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The Real Return of Long-term and Pension Savings

2023 Edition

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Country Case 11

Lithuania

Real returns 2022
Pillar II Funded pensions: -21.41%
Pillar III Voluntary private pensions: -21.51%

Santrauka

Lietuva priėmė tipišką Pasaulio banko daugiapakopę sistemą, kurioje PAYG pakopa (valstybinė pensija, I pakopa) vis dar atlieka dominuojantį vaidmenį užtikrinant senatvės pensininkų pajamas. Nuo 2019 m. pradėtos kaupti santaupos II pakopoje kaupiamos per gyvenimo ciklo pensijų fondus, kuriuose investavimo rizika keičiama keičiant portfelio struktūrą pagal dalyvių amžių. Nuo 2019 m. valdymo mokestis už kaupimą II pakopos gyvavimo ciklo fonduose palaipsniui mažinamas nuo 0,8 proc. 2019 m. iki 0,52 proc. 2022 m. Turto išsaugojimo fonde valdymo mokestis bus tik 0,2%. Apskritai 2022 m. pensijų fondų veiklos rezultatai abiejose pakopose visose turto klasėse buvo iš esmės neigiami. Dėl neigiamos grąžos 2022 m. bendri abiejų pakopų rezultatai per analizuojamą laikotarpį nukrypo į neigiamos realiosios grąžos teritoriją.

Summary

Lithuania adopted the typical World-Bank multi-pillar system, where the PAYG pillar (state pension, Pillar I) still plays the dominant role in ensuring the income for old-age pensioners. Started in 2019, accumulating savings in Pillar II takes place via life-cycle pension funds, which change investment risk via changes in the portfolio structure on the basis of participants' age. Since 2019, management fee for accumulating in Pillar II life-cycle funds is being gradually reduced from 0.8% in 2019 down to 0.52% in 2022. For the asset preservation fund, the management fee will be just 0.2%. Overall, pension funds' performance in both pillars was broadly negative in 2022 across all asset classes. Negative returns in 2022 have moved the overall performance of both pillars into the negative real returns territory over the analysed period.

Introduction: The Lithuanian pension system

There have been no major changes in the pension system in Lithuania announced in 2022. The key changes did occur in the state pensions due to the high inflation. The government has introduced the indexation mechanism in order to limit the impact of high inflation on the buying power of already granted state old-age pensions managed by the state agency SoDra.

In 2022, pensions were increased twice: in January and July. Overall, pension growth in 2022 was 16-17 percent, that is, the average old-age pension increased from €413 to €483 (+€70), and the average old-age pension with the required length of service increased from €441 to €513 (+€72) (Delfi.lt, 2023).

The performance of private pensions (mandatory as well as voluntary) was negative in 2022 both in nominal and real terms mainly due to the sell-off on the markets and levelled inflation.

Table LT.1 – **Long-term and pension savings vehicles analysed in Lithuania**

Product	Pillar	Reporting period *Earliest data*	Reporting period *Latest data*
Pillar II Funded pensions	Occupational (II)	2004	2022
Pillar III Voluntary private pensions	Voluntary (III)	2004	2022

Table LT.2 – **Annualised real net returns of Lithuanian long-term and pension savings vehicles (before tax, % of AuM)**

	Pillar II Funded pensions	Pillar III Voluntary private pensions
Reporting period	2004-2022	2004-2022
1 year (2022)	-21.4%	-21.5%
3 years (2020–2022)	-3.4%	-5.1%
5 years (2018–2022)	-0.1%	-2.4%
7 years (2016–2022)	0.5%	-0.9%
10 years (2013–2022)	1.9%	0.5%
Whole period	1.7%	0.9%

Data: Bank of Lithuania, Eurostat; *Calculations:* BETTER FINANCE.

Lithuania has undertaken a pension reform in 2004, which was renewed in 2013. This was the reason to establish private pension funds.

Pension system in Lithuania: An overview

Currently, the Lithuanian pension system provides three distinct sources of accumulation for retirement funds – so-called pension pillars (Bitinas, 2011):

- 1st pillar (Pillar I) –- State social insurance funds organized as a PAYG pension scheme. State social pension is financed from social insurance contributions paid by people who are currently working.
- 2nd pension pillar (Pillar II) –- funded pension scheme mandatory for all economically active citizens under the age 40 with opt-out operated by the private pension accumulation companies offering life-cycle pension funds in form of personal savings scheme. The part of State social insurance fund is redirected from the PAYG scheme (until 2019). On top of social insurance contributions, savers are obliged to co-finance the individual retirement accounts with additional contributions tied to their salary.
- 3rd pension pillar (Pillar III) –- voluntary private funded pension scheme. Accumulation can be managed by private funds or life-insurance companies.

Lithuania's statutory social insurance pension system is financed at a general rate of 39.5% (without Social insurance for accidents at work and occupational diseases insurance), while 25.3 percentage points (22.3 p.p. + 3 p.p. employee) is paid towards the Social insurance for pensions (Pillar I).

The State social insurance pension system was reformed in 1995 introducing the insurance principle, extending the requirement for contributory years, abolishing early retirement provisions and increasing the retirement age. However, Pillar II was introduced by law in 2002 and started functioning effectively in 2004 when the first contributions of participating individuals started to flow into the pension funds. Supplementary voluntary pension provision (Pillar III) is possible through either pension insurance or special voluntary pension funds (these started operating in 2004, although the law was adopted in 1999). The voluntary pillar can take two different forms: defined contribution (DC), if supplemental contributions are invested into pension funds or unit-linked life insurance or defined benefit (DB) when purchasing a classic life insurance product. Contributions to the system may be made by the individual or his employer.

The overall coverage of Pillar II, measured as a ratio between the number of participants and the economically active population (number of insured persons in Pillar I), was more than 93% in 2022, while Pillar III covered more than 5% of the economically active population. Thus, we can expect that future pension income stream will be influenced mostly by Pillar II pensions, while Pillar III will generate an insignificant part of individuals' income during retirement.

Regarding the income level, Lithuania's citizens have experienced relatively high rates of income increase during the last years.

First pillar: State pensions

The first pillar of the Lithuanian pension system is organized on the pay-as-you-go (PAYG) principle of redistribution, being funded on an ongoing basis, functioning on the pointing system, and taking into account the duration of the vesting period and the level of salary (insurable income) from which the contributions are paid.

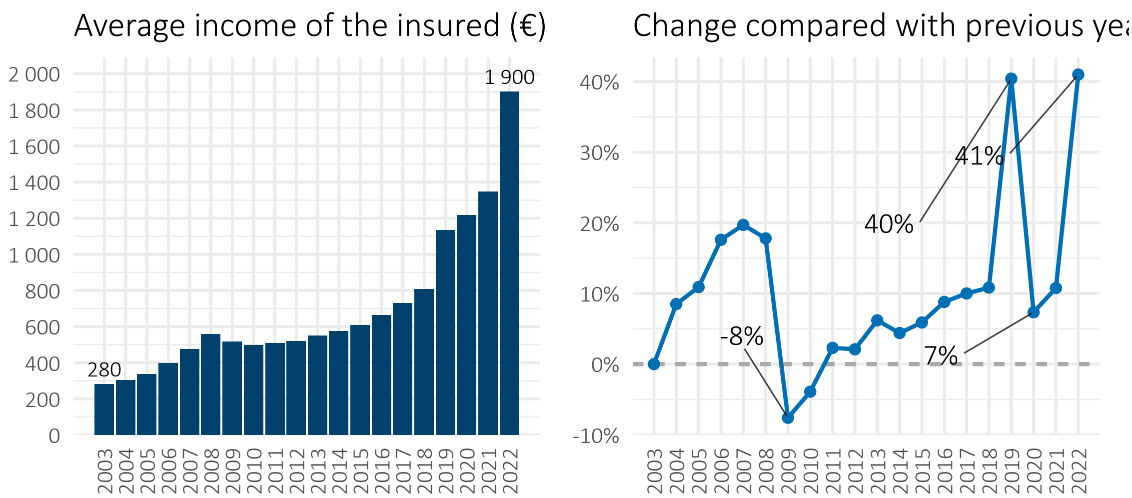
The old-age pension is the main type of state social security in old age. Individuals who meet the requirements for age and for the pension social insurance record are entitled to the old-age pension, i.e.: the person has reached the established old-age pension age (64 years and 4 months

Table LT.3 – Overview of the Lithuanian pension system

Pillar I	Pillar II	Pillar III
State Pension	Funded pension	Voluntary pension
Law on State Social Insurance Pensions	Law on the Reform of the Pension System; Law on Pension Accumulation	Law on the Supplementary Voluntary Pension Accumulation
State Social Insurance Fund institutions	Pension Accumulation Company (PAC)	
Mandatory	Quasi-mandatory	Voluntary
Publicly managed	Privately managed pension funds	
PAYG	Funded	
Pointing System (DB scheme based on salary)	DC Individual personal pension accounts	
Quick facts		
Nb. of old-age pensioners: 616 200	Administrators: 6	Administrators: 4
Average old-age pension: €482.99	Funds: 48	Funds: 16
Average income (gross): € 1 789	AuM: € 5 909.6 mln.	AuM: € 220.3 mln.
Average replacement ratio: 27%	Participants: 1 387 923	Participants: 82 975
Nb. of insured persons: 1 414 800	Coverage ratio: 99.51%	Coverage ratio: 5.86%

Data: SoDra, Bank of Lithuania and Official Statistics Portal, 2023; *Calculations:* BETTER FINANCE.

Figure LT.1 – Average income and annual changes in income of insured persons



Data: State Data Agency, 2023.

for men and 63 years and 8 months for women in 2022). Since 2012, the retirement age has been rising gradually by 2 months a year for men and 4 months a year for women until reaching the statutory retirement age of 65 for both men and women by 2026 ; has the minimum record of pension social insurance established for old-age pension (has paid the pension social insurance contributions for at least 15 years).

The pension social insurance record is the period in which the obligatory pension social insurance payments are made or must be made either by the person themselves or on his/her behalf. Starting from 2018, the obligatory pension social insurance record requirement increased. In 2021, the mandatory record is at least 32 years and will be increased by 6 months every subsequent year until it reaches 35 years in 2027.

A new version of the Law on Social Insurance Pensions came into force on 1 January 2018. The pension system was reformed by changing the pension calculation structure, introducing pension points and setting the indexation rules. A social insurance pension will consist of the general (GP) and individual parts (IP). The old-age pension is equal to the sum of the general and the individual parts of pension.

The general part (GP) of the old-age pension takes into account only the duration of insured period. The general part (GP) of pension is calculated according to the formula:

$$GP = \beta \times B$$

where:

- β represents the ratio of the insurance record of the person and the obligatory insurance record effective in the year of the pension entitlement (for example, if the obligatory insurance record at year of retirement is 35 years and the person's insurance record is 40 years, then the value of β is 40/35 = 1.1429); and

- B represents the basic pension (in €).

The individual part of pension is based on pension point system. Pension points system for the determination of the individual part of pension was introduced on 1 January 2018. Each insured person will receive a certain number of pension points for the amount of pension social insurance contributions paid during the year. If the amount of pension social insurance contributions deducted from the person's income during the year for the individual part of pension is equal to the amount of the annual pension contribution determined on the basis of the average pay (salary) during the year, the person will acquire one pension point. A larger or a smaller amount paid will result, accordingly, in a larger or smaller number of pension points. However, the total number of pension points acquired during one year may not exceed 5. The pension points acquired will be summed up and multiplied by the pension point value. The individual part of pension is calculated according to the formula:

$$IP = V \times p$$

where:

- V is the number of pension points accumulated by the person during the entire working career;
- p is the pension point value (in €).

For example, if a person's salary during the whole career (40 years) was equal to the average salary in the economy (1 point), then the person can acquire 40 $\times$ 1 point = 40 points. If the value of one pension point at moment of retirement is, for example, €10, then the individual part of old-age pension is: 40 $\times$ 10 = €400.

Old-age pensions are indexed every year. Starting from 1 January every year, the values of the basic pension, the value of pension points and the basic amount of widows'/widowers' pensions, used for the granting and determining social insurance pensions, will be indexed based on the average 7-year wage fund growth rate.

The indexing coefficient (IC) is calculated on the basis of the change in the wage fund during the past three years, the year for which the IC is being calculated, and three prospective years. The IC is applied provided that, upon its application, the pension social insurance costs in the year of indexation do not exceed social insurance revenues and the projected pension social insurance costs for the next year do not start exceeding the social insurance revenues projected. If, without indexation, the pension social insurance revenues in the year of indexation exceed the pension social insurance costs, the IC is calculated in such a way that the pension social insurance expenses for pension indexing would not exceed 75% of the pension social insurance contribution surplus planned for the year of indexation in case if no indexation is performed.

Indexation of pensions will not be performed if the determined IC is smaller than 1.01 and/or if the change in the gross domestic product at comparative prices and/or in the wage funds, expressed in percentage terms, is negative in the year for which the IC is being calculated and/or for next calendar year. If no indexation is performed, the values of December of previous year are applied.

In general, we can say that the Pillar I pensions will be subject to the automatic adjustment mechanism ensuring the balance of the State Social Insurance fund over the longer period.

SoDra has launched the indicative retirement calculator,[1] where an individual can assess his projected old-age pension including the expected (projected) Pillar II savings.

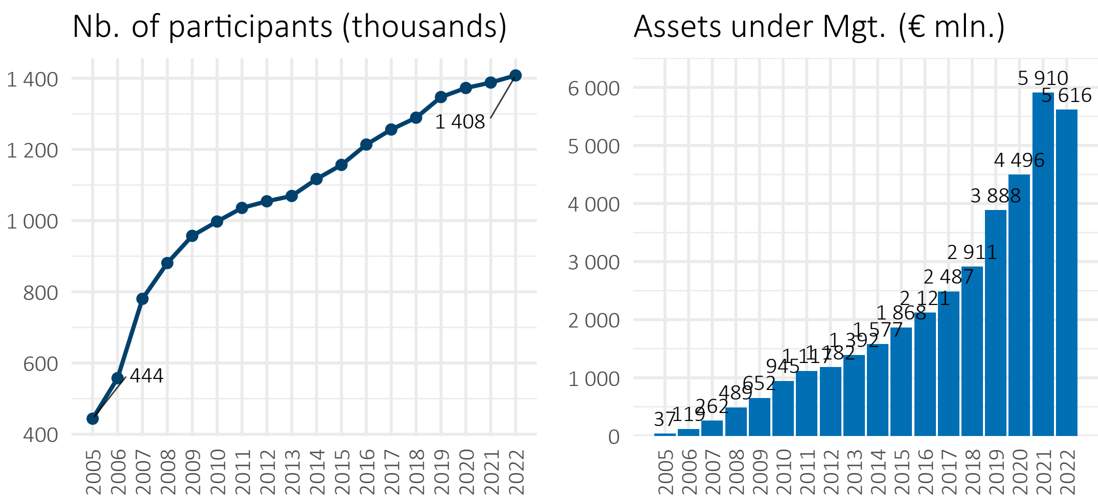
Second pillar: Funded pensions

Lithuania's private pensions system (Pillar II) is based on the World Bank's multi-pillar model. Pillar II pension scheme can be characterized as an accumulation of a redirected part of social insurance contributions towards individual retirement accounts managed by private pension accumulation companies offering and managing private pension funds. All persons with income, from which state social insurance contributions are calculated on a mandatory basis to receive pension, and yet to reach retirement age may become fund participants. The contribution to Pillar II pension funds consists of three parts: a social-security contribution (currently paid to SoDra), salary contribution and an additional pension contribution from the State Budget.

Pillar II can be characterized as a fully funded scheme, with quasi-mandatory participation, distinct and private management of funds, based on personal accounts and on the DC philosophy with no minimum return guarantees.

Since 2004, when the Pillar II was effectively launched, the number of participants as well as AuM has grown rapidly and currently, more almost 94% of working population is covered by the scheme and more than 5 billion € are managed by 5 PACs (see Figure LT.2).

Figure LT.2 – Pillar II – Number of participants and AuM



Data: Bank of Lithuania, 2023.

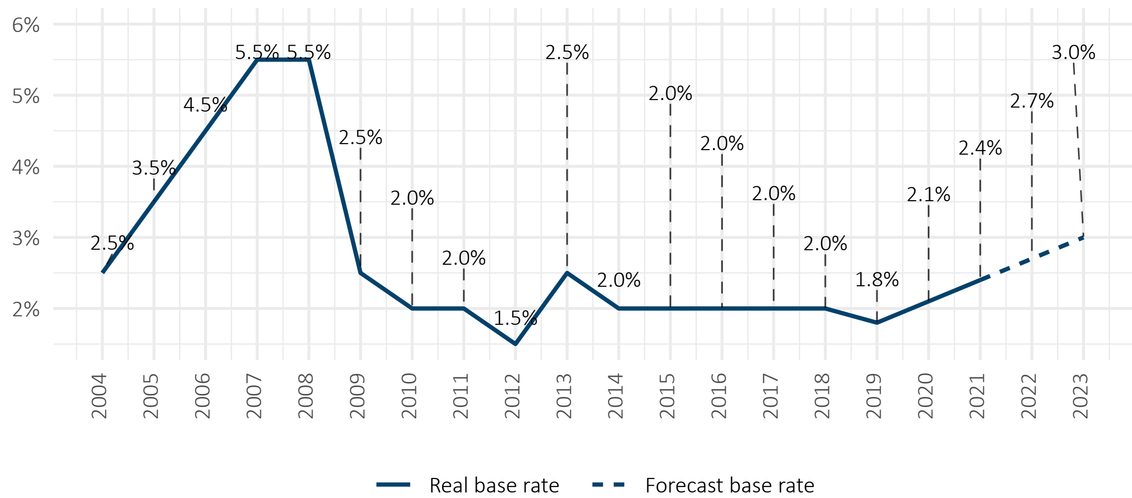
The pension contributions towards the Pillar II are part of the participant's state social insurance contribution rate. Originally, the level of contributions ("base rate") was set at final level of 5.5% of insurable income. This level should have been reached in 2007. The base rate in 2004 was

[1] http://www.sodra.lt/lt/skaiciuokles/prognozuojamos_pensijos_skaiciuokle

2.5%, in 2005 3.5%, in 2006 it was 4.5%, and since 2007 5.5% of the participants' income, from which the state social insurance contributions are calculated. However, it should be noted that there have been significant changes to the Pillar II set-up because of the financial crisis and the following public finance deficits. As a result, the mechanism and level of paid contributions have changed. Since 2014, the level of contributions has remained stable, while participants have been required to match redirected contributions from the social insurance with additional individual contributions and the state must match the individual contributions of savers from the state budget. Under the new system, the "base rate" for Pillar II contributions is 2%, and existing savers can make a further 1% in contributions, matched by a state subsidy of 1% of gross average wages. These both additional contribution rates rose to 2% a piece since 2016. Under Lithuania's current "maximum accumulation" scenario, Pillar II savings during the years of 2016 till 2019 are funded by the so-called "2+2+2" system: 2% of social security system contributions, with an additional 2% of additional payment from a salary of a saver, matched by a state contribution based on the previous year's average state wages.

Since 2019 reform, the new contribution system has been established. The formula for Pillar II pension accumulation in pension funds has changed. As of 2023, all Pillar II participants will accumulate according to the formula "3% + 1.5%" (a contribution by the participant of 3 per cent of their gross wage plus a contribution by the state of 1.5 per cent of the average wage in the country the year before last). Those who accumulated maximally will move to the new formula as of 2019 automatically, while those who accumulated minimally will in 2021 accumulate according to the formula "1.8% + 0.3%" (a participant contribution of 1.8 per cent of one's gross wage plus a state contribution of 0.3% of the average wage in the country the year before last) and then their contributions will increase gradually, by 0.3 percentage points each year, until their accumulation formula reaches "3% + 1.5%".

Figure LT.3 – Level of "base rate" contributions towards Pillar II



Source: Own elaboration based on the Law on Reform of the Pension System.

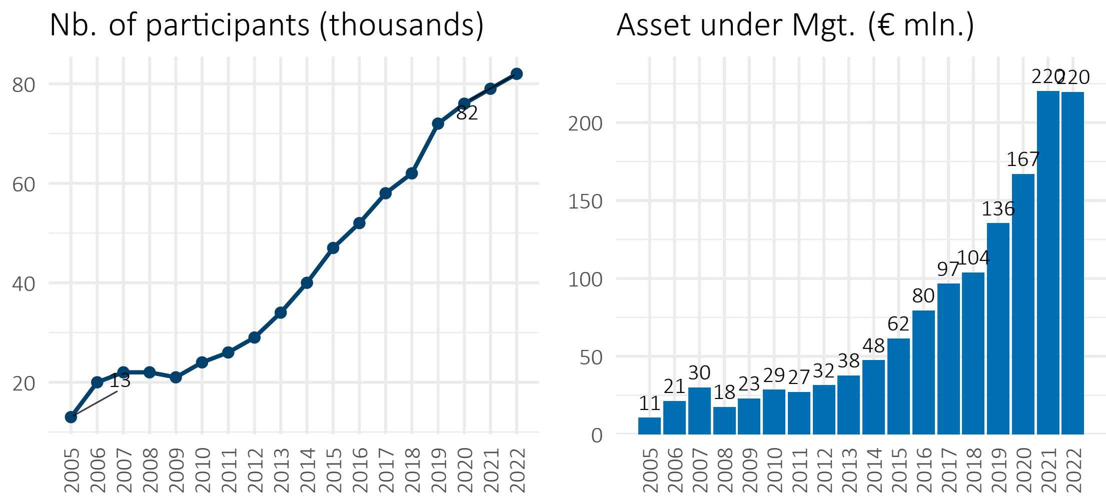
The contributions to Pillar II are recorded on individual personal pension account at selected providers—Pension Accumulation Companies (PACs). Contributions and accumulated savings are invested by the companies into managed pension funds. PACs can manage multiple pension fund based on a "life-cycle" approach. PACs must obtain licenses from market regulator and supervisory body, which is the Bank of Lithuania.

Third pillar: Voluntary private pensions

Lithuania's voluntary supplementary private pensions system (Pillar III) is also based on the World Bank's multi-pillar model and effectively started in 2005. It is also a fully funded system, based on personal accounts and on the DC philosophy. Pillar III pension funds refer to supplementary voluntary pension accumulation. Funds are transferred by participants themselves or by their employers.

Even if the set-up of the pillar is very similar to the Pillar II set-up, the attractiveness of the financial products offered by supplementary pension asset managers is very low. Number of participants (savers) and assets under management in Pillar III providers are presented in Figure LT.4.

Figure LT.4 – Pillar III – Number of participants and AuM



Data: Bank of Lithuania, 2023.

Pillar III is organized in a way that pension providers (Voluntary Supplementary Pension Accumulation Management Companies) offer pension funds on a basis of typical mutual funds. At the end of 2022, 18 supplementary voluntary pension accumulation funds operated in Lithuania were managed by 4 managing companies as Swedbank has entered the market in 2019 by offering 3 new supplementary voluntary pension funds (2 mixed and 1 equity based) and SEB introduced one mixed fund (SEB pensija 50+) in 2020. In 2022, new equity funds SEB index were introduced. New funds Klimato ateitis, Luminor tvari ateitis index and Goindex pasaulio akcijų fonds have been operating only for 5 months in 2022 and were not included in the calculations for this year. In 2022, assets managed by funds have increased to €219 million. Number of participants accumulating their pension in Pillar III pension funds amounted to 82 000.

Long-term and pension savings vehicles in Lithuania

Second pillar: Funded pensions

As indicated above, each provider (PAC) has to offer 7 life-cycle funds and 1 capital preservation fund. Currently, 48 pension funds are offered by 5 management companies.

Table LT.4 – List of Pillar II pension funds

Fund name	Inception date
Life-cycle pension funds, 1996-2002	
Luminor 1996–2002 tikslinės grupės pensijų fondas	02.01.2019
INVL pensija 1996–2002	02.01.2019
SEB 1996–2002 metų tikslinės grupės pensijų kaupimo fondas	28.12.2018
Swedbank pensija 1996–2002	01.03.2018
Allianz Y3 1996–2002 tikslinės grupės pensijų fondas	02.01.2019
Life-cycle pension funds, 1989-1995	
Luminor 1989–1995 tikslinės grupės pensijų fondas	02.01.2019
INVL pensija 1989–1995	02.01.2019
SEB 1989–1995 metų tikslinės grupės pensijų kaupimo fondas	28.12.2018
Swedbank pensija 1989–1995	01.03.2018
Allianz Y2 1989–1995 tikslinės grupės pensijų fondas	02.01.2019
Life-cycle pension funds, 1982-1988	
Luminor 1982–1988 tikslinės grupės pensijų fondas	02.01.2019
INVL pensija 1982–1988	02.01.2019
SEB 1982–1988 metų tikslinės grupės pensijų kaupimo fondas	28.12.2018
Swedbank pensija 1982–1988	01.03.2018
Allianz Y1 1982–1988 tikslinės grupės pensijų fondas	02.01.2019
Life-cycle pension funds, 1975-1981	
Luminor 1975–1981 tikslinės grupės pensijų fondas	02.01.2019
INVL pensija 1975–1981	02.01.2019
SEB 1975–1981 metų tikslinės grupės pensijų kaupimo fondas	28.12.2018
Swedbank pensija 1975–1981	01.03.2018
Allianz X3 1975–1981 tikslinės grupės pensijų fondas	02.01.2019
Life-cycle pension funds, 1968-1974	
Luminor 1968–1974 tikslinės grupės pensijų fondas	02.01.2019
INVL pensija 1968–1974	02.01.2019
SEB 1968–1974 metų tikslinės grupės pensijų kaupimo fondas	28.12.2018
Swedbank pensija 1968–1974	01.03.2018
Allianz X2 1968–1974 tikslinės grupės pensijų fondas	02.01.2019
Life-cycle pension funds, 1961-1967	
Luminor 1961–1967 tikslinės grupės pensijų fondas	02.01.2019
INVL pensija 1961–1967	02.01.2019
SEB 1961–1967 metų tikslinės grupės pensijų kaupimo fondas	28.12.2018
Swedbank pensija 1961–1967	01.03.2018
Allianz X1 1961–1967 tikslinės grupės pensijų fondas	02.01.2019
Life-cycle pension funds, 1954-1960	
Luminor 1954–1960 tikslinės grupės pensijų fondas	02.01.2019
INVL pensija 1954–1960	02.01.2019
SEB 1954–1960 metų tikslinės grupės pensijų kaupimo fondas	28.12.2018

Table LT.5 – Pillar II market share based on AuM and number of participants

Investment strategy	AuM (million €)	Market share (% of total AuM)	Nb. of participants (thousands)	Market share (% of total participants)
Life-cycle pension funds, 1996-2002	136.23	2.43%	119	8.43%
Life-cycle pension funds, 1989-1995	573.31	10.21%	228	16.20%
Life-cycle pension funds, 1982-1988	1035.23	18.43%	302	21.45%
Life-cycle pension funds, 1975-1981	1277.38	22.74%	249	17.70%
Life-cycle pension funds, 1968-1974	1254.18	22.33%	232	16.46%
Life-cycle pension funds, 1961-1967	998.83	17.78%	205	14.58%
Life-cycle pension funds, 1954-1960	250.16	4.45%	52	3.72%
Asset preservation pension funds	90.86	1.62%	21	1.47%
TOTAL	5616.19	100.00%	1408	100.00%

Data: Bank of Lithuania, 2023.

Table LT.4 – List of Pillar II pension funds *(continued)*

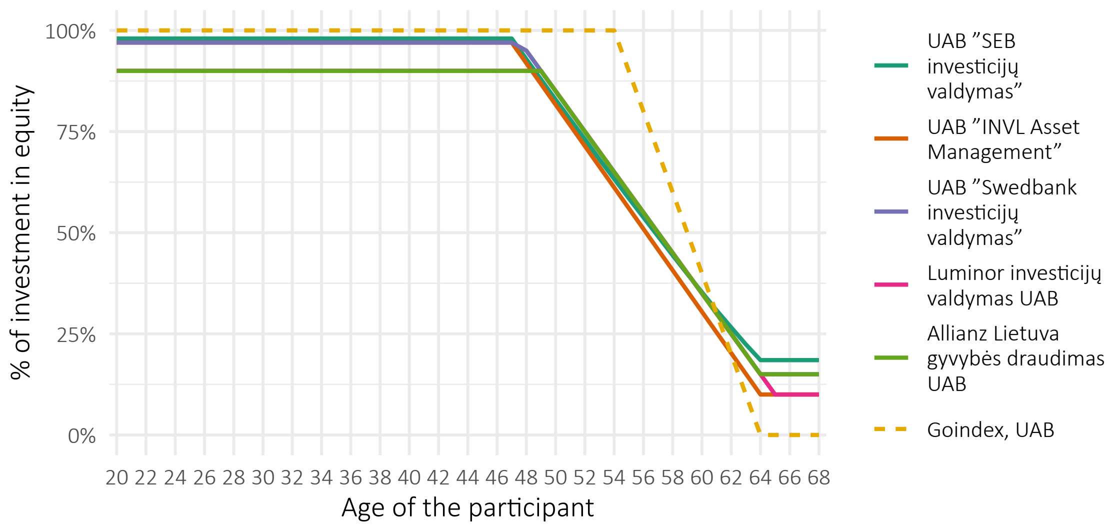
Fund name	Inception date
Swedbank pensija 1954–1960	01.03.2018
Allianz B 1954–1960 tikslinės grupės pensijų fondas	02.01.2019
Asset preservation pension funds	
Luminor turto išsaugojimo fondas	02.01.2019
INVL pensijų turto išsaugojimo fondas	02.01.2019
SEB turto išsaugojimo pensijų kaupimo fondas	28.12.2018
Swedbank turto išsaugojimo pensijų fondas	01.03.2018
Allianz S turto išsaugojimo pensijų fondas	02.01.2019

Data: Bank of Lithuania, 2023.

The structure of savers, assets under management and market share of four group of pension funds according their investment strategy is presented in Table LT.5.

There are no strict quantitative limitations on financial instruments. However, the management company has to ensure risk management principles and avoid concentration risk. Introduction of life-cycle pension funds since 2019 was accompanied by the presentation of asset allocation that follows the age of participants. Almost all pension asset management companies has introduced the same life-cycle investment strategy (see Figure LT.5).

Figure LT.5 – Life-cycle investment strategy of Pillar II pension funds



Data: Bank of Lithuania, 2023.

The portfolio structure of Pillar II pension funds is presented in the graph below. The reform in 2019 delivered significant increase of equities in pension funds' portfolios due to the introduction of "life-cycle" strategies via target-date funds.

It can be seen that dominant financial instruments in Pillar II pension funds' portfolios are the equities and government bonds. The 2019 reform aimed at balancing the remaining saving horizon with the asset allocation has brought significant rise in equity based allocations (from 44% to 77% of all assets) and this adjusted portfolio structure should preserve rather large portion of equities in pension funds' portfolios.

Third pillar: Voluntary private pensions

The Lithuanian Pillar III allows licensed asset management companies (licensing process similar to typical UCITS funds providers) to offer as many voluntary pension funds as they prefer. At its inception, there were only 5 pension funds offered by 3 providers. Currently (at the end of 2019), there are 5 providers offering 18 voluntary pension funds. The list of Pillar III pension funds is presented in Table LT.6

Table LT.6 – List of Pillar III pension funds

Pension fund name	Inception day
Bond pension fund	
INVL STABILO III 58+ / INVL Stabilus	12.20.2004
Luminor pensija 1 plius	10.07.2013
SEB pensija 58+	10.27.2004
Mixed investment pension fund	
Luminor pensija 2 plius	10.26.2004
INVL Medio III 47+	09.24.2007

Table LT.7 – Pillar III market share based on AuM and number of participants

Investment strategy	AuM (million €)	Market share (% of total AuM)	Nb. of participants (thousands)	Market share (% of total participants)
Bond Pension Fund	30.23	14%	9	11.4%
Mixed Investment Pension Fund	71.10	32%	33	40.3%
Equity Pension Fund	118.45	54%	40	48.3%
TOTAL	219.78	100%	83	100.0%

Data: Bank of Lithuania, 2023.

Table LT.6 – List of Pillar III pension funds *(continued)*

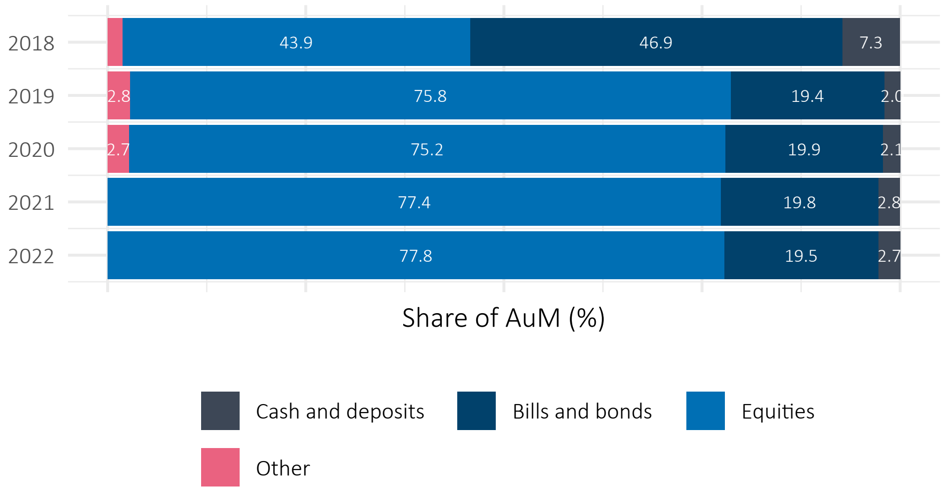
Pension fund name	Inception day
INVL Apdairus	05.13.2013
Luminor pensija darbuotojui 1 pllius	11.20.2014
Luminor pensija darbuotojui 2 pllius	11.20.2014
Swedbank pensijų fondas 30	12.02.2019
Swedbank pensijų fondas 60	12.02.2019
SEB pensija 50+	04.10.2020
Goindex subalansuotas	07.21.2022
Pensijos fondas 60+*	04.07.2022
Pensijos fondas 50+*	04.07.2022
Equity pension fund	
Luminor pensija 3 plius	10.01.2007
INVL Drąsus	12.20.2004
INVL Extremo III 16+	09.24.2007
SEB pensija 18+	10.27.2004
Swedbank pensijų fondas 100	12.02.2019
SEB index. Klimato ateitis	01.03.2022
Luminor tvari ateitis index	05.24.2021
Goindex pasaulio akcijų	08.22.2022

Data: Bank of Lithuania, 2023.

The market share according to the AuM and number of participants is presented in Table LT.7

There are no specific quantitative limitations on financial classes or instruments. However, the investment strategy of the pension fund must include the procedure and areas for investment of pension assets, risk assessment methods, risk management principles, risk management procedures and methods used, and the strategic distribution of pension assets according to the duration and origin of the obligations relating to pension accumulation contracts. The management company must review the investment strategy of the pension fund at least every 3 years. Pillar III pension funds' portfolio structure is presented below (data available since 2013 until 2020). Unfortunately, the Lithuanian national bank do not provide data on individual Pillar III pension funds' portfolio structure since 2021, just share of investment in stocks. The data on the portfolio structure of the Pillar III pension funds as a whole have been extracted from the financial state-

Figure LT.6 – Allocation of Lithuanian Pillar II funded pensions' assets

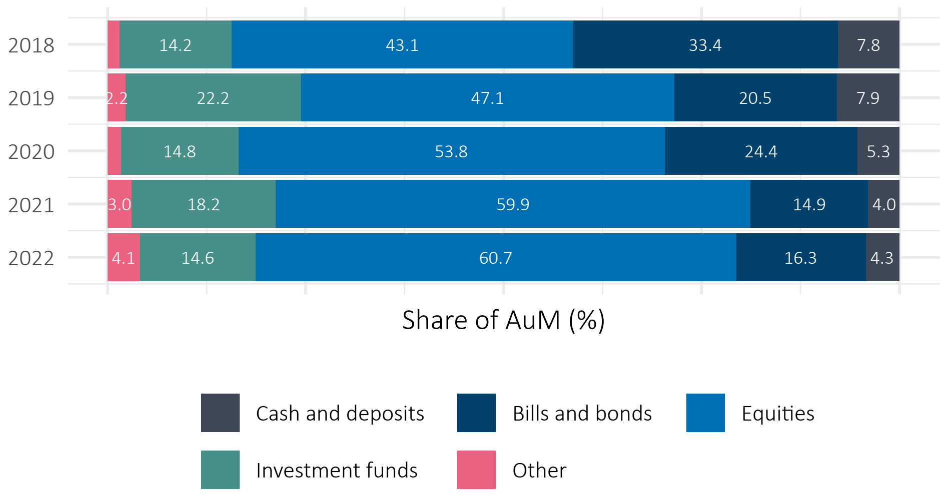


Data: Bank of Lithuania, 2023; *Calculations:* BETTER FINANCE.

ments of the pension funds on an aggregate basis provided by the State data agency, Statistics Lithuania.

Equities and equity based UCITS account for 47% of the Pillar III pension funds' portfolios, while the government bonds account for almost 21%. Pillar III pension funds can be therefore characterized as a fund-of-funds.

Figure LT.7 – Allocation of Lithuanian Pillar III voluntary private pensions' assets



Data: Bank of Lithuania, Statistics Lithuania, 2023; *Calculations:* BETTER FINANCE.

Charges

Charges of Pillar II funded pensions

Major reform introduced in 2018 brought significant drop in Pillar II charges. The reform introduced instant cut in fees and gradual decrease from 1% in 2018 to 0.5% in 2020. Table LT.8 compares effective charges of Pillar II pension funds in Lithuania in 2019.

The year 2022 brought no changes in the fees and charges for Pillar II pension funds. Introduction of low-cost passively managed target date funds and entry of new player Goindex may spur new pressure on the fees, however the year 2022 did not bring any significant downward trend in costs and charges.

Charges of Pillar III voluntary private pensions

The fee structure of the Pillar III pension funds is more complex. Management companies charge various entry fees, in which case the calculation of the overall impact of fees on accumulated assets is harder to obtain. Table LT.9 compares fees of Pillar III pension funds in Lithuania.

In most cases, additional costs, that are charged on the pension fund's account and not directly visible to the savers are the audit fees and custodian (depository) fees. On average, they account for 0.25%, and 0.055% respectively.

Comparing the Pillar II and Pillar III pension funds' fees, it is obvious, that even if the management and investment strategies are very similar, the fee structure and overall level of fees in Pillar III is more than double the fees in Pillar II.

Table LT.8 – Costs and charges of Lithuanian pillar ii funded pensions (% of assets)

Year	Total Expense Ratio
2004	3.35%
2005	2.31%
2006	1.63%
2007	0.97%
2008	1.18%
2009	1.08%
2010	0.11%
2011	1.10%
2012	0.99%
2013	0.97%
2014	1.02%
2015	1.00%
2016	1.00%
2017	0.91%
2018	0.86%
2019	0.72%
2020	0.65%
2021	0.52%
2022	0.52%

Data: Funds' documentation.

Table LT.9 – Costs and charges of Lithuanian pillar iii voluntary private pensions (% of assets)

Year	Total Expense Ratio
2004	0.39%
2005	12.37%
2006	6.38%
2007	5.01%
2008	2.73%
2009	2.50%
2010	2.99%
2011	2.07%
2012	1.83%
2013	2.10%
2014	1.89%
2015	2.06%
2016	2.01%
2017	1.40%
2018	1.63%
2019	1.94%
2020	1.42%
2021	1.44%
2022	1.27%

Data: Bank of Lithuania, 2023.

Taxation

Lithuania applies an "EEE" regime for the taxation of Pillar II pension accounts. Employee contributions are tax-deductible even if they are higher than required (3% + 1.5%). Investment income on the level of the pension fund is tax-exempt. Pension benefits paid out during retirement are tax-exempt from a personal income tax as the old-age income is considered as a part of social system.

A similar tax regime is applied on the Pillar III savings, but there are some ceilings on contributions and withdrawals.

Regarding the contribution phase, there is a tax-refund policy, which means that the contributions of up to 25% of gross earnings, the income tax (15%) is returned. Therefore, we can conclude that the contribution phase is a "E" regime.

Positive returns on accumulated savings are tax-exempt, so the investment phase is an "E" regime.

Regarding the withdrawal (pay-out) phase, pension benefits paid from Pillar III voluntary funds can be received at any age and are levied with 15% income tax, but become tax-free if a person:

1. holds savings in a Pillar III pension fund for at least 5 years and reaches the age of 55 at the time of payment of the benefit (and the pension savings agreement was concluded before December 31, 2012); or

2. holds savings in a Pillar III pension fund for at least 5 years and reaches the age which is five years earlier than the threshold for the old-age pension at the time of payment of the benefit (if the pension savings agreement was concluded after January 1, 2013).

Under the optimum set-up, the "EEE" tax regime can be achieved on Pillar III savings.

Table LT.10 – Taxation of pension savings in Lithuania

Product	Phase *Contributions*	 *Investment returns*	 *Payouts*	Regime
Pillar II Funded pensions	Exempted	Exempted	Exempted	EEE
Pillar III Voluntary private pensions	Exempted	Exempted	Taxed	EET

Data: Own elaboration, 2023.

Performance of Lithuanian long-term and pension savings

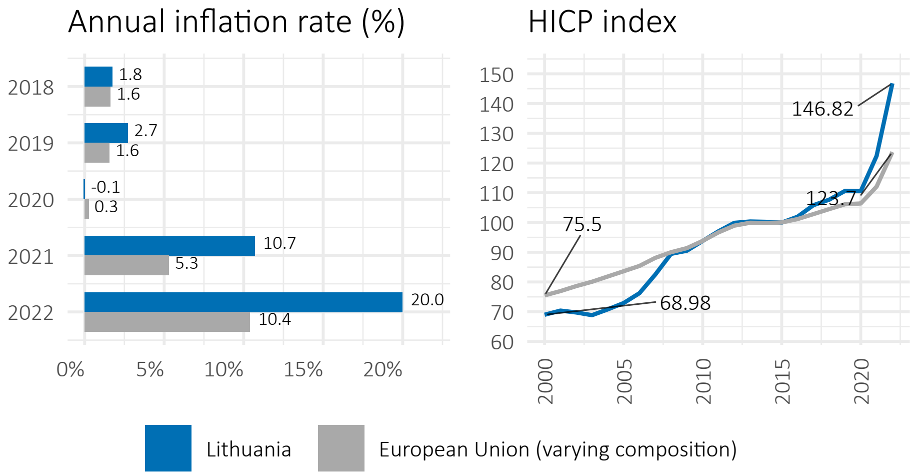
Real net returns of Lithuanian long-term and pension savings

Before inspecting the real net returns of Lithuanian pension funds, the inflation for the last 24 years is presented on the figure below. The inflation has doubled the price level during the last 24 years and considering the small financial market where most of the savings are invested globally, the real returns might by negatively influenced by higher inflation in Lithuania during the analyzed period.

Figure LT.8 – Inflation in Lithuania

Period 2000–2022

	Annualised	Compounded
Lithuania	3.4%	116.4%
European Union (varying composition)	2.3%	67.5%



Data: Eurostat, HICP monthly index (2015 = 100); *Calculations:* BETTER FINANCE

Pension returns of Pillar II pension funds differ according to the life-cycle investment strategy applied. When comparing the returns, it should be noted that the major changes in Pillar II regarding the introduction of the target date funds and reallocation of savers into these funds based on the birth year in 2019 could influence the direct comparison of pre-2019 returns and the returns of the funds beyond the year 2019.

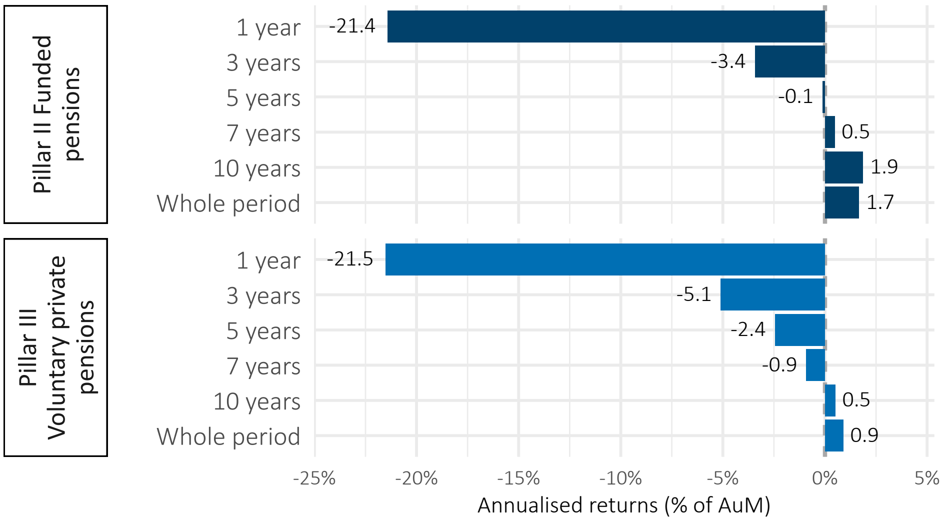
When inspecting particular pension funds within each group, only minor changes in performance were observed between the years 2019 and 2022.

Pillar III pension funds' performance is presented according to their investment strategy, where 3 groups are formed.

Real annual and cumulative returns of pension vehicles in Lithuania are presented in Figures LT.9 and LT.10.

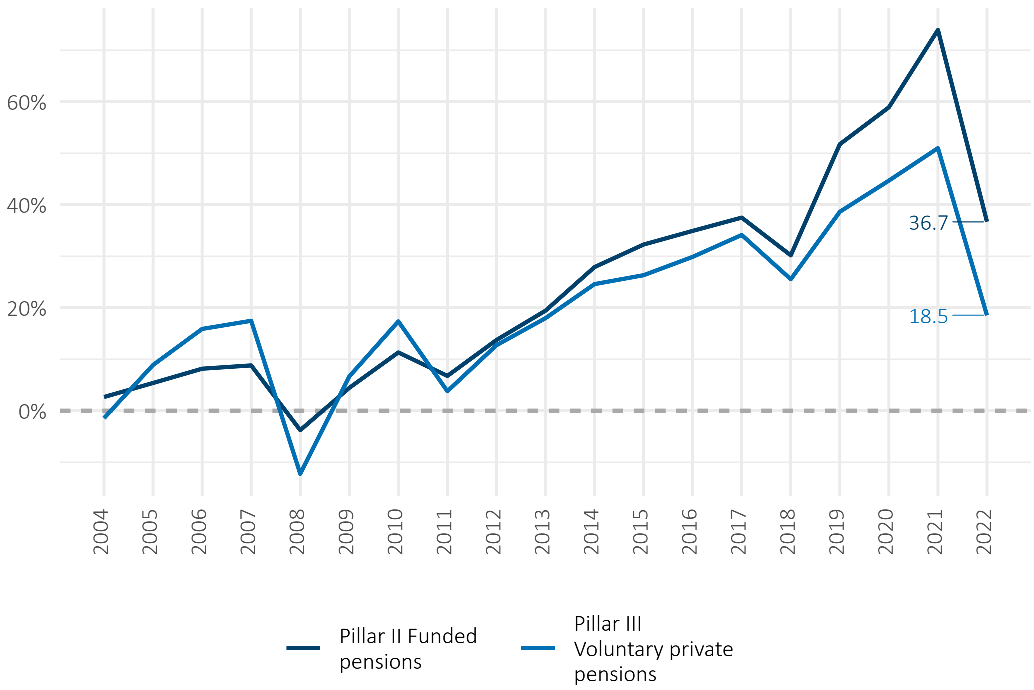
Performance of Pillar II and Pillar III pension funds is quite similar, while the higher fees of Pillar III pension funds drags the after fees returns lower and into negative territory in real terms.

Figure LT.9 – Annualised returns of Lithuanian long-term and pension vehicles over varying holding periods (before tax, % of AuM)



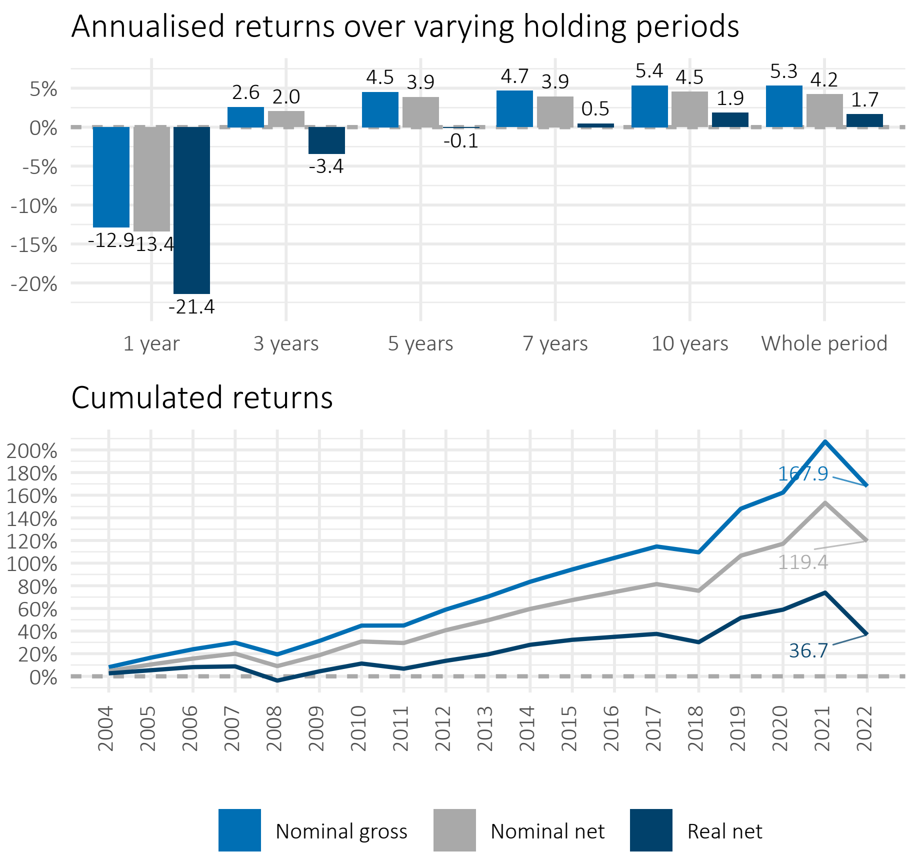
Data: Bank of Lithuania, Eurostat; *Calculations:* BETTER FINANCE.

Figure LT.10 – Cumulated returns of Lithuanian long-term and pension savings vehicles (2003–2022, before tax, % of AuM)



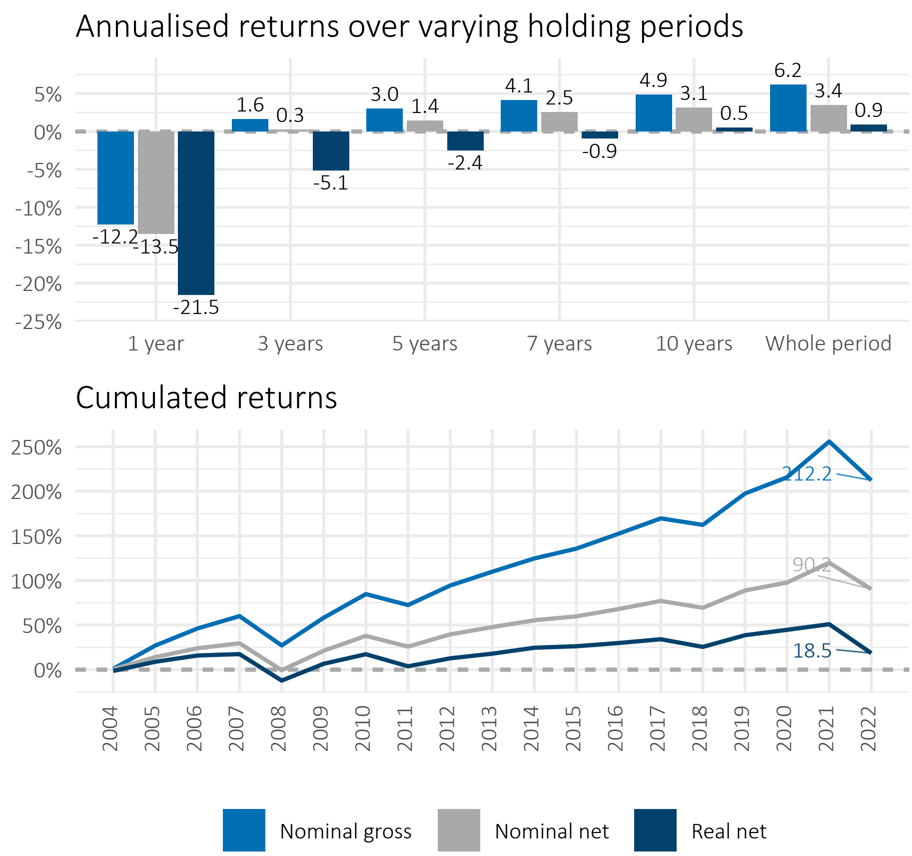
Data: Bank of Lithuania, Eurostat; *Calculations:* BETTER FINANCE.

Figure LT.11 – Returns of Lithuanian Pillar II funded pensions (before tax, % of AuM)



Data: Bank of Lithuania, Eurostat; *Calculations:* BETTER FINANCE.

Figure LT.12 – Returns of Lithuanian Pillar III voluntary private pensions (before tax, % of AuM)



Data: Bank of Lithuania, Eurostat; *Calculations:* BETTER FINANCE.

Do Lithuanian savings products beat capital markets?

In this section, we compare the performance of the mandatory and voluntary pension funds in Lithuania to the performance of relevant capital market benchmarks. By analyzing the portfolio structure of pension funds, we have selected the a balanced benchmark portfolio (50% equity-50% bonds) based on two pan-European indices.

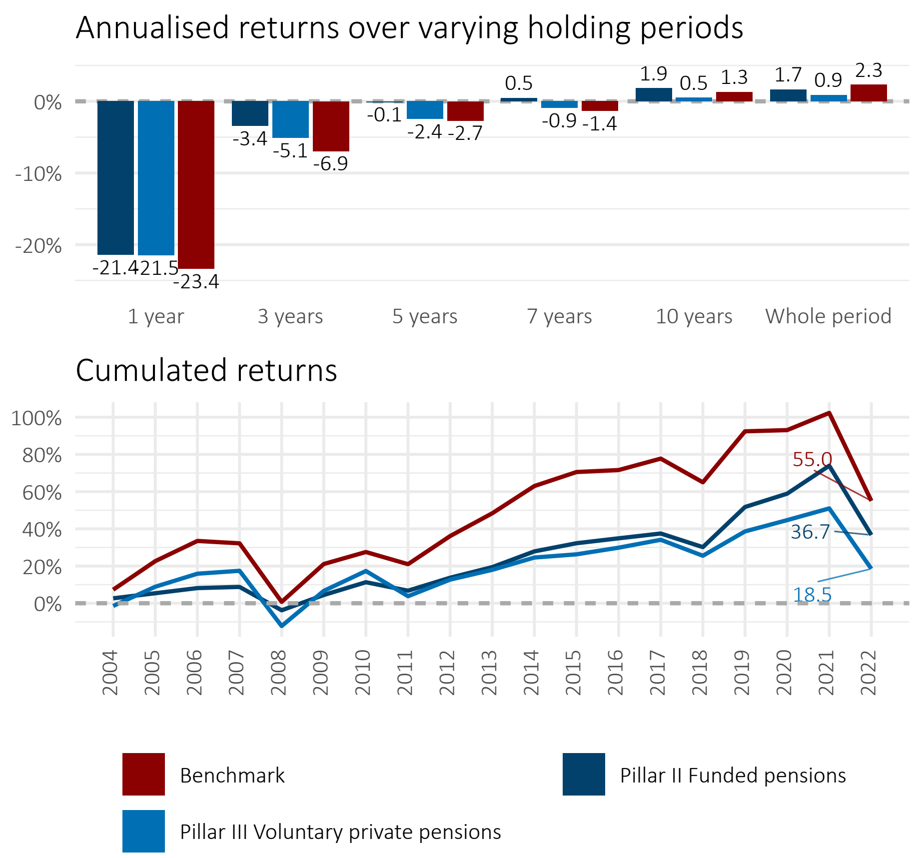
Table LT.11 – Capital market benchmarks to assess the performance of Lithuanian pension vehicles

Product	Equity index	Bonds index	Allocation
Pillar II Funded pensions	STOXX All Europe Total Market	Barclays Pan-European Aggregate Index	50.0%–50.0%
Pillar III Voluntary private pensions	STOXX All Europe Total Market	Barclays Pan-European Aggregate Index	50.0%–50.0%

Note: Benchmark porfolios are rebalanced annually.

We can conclude that Lithuanian pension vehicles are not able to beat the market benchmark. However, detailed analysis of the particular pension funds' performance could show that more aggressive pension funds are able to stay in positive real returns over the analyzed period.

Figure LT.13 – **Performance of Lithuanian mandatory pension funds against a capital market benchmark (returns before tax, after inflation, % of AuM)**



Data: Bank of Lithuania, Eurostat; *Calculations:* BETTER FINANCE.

Conclusions

Considering the wider factors, it is safe to say that the decreasing labor force and the implementation of the automatic balancing mechanism within the PAYG pillar will lead to a lower replacement ratio generated from Pillar I pensions. Therefore, Lithuania can be seen as a strong advocate of private pension savings where the pillars will grow on importance.

Reforms in the area of PAYG scheme supported with the funded pension schemes that have been adopted in 2018 and effective since 2019 are started shifting the preferences of the Lithuanian savers to rely more on their private funded pension schemes.

Real net performance of the Pillar II as well as Pillar III pension funds after the negative returns in 2022 slipped to the negative territory over the entire analysed period. However, the dominance of Pillar II funds opens the question on the further changes in the Pillar III, which cannot compete to the similar and cheaper peers in Pillar II.

The latest changes in the contributory mechanism, where additional individual contributions towards Pillar II are promoted and tax deductible, puts more pressure on Pillar III fund managers due to the growing crowding-out effect.

Introduction of life-cycle investment style into the Pillar II since 2019 created significant differences between the portfolio structure of pension funds within both pillars, which leads to the conclusion that Pillar III with more conservative approach will need to find its competitiveness against promoted Pillar II funds.

Lithuania has a favorable tax treatment of private pension savings, where in both cases an "EEE" tax regime is applied.

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The writing and publication of this report
is co-funded by the European Union.
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