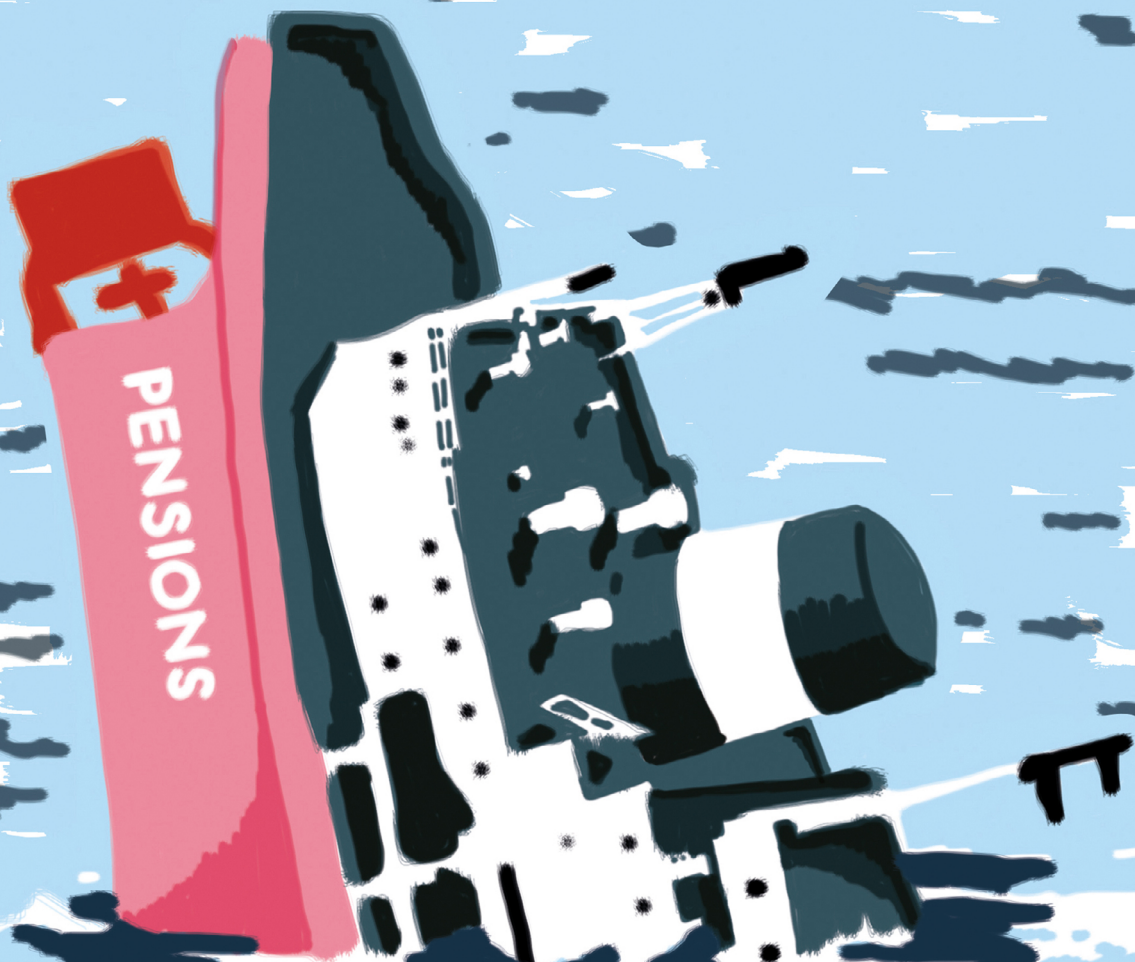


Long-Term and Pension Savings

The Real Return

2020 Edition



BF BETTER FINANCE

The European Federation of Investors and Financial Services Users
Fédération Européenne des Épargnants et Usagers des Services Financiers

Pension Savings: The Real Return

2020 Edition

A Research Report by BETTER FINANCE

COORDINATORS

Aleksandra Mączyńska
Ján Šebo
Ștefan Dragoș Voicu

CONTRIBUTORS

Edoardo Carlucci
Lubomir Christoff
Lars Christensen
Michaël Deinema
Laetitia Gabaut
Yordanka Popova
Lisbeth Grænge-Hansen
Johannes Hagen
José Antonio Herce

Arnaud Houdmont
Matis Joab
Michal Mešťan
Gregoire Naacke
Dayana Nacheva
Carlos Nava
Guillaume Prache
Joanna Rutecka-Góra
Dr. Thomas Url

REVIEWERS

Ján Šebo
Michal Mešťan
Ștefan Dragoș Voicu

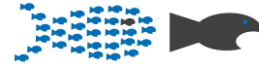


Acronyms

| | |
|----------|---|
| AIF | Alternative Investment Fund |
| AMC | Annual Management Charges |
| AuM | Assets under Management |
| BE | Belgium |
| BG | Bulgaria |
| Bln | Billion |
| BPETR | 'Barclay's Pan-European High Yield Total Return' Index |
| CAC 40 | 'Cotation Assistée en Continu 40' Index |
| CMU | Capital Markets Union |
| DAX 30 | 'Deutsche Aktieindex 30' Index |
| DB | Defined Benefit plan |
| DC | Defined Contribution plan |
| DE | Germany |
| DG | Directorate General of the Commission of the European Union |
| DK | Denmark |
| DWP | United Kingdom's Governmental Agency Department for Work and Pensions |
| EBA | European Banking Authority |
| EE | Estonia |
| EEE | Exempt-Exempt-Exempt Regime |
| EET | Exempt-Exempt-Tax Regime |
| ETF | Exchange-Traded Fund |
| EIOPA | European Insurance and Occupational Pensions Authority |
| ES | Spain |
| ESAs | European Supervisory Authorities |
| ESMA | European Securities and Markets Authority |
| EU | European Union |
| EURIBOR | Euro InterBank Offered Rate |
| EX | Executive Summary |
| FR | France |
| FSMA | Financial Services and Market Authority (Belgium) |
| FSUG | Financial Services Users Group - European Commission's Expert Group |
| FTSE 100 | The Financial Times Stock Exchange 100 Index |
| FW | Foreword |
| GDP | Gross Domestic Product |
| HICP | Harmonised Indices of Consumer Prices |
| IBEX 35 | Índice Bursátil Español 35 Index |
| IKZE | 'Indywidualne konto zabezpieczenia emerytalnego' – Polish specific Individual pension savings account |
| IRA | United States specific Individual Retirement Account |



| | |
|-----------|---|
| IT | Italy |
| JPM | J&P Morgan Indices |
| KIID | Key Investor Information Document |
| LV | Latvia |
| NAV | Net Asset Value |
| Mln | Million |
| MSCI | Morgan Stanley Capital International Indices |
| NL | Netherlands |
| OECD | The Organisation for Economic Co-Operation and Development |
| OFT | United Kingdom's Office for Fair Trading |
| PAYG | Pay-As-You-Go Principle |
| PIP | Italian specific 'Individual Investment Plan' |
| PL | Poland |
| PRIIP(s) | Packaged Retail and Insurance-Based Investment Products |
| RO | Romania |
| S&P | Standard & Poor Indexes |
| SE | Sweden |
| SK | Slovakia |
| SME | Small and Medium-sized Enterprise |
| SPIVA | Standard & Poor Dow Jones' Indices Research Report on Active Management |
| Scorecard | performances |
| TEE | Tax-Exempt-Exempt Regime |
| TCR/TER | Total Cost Ratio/ Total Expense Ratio |
| UCITS | Undertakings for the Collective Investment of Transferable Securities |
| UK | United Kingdom |



Pension Savings: The Real Return

2020 Edition

Country Case: Lithuania

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. As of 2019, accumulating savings in Pillar II takes place in life-cycle pension funds, which change investment risk themselves on the basis of participants' age. Since 2019, management fee for accumulating in Pillar II life-cycle funds is being gradually reduced. In 2019 it will be 0.8 per cent and in 2020 it will be 0.65 per cent, until as of 2021 it reaches an annual asset management fee of 0.5 per cent. For the asset preservation fund, meanwhile, the management fee will be just 0.2 per cent.

Overall, pension funds' performance in both pillars were nicely positive in 2019 across all asset classes, however there were significant differences among the pension funds' returns with different risk-return profiles.

Introduction

Lithuania has undertaken a pension reform in 2004, which was renewed in 2013. This was the reason to establish private pension funds. Currently, the Lithuanian pension system provides three distinct sources of accumulation for retirement funds – so-called pension pillars:²²⁸

- **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 (in 2019) 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 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.

²²⁸ BITINAS, A. (2011). Modern pension system reforms in Lithuania: Impact of crisis and ageing. *Jurisprudence*, 18(3), 1055–1080.



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.

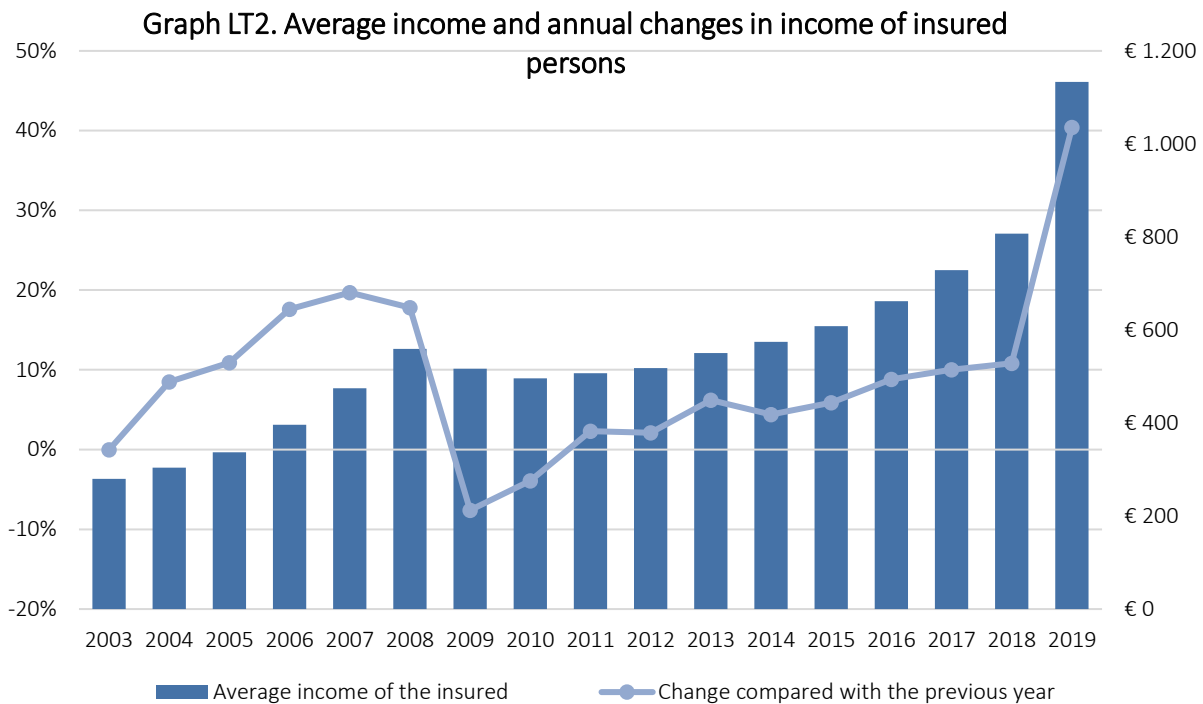
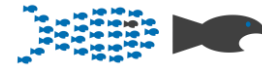
Basic data on the pension system set-up in Lithuania is presented in the table below.

| Table LT1. Multi-pillar pension system in Lithuania | | |
|---|--|---|
| 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 companies | Pension accumulation companies |
| Mandatory | Quasi/Mandatory | Voluntary |
| Publicly-managed | Privately managed pension funds | Privately managed pension funds |
| PAYG | Funded | Funded |
| PS (Pointing System - Defined benefit scheme based on salary) | DC (Defined Contribution scheme) | |
| | Individual personal pension accounts | |
| Quick facts | | |
| Number of old-age pensioners: 614,100 | Administrators: 5 | Administrators: 4 |
| Average old-age pension: € 344.20 | Funds: 40 | Funds: 15 |
| Average income (gross): € 1,133.60 | AuM: € 3,887.86 mil. | AuM: € 135.56 mil. |
| Average replacement ratio: 30.36% | Participants: 1,347,209 | Participants: 71,780 |
| Number of insured persons: 1,435,400 | Coverage ratio: 93.86% | Coverage ratio: 5.00% |

Source: Own calculation based on SoDra data, 2020.

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 almost 94% in 2019, while Pillar III covered merely 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 15 years (9.62% annually).



Source: Own composition and calculation based on SoDra data, 2020

Pillar I – 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.:

- 1) the person has reached the established old-age pension age (63.8 years for men and 62.7 years for women in 2019). 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;
- 2) 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 2018, the mandatory record is at least 30 years and 6 months and will be increased in 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 30 years and the person's insurance record is 40 years, then the value of β is $40/30 = 1.33333$); and

B represents the basic pension (in euros).

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 euros).

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 40×1 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: $40 \times 10 = 400$ Eur.

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, where an individual can assess his projected old-age pension including the expected (projected) Pillar II savings. The calculator web site (in Lithuanian language):

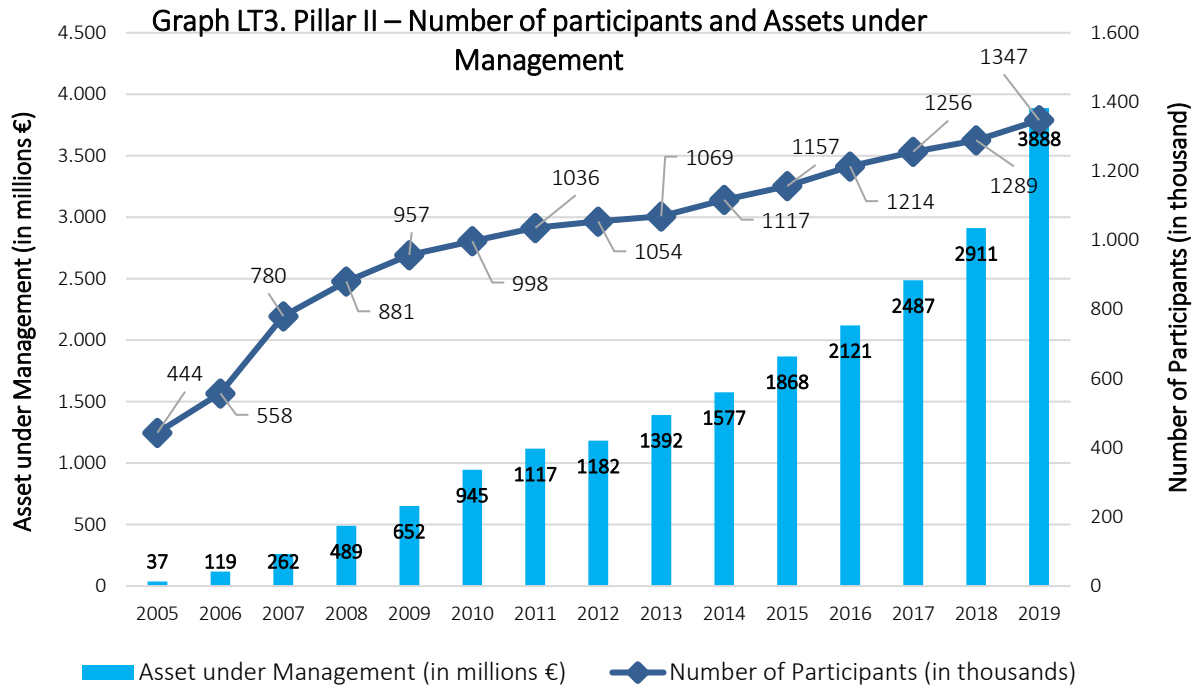
http://www.sodra.lt/lt/skaiciuokles/prognozuojamos_pensijos_skaiciuokle

Pillar II – 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 defined contribution (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 almost 4 billion € are managed by 5 PACs (see graph below).



Source: Own calculations based on SoDra data, 2020

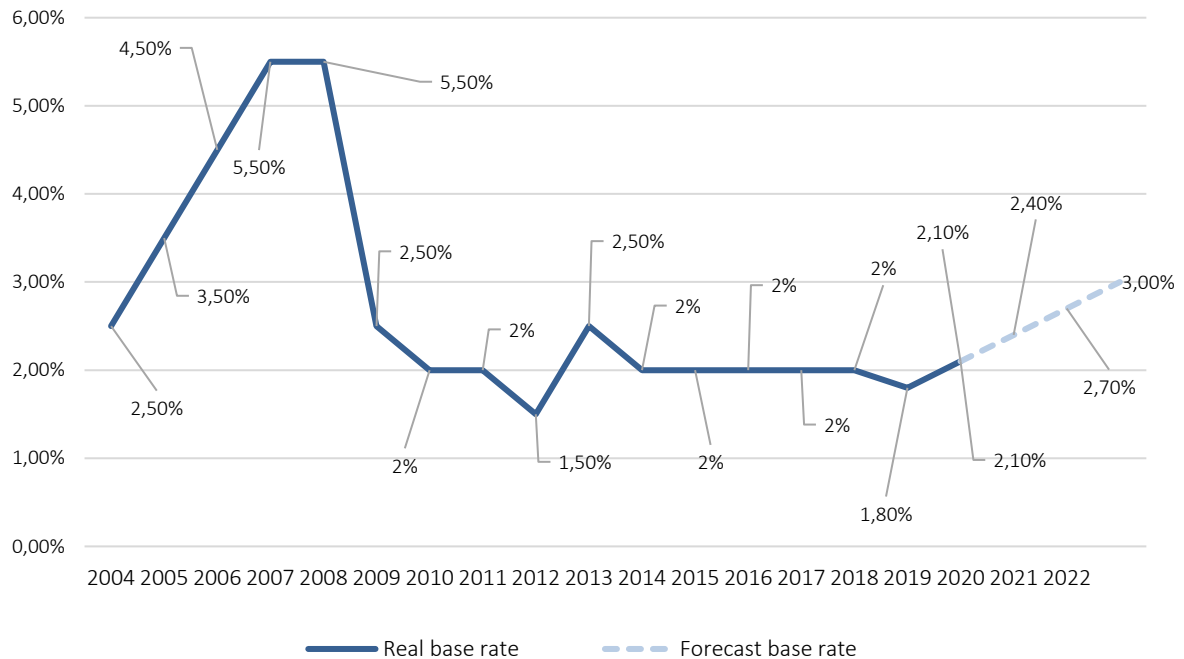
The pension contributions towards the Pillar II are part of the participant's state social insurance contribution rate. Originally, the level of contributions (“base rate”) was set at final level of 5.5% of insurable income. This level should have been reached in 2007. The base rate in 2004 was 2.5%, 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 is changing. 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). In 2019, the state’s incentive contribution for maximal accumulation was 16.41 euros per month. Those who accumulated maximally will move to the new formula as of 2019 automatically, while those who accumulated minimally will in 2019 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 per cent”.

Graph LT4. Level of “base rate” contributions towards Pillar II



Source: Ministry of Social Security and Labour (2019)

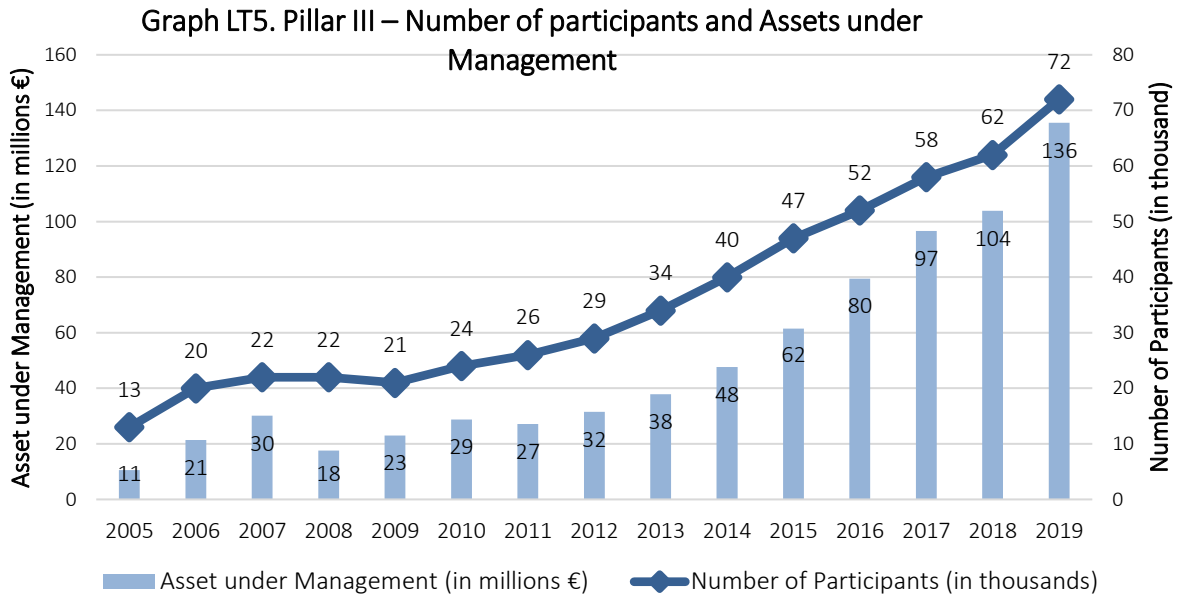
The contributions to Pillar II are recorded on individual personal pension account at selected providers (Pension Accumulation Companies). Contributions and accumulated savings are invested by the companies into managed pension funds. Pension Accumulation Companies (PACs) can manage multiple pension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

Pillar III – Voluntary private pension

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 defined contribution (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 the graph below.



Source: Bank of Lithuania, own composition

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 2019, 15 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). In 2019, assets managed by funds grew by 30% and amounted to €136 million driven by positive market returns. Number of participants accumulating their pension in Pillar III pension funds increased by 16% and amounted to close to 72,000. The average value of savings per member is only €1,888.

Pension Vehicles

Pillar II – Funded pensions

As indicated above, each provider (PAC) has to offer 7 life-cycle funds and 1 capital preservation fund. Currently, 40 pension funds are offered by 5 management companies.

Table LT6. List of Pillar II pension Funds after reform in 2019

| Investment style of the pension plan since 2019 | Pension Fund Name | Inception day |
|---|--|---------------|
| | Luminor 1996–2002 tikslinės grupės pensijų fondas | 02/01/2019 |
| | INVL pensija 1996–2002 | 02/01/2019 |
| Life-cycle pension funds, 1996-2002 | SEB 1996–2002 metų tikslinės grupės pensijų kaupimo fondas | 28/12/2018 |
| | Swedbank pensija 1996–2002 | 01/03/2018 |
| | Aviva 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 |
| | Aviva Y2 1989–1995 tikslinės grupės pensijų fondas | 02/01/2019 |
| | Luminor 1982–1988 tikslinės grupės pensijų fondas | 02/01/2019 |
| | INVL pensija 1982–1988 | 02/01/2019 |
| Life-cycle pension funds, 1982-1988 | SEB 1982–1988 metų tikslinės grupės pensijų kaupimo fondas | 28/12/2018 |
| | Swedbank pensija 1982–1988 | 01/03/2018 |
| | Aviva Y1 1982–1988 tikslinės grupės pensijų fondas | 02/01/2019 |
| | Luminor 1975–1981 tikslinės grupės pensijų fondas | 02/01/2019 |
| | INVL pensija 1975–1981 | 02/01/2019 |
| Life-cycle pension funds, 1975-1981 | SEB 1975–1981 metų tikslinės grupės pensijų kaupimo fondas | 28/12/2018 |
| | Swedbank pensija 1975–1981 | 01/03/2018 |
| | Aviva X3 1975–1981 tikslinės grupės pensijų fondas | 02/01/2019 |
| | Luminor 1968–1974 tikslinės grupės pensijų fondas | 02/01/2019 |
| | INVL pensija 1968–1974 | 02/01/2019 |
| Life-cycle pension funds, 1968-1974 | SEB 1968–1974 metų tikslinės grupės pensijų kaupimo fondas | 28/12/2018 |
| | Swedbank pensija 1968–1974 | 01/03/2018 |
| | Aviva X2 1968–1974 tikslinės grupės pensijų fondas | 02/01/2019 |
| | Luminor 1961–1967 tikslinės grupės pensijų fondas | 02/01/2019 |
| | INVL pensija 1961–1967 | 02/01/2019 |
| Life-cycle pension funds, 1961-1967 | SEB 1961–1967 metų tikslinės grupės pensijų kaupimo fondas | 28/12/2018 |
| | Swedbank pensija 1961–1967 | 01/03/2018 |
| | Aviva X1 1961–1967 tikslinės grupės pensijų fondas | 02/01/2019 |
| | Luminor 1954–1960 tikslinės grupės pensijų fondas | 02/01/2019 |
| | INVL pensija 1954–1960 | 02/01/2019 |
| Life-cycle pension funds, 1954-1960 | SEB 1954–1960 metų tikslinės grupės pensijų kaupimo fondas | 28/12/2018 |
| | Swedbank pensija 1954–1960 | 01/03/2018 |
| | Aviva B 1954–1960 tikslinės grupės pensijų fondas | 02/01/2019 |
| | Luminor turto išsaugojimo fondas | 02/01/2019 |
| Asset preservation pension funds | 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 |
| | Aviva S turto išsaugojimo pensijų fondas | 02/01/2019 |

Source: Own calculation based on Bank of Lithuania data (2020)

The structure of savers, assets under management and market share of four group of pension funds according their investment strategy is presented in a table below.



Table LT7. Pillar II Market share based on AuM and Number of participants

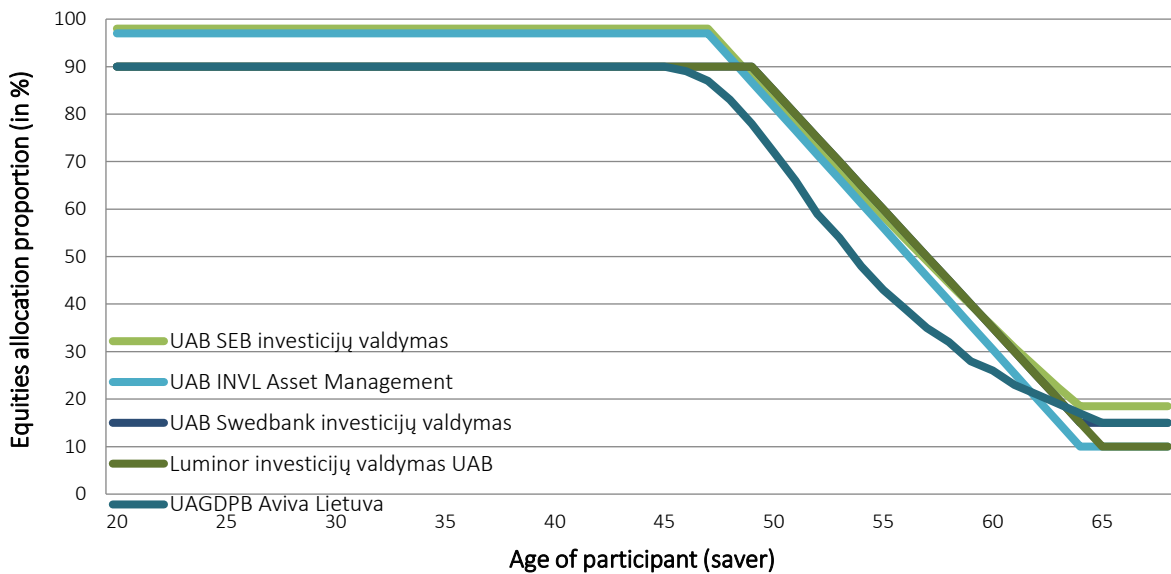
| Investment strategy | AuM | Market share | Number of Participants | Market share |
|-------------------------------------|--------------------------|----------------|------------------------|----------------|
| Life-cycle pension funds, 1996-2002 | 33,918,346.37€ | 0.87% | 67.825 | 5.03% |
| Life-cycle pension funds, 1989-1995 | 278,498,022.33€ | 7.16% | 204.288 | 15.16% |
| Life-cycle pension funds, 1982-1988 | 628,665,333.99€ | 16.17% | 284.950 | 21.15% |
| Life-cycle pension funds, 1975-1981 | 876,997,700.66€ | 22.56% | 246.071 | 18.27% |
| Life-cycle pension funds, 1968-1974 | 904,784,963.28€ | 23.27% | 232.329 | 17.25% |
| Life-cycle pension funds, 1961-1967 | 785,897,561.36€ | 20.21% | 208.547 | 15.48% |
| Life-cycle pension funds, 1954-1960 | 350,443,194.93€ | 9.01% | 94.140 | 6.99% |
| Asset preservation pension funds | 28,654,627.18€ | 0.74% | 9.059 | 0.67% |
| TOTAL | 3,887,859,750.10€ | 100.00% | 1,347,209 | 100.00% |

Source: Own elaboration based on Bank of Lithuania data, 2020.

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 the graph below).

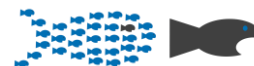
Graph LT8. Life-cycle investment strategy of Pillar II pension funds



Source: Own elaboration based on Bank of Lithuania data, 2020

The portfolio structure (data available since 2013) of Pillar II pension funds is presented in the graph below.

It can be seen that dominant financial instruments in Pillar II pension funds' portfolios are the equity UCITS funds (CIUs) and government bonds. However, 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).



Pillar III – 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 15 voluntary pension funds. The list of Pillar III pension funds is presented below.

| Investment style of the pension plan | Pension Fund Name | Inception day |
|--------------------------------------|-------------------------------------|---------------|
| BOND PENSION FUNDS | INVL STABILO III 58+ | 20/12/2004 |
| | Luminor pensija 1 plius | 07/10/2013 |
| | SEB Pensija 1 plius | 27/10/2004 |
| MIXED INVESTMENT PENSION FUNDS | Luminor pensija 2 plius | 26/10/2004 |
| | INVL Medio III 47+ | 24/09/2007 |
| | INVL Apdairus | 13/05/2013 |
| | Luminor pensija darbuotojui 1 plius | 20/11/2014 |
| | Luminor pensija darbuotojui 2 plius | 20/11/2014 |
| | Swedbank pensijų fondas 30 | 02/12/2019 |
| | Swedbank pensijų fondas 60 | 02/12/2019 |
| EQUITY PENSION FUNDS | Luminor pensija 3 plius | 01/10/2007 |
| | INVL Drąsus | 20/12/2004 |
| | INVL Extremo III 16+ | 24/09/2007 |
| | SEB Pensija 2 plius | 27/10/2004 |
| | Swedbank pensijų fondas 100 | 02/12/2019 |

Source: Own calculation (Bank of Lithuania data), 2020.

The marketshare according to the AuM and number of participants is presented in the table below.

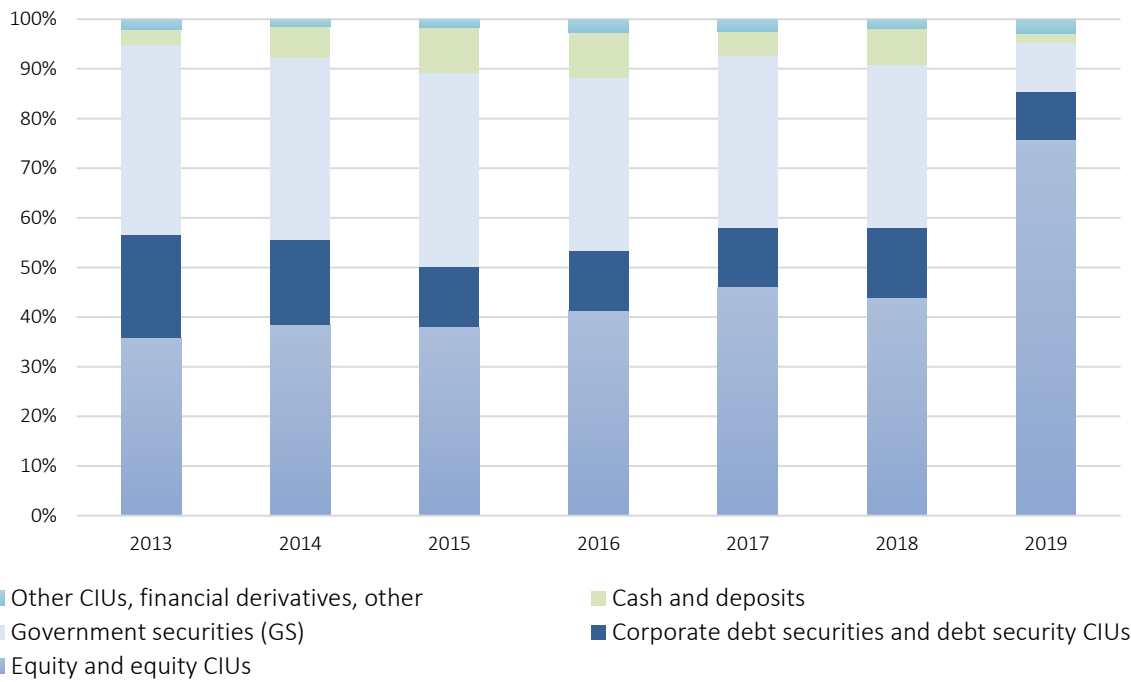
| Investment strategy | AuM | Market share | Number of Participants | Market share |
|-------------------------------|------------------------|----------------|------------------------|----------------|
| Bond Pension Fund | 32,612,429.00€ | 24.06% | 10.939 | 15.24% |
| Mixed Investment Pension Fund | 51,308,775.00€ | 37.85% | 33.762 | 47.04% |
| Equity Pension Fund | 51,634,889.00€ | 38.09% | 27.079 | 37.72% |
| TOTAL | 135,556,093.00€ | 100.00% | 71.780 | 100.00% |

Source: Own elaboration based on Bank of Lithuania data, 2020.

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).



Graph LT11. Pillar II Portfolio structure



Source: Own calculation and composition based on Bank of Lithuania data (2020)

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.

Charges

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. The next table compares effective charges of Pillar II pension funds in Lithuania in 2019.

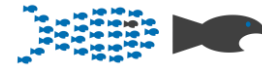


Table LT12. Pillar II Pension Funds' Categories Average Fees and Charges

| Pension Fund Category | Type of fee | Year 2019 |
|-------------------------------------|----------------------|-----------|
| Life-cycle pension funds, 1996-2002 | Contribution fee | 0.00% |
| | Asset management fee | 0.65% |
| | Company Change fee | 0.04% |
| Life-cycle pension funds, 1989-1995 | Contribution fee | 0.00% |
| | Asset management fee | 0.65% |
| | Company Change fee | 0.04% |
| Life-cycle pension funds, 1982-1988 | Contribution fee | 0.00% |
| | Asset management fee | 0.65% |
| | Company Change fee | 0.04% |
| Life-cycle pension funds, 1975-1981 | Contribution fee | 0.00% |
| | Asset management fee | 0.65% |
| | Company Change fee | 0.04% |
| Life-cycle pension funds, 1968-1974 | Contribution fee | 0.00% |
| | Asset management fee | 0.65% |
| | Company Change fee | 0.04% |
| Life-cycle pension funds, 1961-1967 | Contribution fee | 0.00% |
| | Asset management fee | 0.65% |
| | Company Change fee | 0.04% |
| Life-cycle pension funds, 1954-1960 | Contribution fee | 0.00% |
| | Asset management fee | 0.65% |
| | Company Change fee | 0.04% |
| Asset preservation pension funds | Contribution fee | 0.00% |
| | Asset management fee | 0.20% |
| | Company Change fee | 0.04% |

Source: Own calculation based on Bank of Lithuania data (2020)

Considering the asset management fee, it can be seen that pension funds charge the same level of asset management fee (0.65% in 2019) regardless of the investment strategy. The only difference is for the asset preservation funds, where the asset management fee is significantly lower (0.2% in 2019).

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. The table below compares fees of Pillar III pension funds in Lithuania.



Table LT13. Pillar III Pension Funds' Fees and Charges

| Pension Fund | Type of fee | 2019 |
|-----------------------------------|---------------------------|---|
| SEB Pensija 1 plius | Contribution fee | 2.00% |
| | Asset management fee | 0.65 percent average annual value of funds in the pension account |
| | Company Change fee | 0.00% |
| SEB Pensija 2 plius | Contribution fee | 3.00% |
| | Asset management fee | 1.00% average annual value of funds in the pension account |
| | Company Change fee | 0.00% |
| INVL Drąsus | Contribution fee | 0.00% |
| | Entry fee | 0.00% |
| | Asset management fee | 1.50% |
| | Performance Fee | 0.00% |
| | Switch Fee | 0.00% |
| | Partial Withdrawal Fee | 10.00% |
| | Minimum investment amount | 0.00% |
| INVL Apdairus | Contribution fee | 0.00% |
| | Entry fee | 0.00% |
| | Asset management fee | 1.50% |
| | Performance Fee | 0.00% |
| | Switch Fee | 0.00% |
| | Partial Withdrawal Fee | 10.00% |
| INVL STABILO III 58+ | Minimum investment amount | 0.00% |
| | Contribution fee | 0.00% |
| | Entry fee | 0.00% |
| | Asset management fee | 1.00% |
| | Performance Fee | 0.00% |
| | Switch Fee | 0.00% |
| INVL Medio III 47+ Pension fund | Partial Withdrawal Fee | 10.00% |
| | Minimum investment amount | 0.00% |
| | Contribution fee | 0.00% |
| | Entry fee | 30.00% |
| | Asset management fee | 0.80% |
| | Performance Fee | 0.00% |
| INVL Extremo III 16+ Pension Fund | Switch Fee | 0.00% |
| | Partial Withdrawal Fee | 10.00% |
| | Minimum investment amount | - |
| | Contribution fee | 0.00% |
| | Entry fee | 30.00% |
| | Asset management fee | 0.80% |
| | Performance Fee | 0.00% |
| Luminor pensija 1 plius | Switch Fee | 0.00% |
| | Partial Withdrawal Fee | 10.00% |
| | Minimum investment amount | - |
| | Contribution Fee >= 100 € | 1.00% |
| | Contribution Fee <100 € | 2.0% |
| Luminor pensija 1 plius | Asset Management Fee | 0.65% |
| | Depository Fee | 0.07% |
| | Change of fund | free of charge |



| | | |
|--|---|---------------------------|
| | Change of management company | free of charge |
| | Withdrawal from pension funds | 1 % of transfared savings |
| | Withdrawal from pension fund (in pension age) | free of charge |
| Luminor pensija 2 plius | Contribution Fee >= 100 € | 1.00% |
| | Contribution Fee <100 € | 2.0% |
| | Asset Management Fee | 1.00% |
| | Depository Fee | 0.07% |
| | Change of fund | free of charge |
| | Change of management company | free of charge |
| | Withdrawal from pension funds | 1 % of transfared savings |
| | Withdrawal from pension fund (in pension age) | free of charge |
| Luminor pensija 3 plius | Contribution Fee >= 100 € | 1.00% |
| | Contribution Fee <100 € | 2.0% |
| | Asset Management Fee | 1.00% |
| | Depository Fee | 0.07% |
| | Change of fund | free of charge |
| | Change of management company | free of charge |
| | Withdrawal from pension funds | 1 % of transfared savings |
| | Withdrawal from pension fund (in pension age) | free of charge |
| Luminor pensija darbuotojai 1 plius | Contribution Fee | 1.00% |
| | Asset Management Fee | 0.80% |
| | Depository Fee | 0.07% |
| | Change of fund | free of charge |
| | Change of management company | free of charge |
| | Withdrawal from pension funds | 1 % of transfared savings |
| | Withdrawal from pension fund (in pension age) | free of charge |
| Luminor pensija darbuotojai 2 plius | Contribution Fee | 1.00% |
| | Asset Management Fee | 0.80% |
| | Depository Fee | 0.07% |
| | Change of fund | free of charge |
| | Change of management company | free of charge |
| | Withdrawal from pension funds | 1 % of transfared savings |
| | Withdrawal from pension fund (in pension age) | free of charge |
| | Asset Management Fee | 0.75% |



| | | |
|------------------------------------|---|-------|
| Swedbank pensijų fondas 30 | Change of management company | 0.50% |
| | Contribution Fee | 0.00% |
| | Partial withdrawal fee (after 55 years) | 0.00% |
| | Contract termination fee (after 55 years) | 0.00% |
| Swedbank pensijų fondas 60 | Asset Management Fee | 0.75% |
| | Change of management company | 0.50% |
| | Contribution Fee | 0.00% |
| | Partial withdrawal fee (after 55 years) | 0.00% |
| Swedbank pensijų fondas 100 | Contract termination fee (after 55 years) | 0.00% |
| | Asset Management Fee | 0.75% |
| | Change of management company | 0.50% |
| | Contribution Fee | 0.00% |
| | Partial withdrawal fee (after 55 years) | 0.00% |
| | Contract termination fee (after 55 years) | 0.00% |

Source: Own calculation based on Bank of Lithuania data (2020)

* During the first 12 months after becoming a Participant, a 30% entry fee applies to pension contributions, with the total fee not to exceed € 200 during the period. This fee applies only to new Participants whose agreements took effect after the fee's introduction was announced on the website www.invl.com, and to Participants who have switched from a pension fund managed by another management company. The entry fee does not apply to Participants who have switched from one of the Management Company's other pension funds

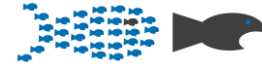
In most cases, additional costs, that are charged on the pension fund's account and not directly visible to the savers are the audit fees and custodian (depository) fees. On average, they account for 0.25%, and 0.055% respectively.

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.

Taxation

Pillar II – Funded pensions

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.



Pillar III – Voluntary private pensions

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 a “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 31 December 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 1 January 2013).

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

Pension Returns

Pillar II – Funded pensions

Pension returns of Pillar II pension funds differ according to the life-cycle investment strategy applied. As the major changes in Pillar II do not allow for direct historical comparison of returns, we present the returns for the year 2019 only where the returns of offered life-cycle funds are compared.

Table LT14. Pillar II Pension Funds’ Categories Nominal returns

| Pension Fund Category | Year 2019 |
|-------------------------------------|-----------|
| Life-cycle pension funds, 1996-2002 | 22.68% |
| Life-cycle pension funds, 1989-1995 | 22.39% |
| Life-cycle pension funds, 1982-1988 | 22.31% |
| Life-cycle pension funds, 1975-1981 | 22.86% |
| Life-cycle pension funds, 1968-1974 | 21.77% |
| Life-cycle pension funds, 1961-1967 | 14.97% |
| Life-cycle pension funds, 1954-1960 | 7.99% |
| Asset preservation pension funds | 6.19% |

Source: Own composition based on Bank of Lithuania data (2020)

When comparing pension funds within each group, we see that the asset managers of INVL pension funds outperform their peers within each group. Nominal as well as real returns of Pillar II pension funds in Lithuania are presented in a summary table below.



Table LT15. Nominal and Real Returns of II. Pillar in Lithuania

| Year | Nominal return after charges, before inflation and taxes | Real return after charges and inflation and before taxes |
|------|--|--|
| 2004 | 4.71% | 1.86% |
| 2005 | 5.49% | 2.50% |
| 2006 | 4.76% | 0.20% |
| 2007 | 3.72% | -4.48% |
| 2008 | -9.16% | -17.63% |
| 2009 | 8.89% | 7.72% |
| 2010 | 10.19% | 6.57% |
| 2011 | -1.04% | -4.51% |
| 2012 | 8.74% | 5.83% |
| 2013 | 6.24% | 5.79% |
| 2014 | 6.67% | 6.78% |
| 2015 | 4.92% | 5.17% |
| 2016 | 4.25% | 2.29% |
| 2017 | 4.01% | 0.20% |
| 2018 | -3.24% | -5.00% |
| 2019 | 17.65% | 14.92% |
| | 4.64% | 1.50% |

Source: Own calculations based on Bank of Lithuania data (2020)

Another view on the performance is according to the holding period.

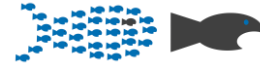
Table LT16. Performance of Pillar II Pension Funds according the holding period

| Holding Period | Net Nominal Annualized Performance | Real Net Annualized Performance |
|-----------------|------------------------------------|---------------------------------|
| 1-year | 17.65% | 14.92% |
| 3-years | 5.79% | 3.04% |
| 5-years | 5.31% | 3.31% |
| 7-year | 5.63% | 4.15% |
| 10-years | 5.70% | 3.65% |
| Since inception | 4.64% | 1.50% |

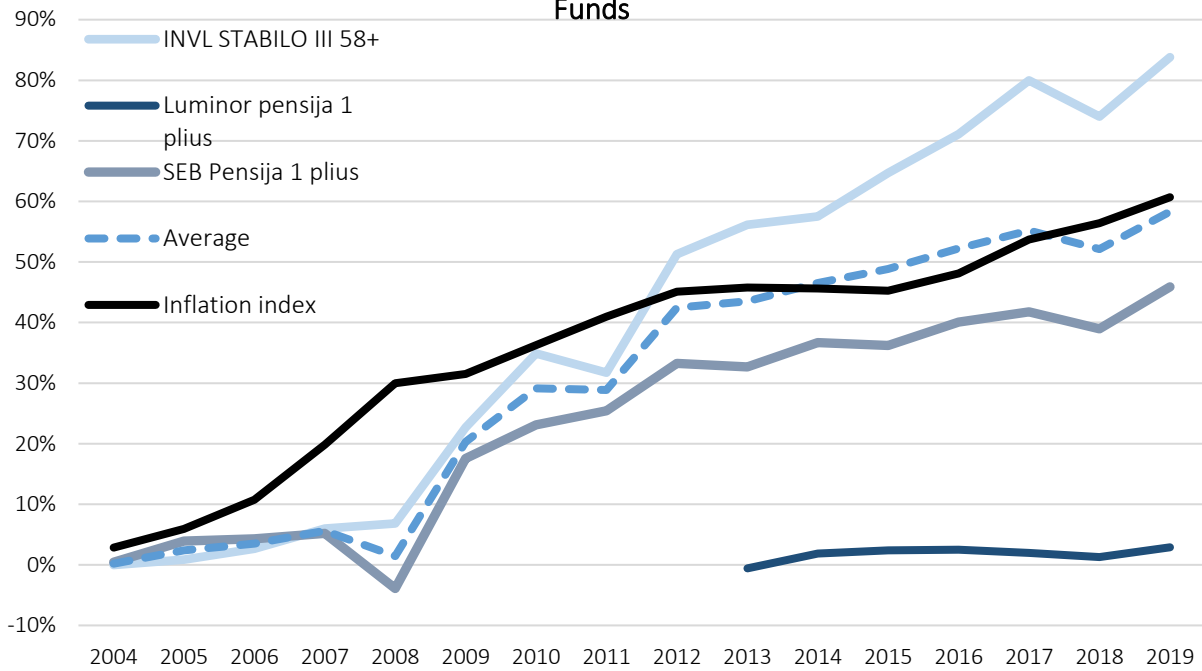
Source: Table LT15

Pillar III – Voluntary private pensions

Pillar III pension funds' performance is presented according to their investment strategy, where 3 groups are formed. The graphs below present the pension funds' performance on a nominal cumulative basis compared to inflation.

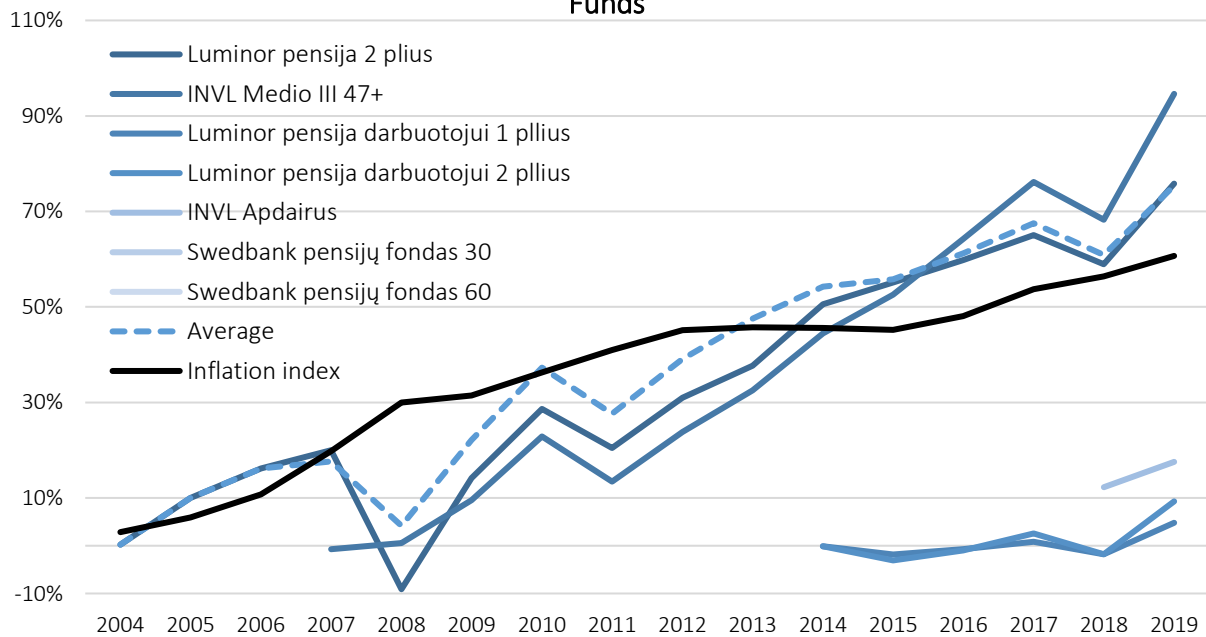


Graph LT17. Pillar III Cumulative Nominal Performance of Bond Pension Funds



Source: Own composition based on Bank of Lithuania data (2020)

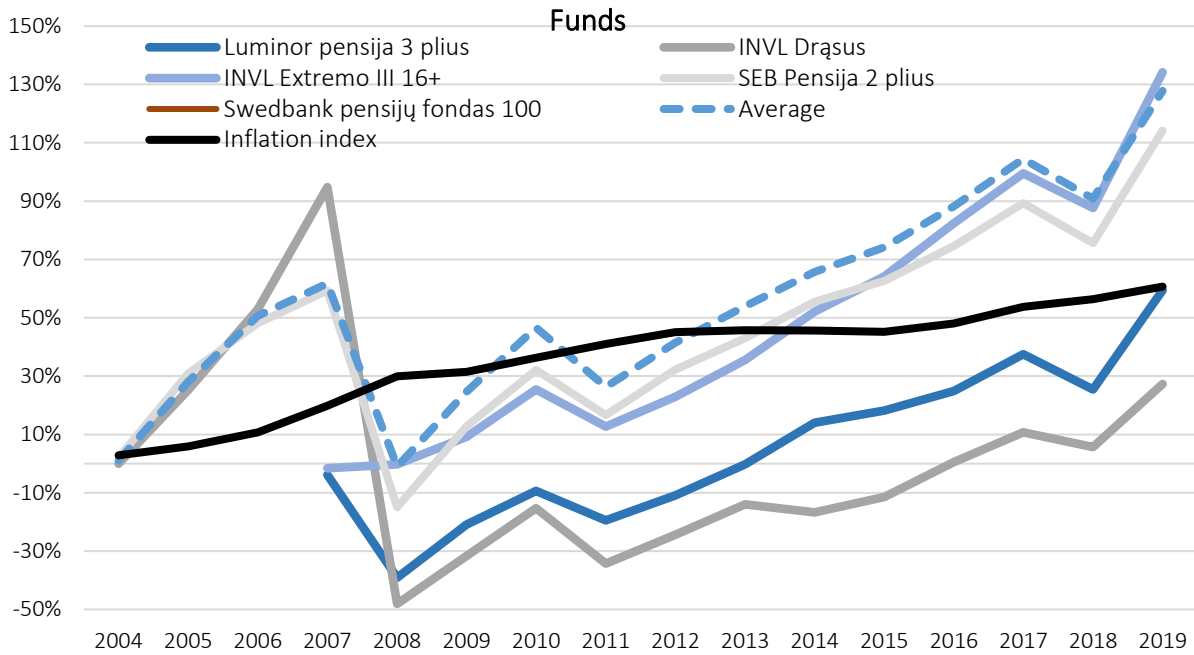
Graph LT18. Pillar III Cumulative Nominal Performance of Mixed Pension Funds



Source: Own composition based on Bank of Lithuania data (2020)



Graph LT19. Pillar III Cumulative Nominal Performance of Equity Pension



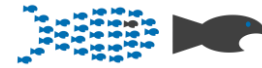
Source: Own composition based on Bank of Lithuania data (2020)

Table LT20. Nominal and Real Returns of III. Pillar in Lithuania

| Year | Nominal return after charges, before inflation and taxes | Real return after charges and inflation and before taxes |
|------|--|--|
| 2004 | 0.53% | -2.31% |
| 2005 | 13.52% | 10.53% |
| 2006 | 8.64% | 4.08% |
| 2007 | 4.51% | -3.68% |
| 2008 | -23.27% | -31.73% |
| 2009 | 21.94% | 20.77% |
| 2010 | 13.74% | 10.12% |
| 2011 | -8.73% | -12.21% |
| 2012 | 10.86% | 7.95% |
| 2013 | 5.88% | 5.43% |
| 2014 | 5.19% | 5.30% |
| 2015 | 2.86% | 3.11% |
| 2016 | 5.09% | 3.13% |
| 2017 | 5.40% | 1.59% |
| 2018 | -4.35% | -6.10% |
| 2019 | 11.45% | 8.72% |
| | 4.05% | 0.82% |

Source: Own calculations based on Bank of Lithuania data (2020)

Again, we present the performance of Pillar III funds according to various holding period.



| Table LT21. Performance of Pillar III Pension Funds according the holding period | | |
|--|------------------------------------|---------------------------------|
| Holding Period | Net Nominal Annualized Performance | Real Net Annualized Performance |
| 1-year | 11.45% | 8.72% |
| 3-years | 3.96% | 1.22% |
| 5-years | 3.96% | 1.98% |
| 7-year | 4.41% | 2.93% |
| 10-years | 4.53% | 2.48% |
| Since inception | 4.05% | 0.82% |

Source: Own calculations based on Table LT20

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.

Performance of the Pillar II as well as Pillar III pension funds can be seen as satisfactory. 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.

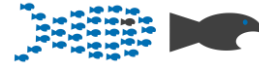
The latest changes in the contributory mechanism, where additional individual contributions towards Pillar II are promoted and tax deductible, puts more pressure on Pillar III fund managers due to the growing crowding-out effect.

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 European Federation of Investors and Financial Services Users
Rue d'Arenberg 44
1000 Brussels
Belgium
info@betterfinance.eu

Coordinators

Aleksandra Mączyńska
Ján Šebo
Ştefan Dragoş Voicu

Contributors

| | |
|-----------------------|---------------------|
| Edoardo Carlucci | Arnaud Houdmont |
| Lubomir Christoff | Matis Joab |
| Lars Christensen | Michal Mešťan |
| Michaël Deinema | Gregoire Naacke |
| Laetitia Gabaut | Dayana Nacheva |
| Yordanka Popova | Carlos Nava |
| Lisbeth Grænge-Hansen | Guillaume Prache |
| Johannes Hagen | Joanna Rutecka-Góra |
| José Antonio Herce | Dr. Thomas Url |

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