and 2017
- Calculation of pensions with period instead of cohort life expectancy



How to improve the NDC scheme?

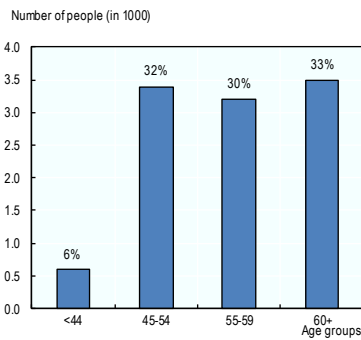
- Stabilise the contribution rate going to NDC pension to 14%.
- Use cohort life expectancy in the NDC annuity divisor.
- Index fully the NDC benefits in payment to the nominal growth of the contribution base.
- Remove the option to convert the FDC accounts into an NDC annuity.

PENSION SCHEMES FOR SELECTED OCCUPATIONS



Service pension are high and granted at early ages

Figure 6.1. Recipients of service pensions by age in Latvia in 2016

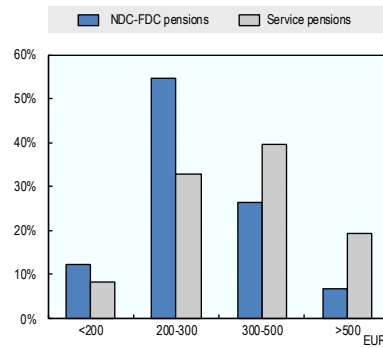


Note: Per cent of all service pension recipients above the bars. The recipients of service pensions include recipients of service pensions transformed into old-age pensions.

Source: OECD computations based on data provided by the Central Statistical Bureau of Latvia.

StatLink <http://dx.doi.org/10.1787/888933657923>

Figure 6.2. Distribution of service pensions and NDC-FDC pensions in Latvia in 2016



Note: The recipients of service pensions include recipients of service pensions transformed into old-age pensions.

Source: OECD computations based on data provided by the Central Statistical Bureau of Latvia.

StatLink <http://dx.doi.org/10.1787/888933657942>



Limit the fragmentation of the pension system

- Incorporate service pensions back to the main pension scheme.
- Maintain the commitment to eliminate special pension rights for arduous and hazardous occupations.

IMPROVE THE DESIGN OF
THE MANDATORY AND
VOLUNTARY FUNDED
PENSION SCHEMES



Investment regime: Issues identified

- Low returns over past 10 years (including GFC and European sovereign debt crisis)
- Conservative investment strategies compared to other countries
 - Equity investment well below regulatory limits
- Conservative default investment strategy: only appropriate for very risk-averse individuals and those approaching retirement age



Investment regime: Policy options

- Introduce a default life-cycle investment strategy
 - Reduces the amount of assets invested in risky assets as the plan member gets closer to retirement
 - Potentially enhance returns while still protecting people close to retirement against extreme market swings
 - Additional option to those already offered
 - SSIA to provide information to asset managers about the age structure of their clients
- Gradually relax quantitative investment limits and increase the skills of professionals in the investment teams of asset managers to allow for appropriate portfolio diversification



Continue efforts to reduce fees in the pension industry

- The new fee structure, with a regressive scale, lower caps and a tighter definition of the benchmark for the performance fee, goes in the right direction
- Disclose fees paid by participants in nominal amounts in the pension statement to increase people's awareness and put further pressure down on fees
- Harmonise the fee structure for voluntary private pension funds to facilitate comparisons and increase confidence in the system



The performance fee could include risk sharing features: 2 options

- High-water mark: It is the highest value that a pension account has ever reached. The purpose is to make sure that any losses occurring after the last high-water mark will be compensated before the pension fund is paid a performance fee.
- Symmetric performance fee: Underperformance is penalised as much as outperformance is rewarded. In case of underperformance compared to the benchmark, the fund must compensate participants through lower fixed fees, cash refunds or credits against future fees.



Balance market opportunities and increase competition

- Make sure that individuals have access to complete and comparable information about all asset managers' pension plans when selecting a plan
- Introduce independent members in the governing body of asset managers in a more systematic manner to help reinforce its commitment to act in the best interests of participants only (cf. OECD Core Principles of Private Pension Regulation)
- Increase transparency requirements to foster competition (e.g. detailed and granular information on administration and investment costs)



Streamline the design of the retirement phase

- Eliminate the option to transfer assets to the NDC scheme
- Separate life annuity products and drawdown products like the upfront-withdrawal annuity to avoid confusion about product features
- Consider implementing an electronic platform where participants about to retire could see the bids from all life insurance companies in one place
- Strengthen the supervision of insurance companies regarding the mortality tables used for reserving (include expected future improvements in mortality; regularly updated; based on the mortality experience of the relevant population)



Improve communication within the system

- Between the SSIA and asset managers: Allow asset managers to propose more varied investment options to their members, including life-cycle investment strategies
- Between the SSIA and participants:
 - Emphasize that the amount accumulated in their pension account is their money
 - Send the account statement
 - Include information on fees in nominal amounts
 - Include projections of future total pension benefits under different scenarios for the age of retirement and the level of voluntary contributions to prompt action



Thank you

Further information:

<http://oe.cd/pensions-latvia-2018>

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OECD flagship pension publications:

Pensions at a Glance

http://dx.doi.org/10.1787/pension_glance-2017-en

Pensions Outlook

http://dx.doi.org/10.1787/pens_outlook-2016-en

