Will You Afford to Retire?

The Real Return on Long-Term and Pension Savings

2024 Edition

BETTER FINANCE

The European Federation of Investors and Financial Services Users

Fédération Européenne des Épargnants et Usagers des Services Financiers

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The Real Return of Long-term and Pension Savings

2024 Edition — Lithuania

A research report by BETTER FINANCE

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Executive Summary

Was 2023 the year when European retail investors finally obtain the "fairer deal" that the outgoing European Commissioner Mairead McGuiness wished for them (McGuinness, 2023)? As far as long-term and pension products are concerned, this report presents mixed results. While European capital markets performed strongly in 2023, helping many pension funds and life insurance companies to rebound after a calamitous 2022, we find that many of the products we analyse failed to pass on the benefits of this renewed performance to pension savers. One or even two years of past performance, however, do not tell us much about the long-term performance of saving products. What matters for individuals who invest part of their income into those products is how much income they will be able draw from them in the distant future, in particular for retirement purposes. The objective of this report therefore is to provide readers with a long-term perspective on performance that aligns with the extended investment horizon. We analyse the costs and performance of a broad range of products across various holding periods, spanning up to 24 years. Over this longer period good years supposedly make up for bad ones. Nevertheless, we observe that many of the product categories do not offer sufficient nominal returns in the long run to compensate for inflation, even with the moderate inflation rates of the of the 2000s and 2010s. This weak performance then results in a loss of purchasing power for many European savers and investors.

The real net return of European long-term and pension savings

The object of this report is to assess the ability of long-term and pension savings products to at least preserve the purchasing power of European retail investors' savings over more than two decades, and at best increase the real value of these savings, increasing the capital on which European pension savers may rely on to maintain their living standard in retirement. That is why we focus our analysis on time-weighted returns.

The risk of financial losses is inherent in any investment in capital markets: capital markets are volatile—as their performance over the last two years clearly shows (see Figure XS.4). Nevertheless, we share European Insurance and Occupational Pensions Authority (EIOPA)'s view that

> the riskiness of a personal pension product is its potential inability to outperform inflation, and so to lose savings in real terms, or not being sufficiently "aggressive" to reach higher investment returns to compensate for potentially low contribution levels (European Insurance and Occupational Pensions Authority [EIOPA], 2020, p. 3),

and generalise it to any long-term and pension savings product. Short-term volatility—the alternance of good and bad years—is of little consequence for most pension savers; what matters is the cumulated performance over the life of the contract, the holding period, which often spans more than two decades. Over such long periods, the crucial risks are those arising from cumulated costs—which divert a portion of the accumulated capital towards financial intermediaries profit and loss accounts—and inflation—which progressively erodes the purchasing power of savings. The *real net rate of return* is therefore the main metric of interest for pension savers.

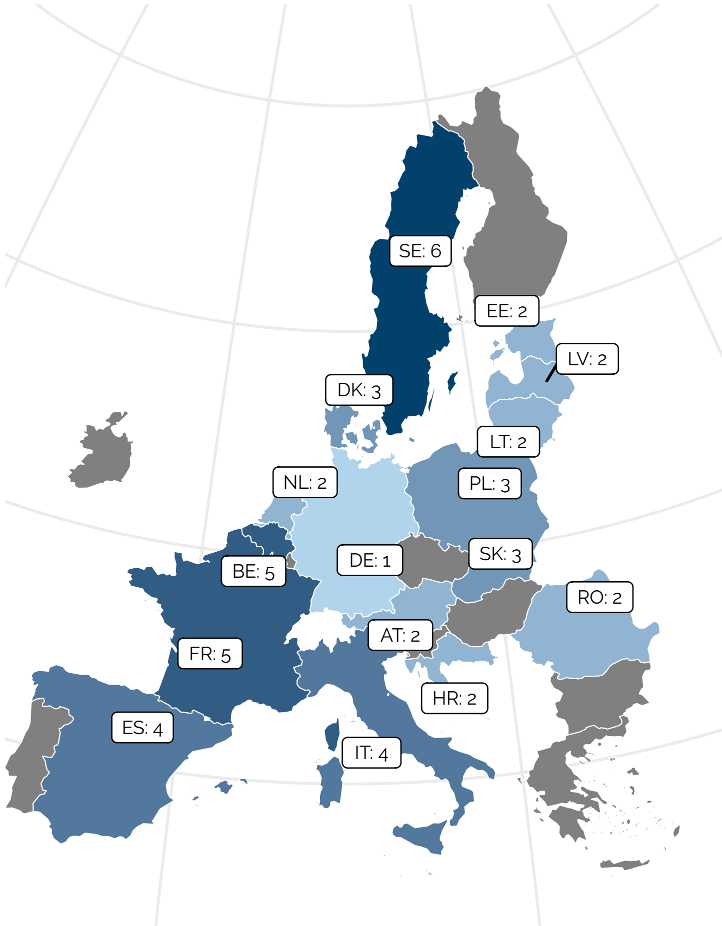
This research report by BETTER FINANCE covers 16 of the 27 European Union (EU) Member States. In each of these countries the team of contributors analyses the costs and performance of up to 6 product categories. Our goal is to calculate, based on publicly available data about these product categories, the *real net return* that long-term and pension savers may expect to obtain from their investments, going back as far as the year 2000. When we refer to real net return, we are indicating the rate of return on an investment after deducting all costs and charges levied by the product provider. This calculation also accounts for inflation, which reduces the purchasing power of both the invested capital and returns. The map in Figure XS.1 shows the countries included in this study, and the total number of product categories analysed in each country.

Assessing the real net return of a category of pensions products requires three classes of information about these products: (a) reliable data about the nominal, gross return of investments made on behalf of pension savers in relation to the total amount of accumulated capital; (b) total costs being levied for the management of these investments (administrative costs of managing the investor's contract, cost of management of investment fund "units", entry fees, exit fees, etc.) and; (c) the rate of inflation in one's country for each year of the investment period.

These are but typical examples of the data availability issues that our team of expert contributors face across countries and product categories. While data about average inflation is easy to come by—thanks, inter alia, to the work of Eurostat—, we can hardly say the same for data about returns and costs. The availability of such data often limits the scope of our study. Reliable information about the average performance of a product category may be unavailable, as is the case of most German long-term and pension saving products, or not fully appropriate for an assessment of what the client actually get, as is the case with Belgium's *Assurance Groupe* products. Costs data are even more difficult to obtain: for many of the product categories we analyse, cost information is too scarce to assess the impact of costs on performance.

Long-time followers of BETTER FINANCE's work on pensions might remember that past editions of the report also included Bulgarian pensions products and may be surprised to see that we analyse no product category in Bulgaria in this report. In the case of Bulgaria, despite BETTER FINANCE's multiple calls to the relevant authorities, essential data necessary to calculate the real net returns of Bulgarian pension savings remain unavailable, forcing us to renounce including any Bulgarian long-term or pension savings product category in our study.

Figure XS.1 – Countries and number of product categories included in the report

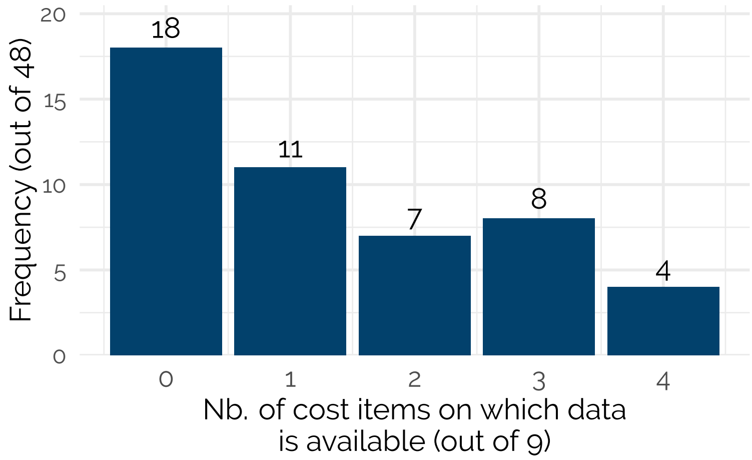


Besides performance data, information on costs is very often patchy and displayed in a way that makes it impossible for investors to compare cost levels across product providers, and for our contributors to aggregate this information at the level of product categories. The reader can appreciate this reality in Figure XS.2: for none of the 48 product categories included in our study could our contributors find data for more than 4 out of the 9 cost items defined in our methodology. Additionally, for more than a third of the product categories in our study, there is simply no cost information available.

For the 18 product categories for which no cost data is available, the lack of information on costs and charges prevents us from evaluating the average effect of charges on investors' returns. Consequently, we are forced to start our analysis with disclosed nominal *net* returns, whereas providers' marketing communications usually communicate on the basis of nominal *gross* returns.

Given the challenges in obtaining fundamental data on the average costs and performance of long-term and pension savings products, which capture a large share

Figure XS.2 – **Availability of cost and charges data for 2023**



of the wealth of European households, we advocate for EU and national authorities to urgently enact and implement the proposed rules on product oversight, governance, and information to investors, as outlined in the recent Retail Investment Strategy (RIS) proposals made by the European Commission (see our policy recommendations on Page xiii). Costs and performance disclosures are key to properly assess the functioning of the European market for pension savings products.

While opacity on cost and charges presents a challenge for many of the product categories we study, it is only fair to acknowledge the few cases in which industry and supervisors made significant efforts to define and implement coherent reporting frameworks, such as that of the Dutch pension funds or the Italian *Commissione di Vigilanza sui Fondi Pensione* (COVIP)'s annual report on pension funds and *Piani Individuali Pensionistici* (PIP).

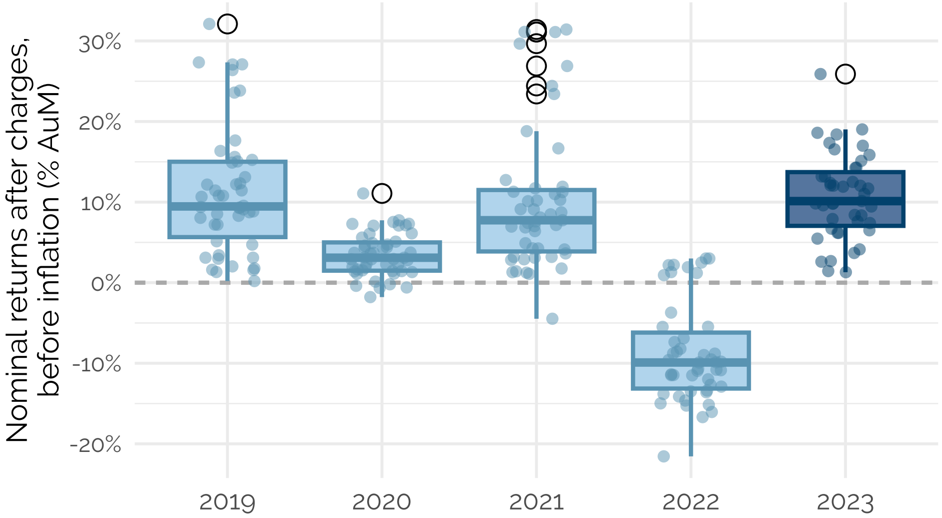
2023: Recovering from the slump

The product categories included in our study generally performed strongly in 2023. All of the 43 product categories for which we could obtain performance data for 2023 had a positive nominal net return. As can be appreciated in Figure XS.3, this performance is in sharp contrast with the previous year, when out of 47 product categories, 38 returned a loss in nominal terms, after charges.[1]

These good results reflect the good performance of, in particular, equity markets between January and December 2023, which recovered strongly after the slump of 2022. Figure XS.4 shows the performance of European capital markets. Using two pan-European market indices as proxies—one for equities and one for bonds, we calculate the cumulative return of a hypothetical portfolio composed of European equity and bonds in equal proportion, with annual rebalancing. The cumulated return, in nominal terms, of this portfolio dropped by 44.8 percentage points between

[1] In box plots such as Figure XS.3, the central box represents the interquartile range (i.e., 50% of the data), the thick central line is the median, the whiskers (vertical lines) indicate where roughly 99% of the data points are located, and the black circles at each end of the whiskers represent outliers.

Figure XS.3 – Average 1-year return rates of analysed product categories (2019–2023)



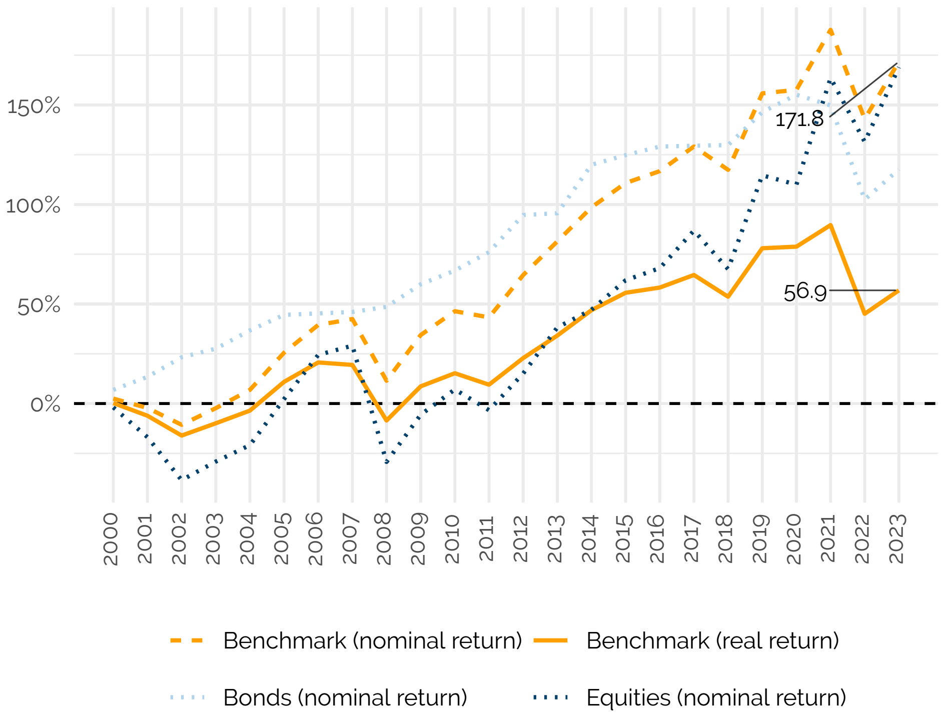
Data: NCAs and sectoral associations (see Country Cases); *Calculations:* BETTER FINANC

end-2021 and end-2022 before rebounding to 171.8% by the end of 2023. After adjusting for the average inflation across the EU, we obtain a 56.9% real net return, +11.8 percentage points (p.p.) from end-2022.

Inflation, in turn, slowed down in most EU countries in 2023, after the peak of 2022. In 8 of the 16 countries of our study, inflation in 2023 was below the annual average over the period 2000–2003. Nevertheless, for most of our sample, inflation remained high, as can be observed in Figure XS.5. Inflation across the Euro Area, stood at 2.93%, still significantly above the close-to-but-below-2% target of the European Central Bank (ECB).

The result of this combination of strong capital market performance and slowing inflation is a reduced gap between nominal net returns and real net returns for 2023: With a median net return standing at 10.1% in nominal terms and 7.4% after inflation, the gap is reduced to 2.8 p.p. (see Figure XS.6), down from 8.6 p.p. in 2022, when the already severly negative median nominal returns (-9.9%) where further depressed by the strongest inflation seen in Europe is decades, yielding a median real net return of -18.5%. These median values, it should be noted, hide markedly contrasting differences: The maximum performance for 2023, in nominal terms and after deduction of charges, stands at +25.9% (Poland's Employee Capital Plans), while the poorest performance with +1.3% (ironically, that of Italian PIP "with profits" contracts) narrowly avoids returning a loss in real terms thanks to the low level of inflation in Italy (+0.46%).

Figure XS.4 – **Cumulated performance of European capital markets (2000–2023)**



Pan-European Pension Product (PEPP): First full year of return data

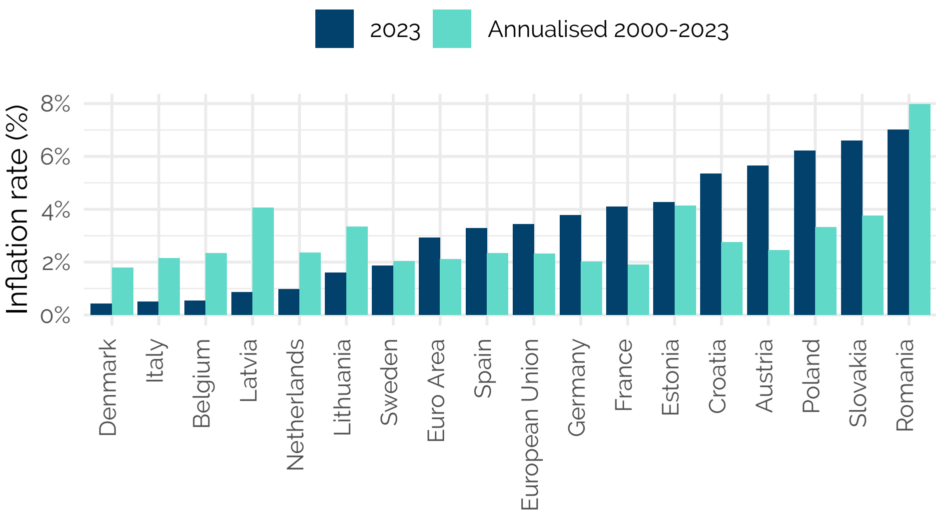
We wish to highlight the good performance of the first PEPP to be included in our study: with a nominal return before charges and inflation standing at +15% and charges amounting to 0.72% of assets under management (AuM), the Slovak PEPP yielded a net return of +14.3% in nominal terms and 7.2% in real terms, largely outperforming its capital markets benchmard (11.8% and 4.9% in nominal and real terms, respectively). Find more information in the Slovak country case in part II of this report.

These data show that the PEPP is indeed a promising personal pension product. The Slovak case shows that it is indeed possible to offer a PEPP under the conditions set by the current PEPP regulation, including the "1% fee cap", that is, the limiting of fees to 1% of accumulated capital per annuum for the Basic PEPP.

BETTER FINANCE will keep monitoring its development not only in Slovakia, but also in Poland—another of the country cases of this report, where PEPP was introduced in the course of the year 2023—and other countries.

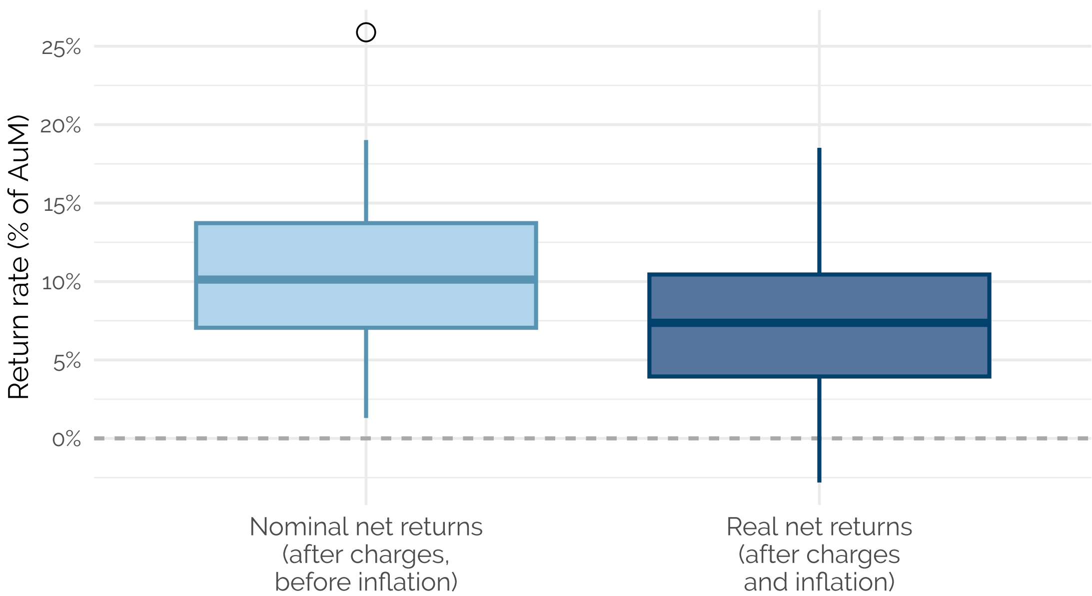
In the meantime, we urge Member State governments to offer the PEPP the same treatment, as regards taxation, subsidies and transferability of accrued pension benefits, that existing national personal pension products enjoy (see our policy recommendation on this topic on Page xvii).

Figure XS.5 – **Inflation 2023 vs. 2000–2023 annual average**



Data: Eurostat (HICP monthly index); *Calculations:* BETTER FINANCE.

Figure XS.6 – **Average 1-year nominal vs. real return in 2023 (after charges, % of AuM)**

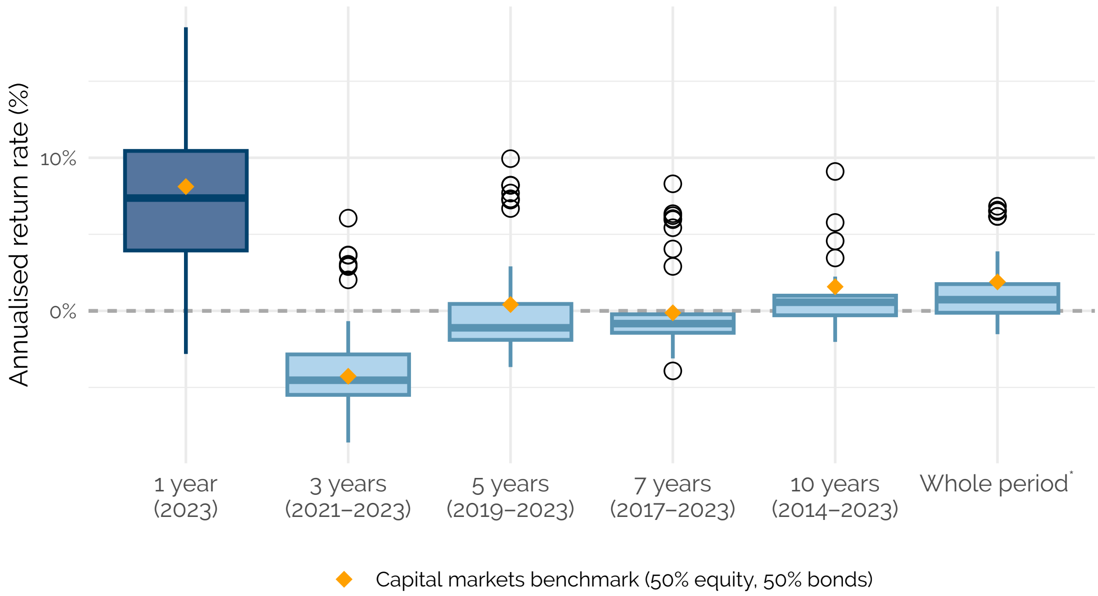


Calculations: BETTER FINANCE

The long-term view on long-term savings

Naturally, one should not assess the performance of long-term and pension savings products based on the results obtained in one bad year but rather take a long-term view. That is why our ambition in this report is to gather data about costs and performance for a period of up to 24 years (2000–2023).

Figure XS.7 – Average annualised real net returns over varying holding periods



Calculations: BETTER FINANCE; * Up to 24 years, the reporting period varies across products

Figure XS.7 displays the distribution of average performances after charges and inflation of the long-term and pension saving products analysed in our report, over varying holding periods from 1 year (2023) to the whole period for which data could be found ("whole period", up to 24 years). We immediately observe that the capital markets slump of 2022 still weighs down on performance over shorter periods (3, 5 and even 7 years), with annualised rates after charges and inflation negative for a large majority of product categories. Over 7 years (2017–2023), the negative performance of 2022 comes atop that of the year 2018, with the result that only a few outliers manage to yield a positive real net return over that period.

Market volatility, whether upwards or downwards, is cancelled out over longer periods (the standard devaition falls from 4.9 p.p. for 1 year to 2 p.p. for 10 years, see Table XS.1), allowing us to more accurately assess the returns offered by the various product categories. Over 10 years and over whole reporting periods (up to 24 years), we see that the most of the interquartile range (the boxes in Figure XS.7) lies in positive territory. This may seem reassuring, until one notes that over 7 years, 10 years and whole periods, the annualised real performance of our capital markets benchmark (50% equity–50% bonds, rebalanced annually), shown with a yellow diamond in the figure, lies in the top quartile of the returns of product categories (above the upper bound of the box), meaning that 75% of the product categories fail to beat the benchmark.

Table XS.1 – Summary statistics of real performance over varying holding periods

Holding period	Nb. of product cat.	Median	Mean	Standard Deviation	Best performance	Worst performance
1 year	43	7.4%	7.3%	4.9pp.	18.5%	-2.8%
3 years	47	-4.5%	-3.6%	3.4pp.	6.1%	-8.6%
5 years	46	-1.1%	0.2%	3.5pp.	9.9%	-3.7%
7 years	46	-0.8%	0.0%	2.8pp.	8.3%	-3.9%
10 years	40	0.6%	0.7%	2.0pp.	9.1%	-2.0%
Whole period*	48	0.8%	1.3%	2.3pp.	7.2%	-1.5%

Calculations: BETTER FINANCE

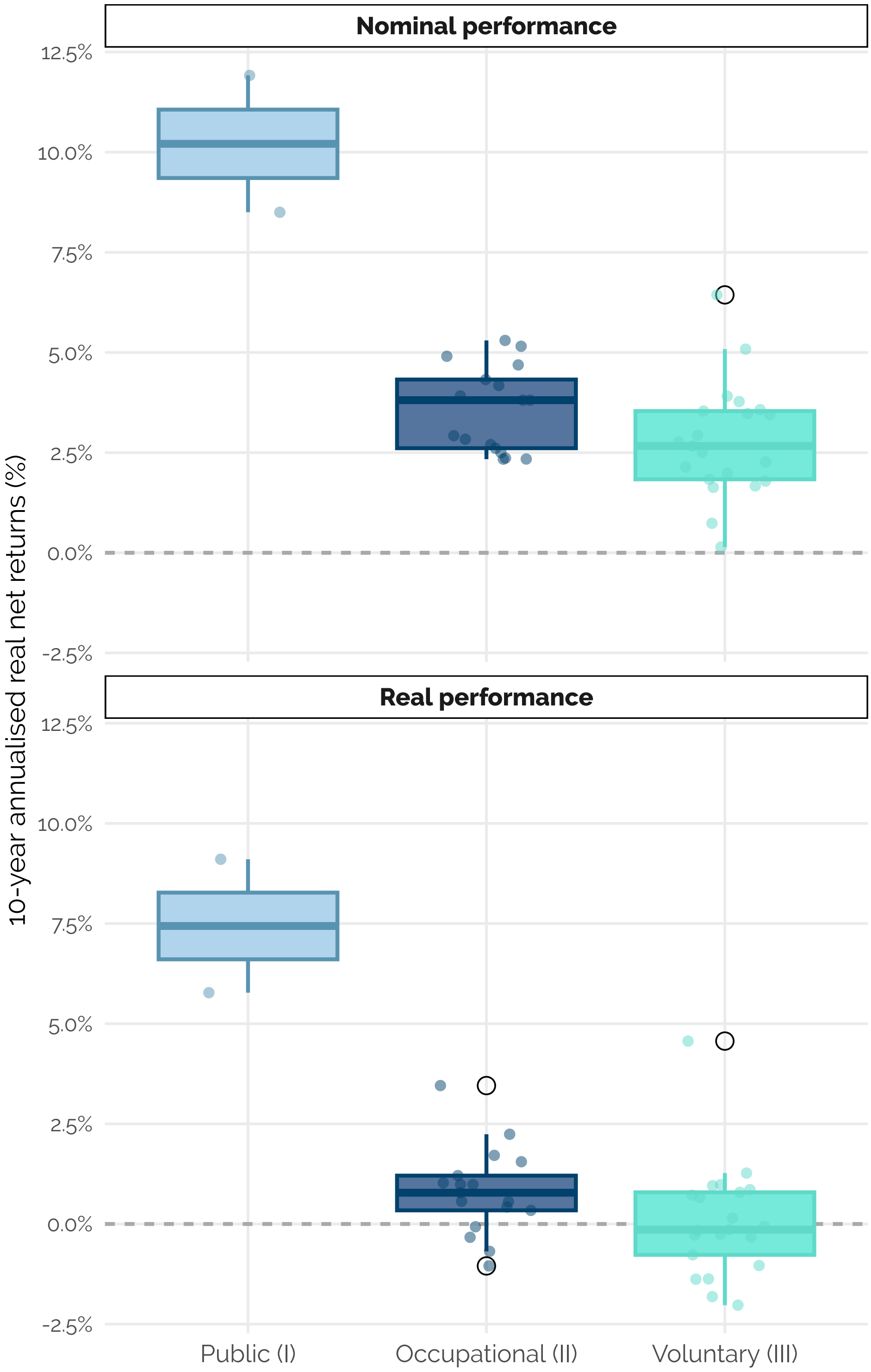
* Whole period varies across products (up to 24 years).

Observing the distribution of performance levels across pension system pillars, we also note that occupational pension schemes in Pillar II generally outperform voluntary products within Pillar III. Figure XS.8 illustrates the distribution of 10-year performance per pillar.

Swedish Premium pensions, which show very strong performance compared to the rest of the analysed product categories, are classified as Pillar I but although they are funded, earnings-based pensions that bear strong resemblance to occupational pension schemes (Pillar II). Leaving these extreme positive outliers aside, we observe that median 10-year performance of Pillar II products (central line of the middle box) is above the upper limit of the interquartile range of Pillar III performances (upper bound of the right-hand box), meaning that 75% of Pillar III products have a performance below the median performance of Pillar II products.

It is beyond the scope of this report to explore the significance of the trend, although future research should investigate the factors that may explain it, including differences in asset allocation, management costs, distribution costs, and the potential effect of auto-enrolment schemes. Additional cost data would be particularly valuable to consistently analyse whether the observed divergence in performance might arise from higher costs associated with Pillar III products. We hope that such data becomes available if the EU legislator follows the much-welcomed proposals regarding cost disclosures under the Markets in Financial Instruments Directive (MiFID) and Insurance Distribution Directive (IDD), crucial elements of the European Commission's proposals for the Retail Investment Strategy (RIS).

Figure XS.8 – Average 10-year annualised performance per Pillar



Calculations: BETTER FINANCE, returns are shown after charges and inflation.

Policy recommendations

Policy recommendation 1 — Supervisory reporting and statistics

Step up efforts to collect and disclose data on long-term and pension savings products, both at the national and EU level (ESAs's cost and past performance reports) to empower European citizens as retail investors.

The contributors to this report can testify of the difficult to obtain even basic, aggregated data about long-term and pension products in many EU countries. If a team of expert contributors, with knowledge and experience in the field, find it challenging, how can we expect EU citizens to make any use of these data to assess the performance of their own pension products in relation to the market? Making available full historical data sets of both aggregated and provider-level data would enable non-profit organisations like BETTER FINANCE to provide an independent, consumer-friendly analysis of this market. But national competent authorities (NCAs) could also step up their efforts to create consumer-friendly reports and comparison tools.

Harmonised frameworks for reporting from product providers to NCAs and pension scheme participants already exist for various of the product categories we analyse in this report. These commendable efforts should be assessed through a peer-review process to be organised by the European supervisory agencies (ESAs) in order to identify best practices, but also discard misleading disclosure practices that prevent retail investors to obtain a clear picture of the cost and performance of the products on offer. As part of these efforts to better report on the costs and performance of retail investment products, BETTER FINANCE calls on the ESAs to keep improving their annual costs and performance reports. Currently, the data and coverage of these reports are incomplete and based on commercial databases or surveys. The European Securities Markets Authority (ESMA), the EIOPA and—in the future—the European Banking Authority (EBA) should be able to rely on regular reporting of supervisory data from NCAs, which themselves should have the necessary powers to require regular reporting of data on the costs and performance of saving and investment products in their respective areas of competence.

Going further, the EU legislator should draw inspiration from these examples and incorporate into EU law - specifically, theMiFID and IDD legislation for Pillar III products, currently under review as part of the Retail Investment Strategy (RIS), or the next revision of the IORP II directive on occupational pensions - requirements for NCAs to adequately report figures on a quarterly or monthly basis. This should include the constant updating and public reporting of AuM and net AuM, unit value, asset allocation, as well as the number of participants for all supervised vehicles in the area of long-term and pension savings.

Policy recommendation 2 — Conflicts of interest in scheme management and product distribution

Harmonise and reinforce rules to curb the conflicts of interests in the distribution of long-term and pension saving products, and improve the governance of collective long-term pension schemes.

Conflicts of interest plague the management and distribution of long-term and pension saving products in Europe. The sales commissions-based distribution system of voluntary long-term and pension saving products (Pillar III) directs retail investors towards fee-laden and often underperforming products. Our report showcases various product categories with high average fees and poor long-term returns that so-called "advisors" are paid to recommend to consumers, against the best interest of the latter.

BETTER FINANCE has consistently opposed this system, and strongly supported the European Commission's proposal to partially ban so-called "inducements" as part of the RIS. We believe that the inducements-based distribution system hurts retail investors through higher charges, the illusion of "free" investment advice and a selection bias in distributors' recommendations, all of which result in lower returns and inadequate retirement income for European citizens (BETTER FINANCE, 2023b, pp. 4–13). The financial industry failure to acknowledge the problem and its intense lobbying efforts to maintain a damaging status quo resulted in the utterly disappointing provisional positions of the Council and, especially, the European Parliament (BETTER FINANCE et al., 2024), which should not be expected to improve outcomes for consumers in any meaningful way. Nevertheless, ignoring the problem will hardly make it disappear, and so we urge all involved policy-makers, supervisors, but also willing representatives of the indsutry, to keep working towards the generalisation of high-quality bias-free financial advice that EU citizens can rely for their retail investments.

In occupational pension schemes (Pillar II), the issue of conflicts of interest takes on a different form. In those schemes, it is crucial that the board, which takes decisions on behalf of the scheme's members, includes independent members representing the interests of beneficial owners.

Policy recommendation 3 — Information to (prospective) investors

Provide simple, intelligible, and comparable information on cost and performance of long-term and pension saving products.

Obtaining information on long-term and pension vehicles, as well as monitoring them, should not be difficult for non-professional savers. This implies also reinstating standardised actual cost and past performance disclosure, and in real terms alongside the less relevant nominal ones.

The proposed revisions to the EU's MiFID and IDD legislation, along with the amendments to the PRIIPs regulation, offer the opportunity to finally provide investors with the information they actually need to compare the costs of products. BETTER FINANCE strongly supports, in particular, the provision of annual statements to holders of investment funds' shares distributed under MiFID and to life insurance policyholders distributed under IDD, including the provision of information on the cost of distribution and the possibility to obtain a detailed breakdown of all charges.

Although we welcome the innovations introduced to the format of Key Information Documents (KIDs) by the proposed amendments to the PRIIPs regulation, we still call for a thorough review of this legislation to drastically improve the understandability and comparability of the information provided in the KID. We strongly believe that providers of packaged retail and insurance-based investment products (PRIIPs) should include the actual most recent costs of their products in the KID.

PRIIPs providers should also be required to provide 10 years of past performance data together with the benchmark that is used as investment objective by the product provider. While past performance is not indicative of future performance, it is a good indicator of whether a PRIIP has ever made money or not for the investor, and of an asset manager or insurance company's ability to meet its investment objectives, and to generate returns for the client. Furthermore, it is comparable across product providers and timelines, as it does not rely on assumptions and hypothetical scenarios. The past performance of various products shows how their respective providers navigated through a similar set of real-world circumstances. Finally, displaying past performance in comparison with the product's stated benchmark enables the prospective investor to clearly see whether the provider has been able to make good on their commitment to meet its target.

While we are generally disappointed with the current state of the legislative negotiations on the EU's RIS, we urge the co-legislators to adopt these proposals on disclosures. For more information about our recommendations regarding information to investors and prospective investors, see BETTER FINANCE (2023b, pp. 17–22).

Readers may also refer to BETTER FINANCE's response to the consultation conducted by EIOPA on the review of the Directive on institutions for occupational retirement provision (IORPs) (BETTER FINANCE, 2023a). In occupational pension schemes too, managers should provide pension scheme participants with the information necessary to keep track of their pension benefits and effectively plan their savings and investments to ensure adequate levels of retirement income.

Finally, we urge EU and member state authorities to step up efforts towards the implementation of comprehensive individual pension tracking systems, following the recommendation of the High-Level Forum on the Future of the Capital Markets Union (HLF CMU). These constitute crucial empowering tools, enabling individuals to keep track of their accumulated pension rights across employers and across borders.

Policy recommendation 4 — Sustainability

Provide clear, intelligible information on the sustainability of European long-term and pension savings and investments.

An increasing number of retail investors expresses a desire to invest in financial products that consider sustainability criteria and pursue environmental, social and governance (ESG) objectives (2° Investing Initiative [2DII], 2020). Despite significant progress in recent years, much remains to be done to provide retail investors with an investing environment that accommodates both their financial and sustainability preferences.

First, EU policymakers should increase their efforts to develop a clear, precise, and standardised taxonomy of economic activities. This taxonomy should be grounded in scientific analyses and address all three major aspects of sustainability: environmental, social and governance (ESG). These efforts should also include the development of a well-designed EU-wide Ecolabel for retail investment products that avoids the pitfalls of existing national labels.

EU policy-makers should also address the short-termism of the financial industry by reinforcing the consistent linkage between sustainability and long-term value creation. It must be clearly emphasised that exemplarity with regard to investor protection rules first and ensuring decent returns for individual investors is compatible with investing in a way that respects environment and society. To this end, clear and intelligible ESG disclosures should be combined with financial disclosures, preferably integrated into one document providing savers and investors with a holistic picture of the products they buy.

Finally, EU and national policymakers should require sustainability and ESG knowledge and training for board members in long-term and pension savings vehicles, as well as for financial advisors and sales personnel distributing such products. Regarding the latter, BETTER FINANCE supports the European Parliament's proposal, within the framework of the RIS to impose on financial advisors and sales personnel a yearly training requirement on sustainable investing (see BETTER FINANCE, 2023b, pp. 12–13).

Policy recommendation 5 — Asset allocation

End the fixed-income bias in the asset allocation of long-term savings.

Prudential rules, designed to protect investors against the risk of excessive risk-taking leading to financial losses, require pension fund managers and life insurance providers to allocate a significant portion of participants' and policyholders' funds into fixed-income assets, particularly sovereign debt from EU Member States.

However, in doing so, these rules excessively restrict the possibility for long-term and pension savers to take advantage of investment opportunities in equity markets, which, while more volatile, also offer higher yields in the long term.

Regulations governing long-term and pension savings should not discriminate against long-term equity investments. Specifically, life-cycling strategies that adjust risk to the investment horizon of the saver should enable managers to invest a substantial portion of younger investors' contributions or premiums in equity market instruments (as is the case of Sweden's Premium pensions, in particular the AP7 Såfa fund).

Policy recommendation 6 — Taxation

Stop penalising taxation of long-term and pension products.

Taxation on pensions, whether on contributions, returns, or payouts, should be based on real values rather than nominal ones. Taxes should be applied to values adjusted for inflation, using the harmonised index of consumer prices (HICP). To recoup the value of pension pots, at least occupational schemes (Pillar II) should apply an "EEE" regime. Pillar II contributions should be deductible from the income base tax.

Policy recommendation 7 — Pan-European Pension Product (PEPP)

Create a friendly environment for the PEPP

This year's report, for the first time, includes cost and performance data on PEPP, as implemented in Slovakia. As previously mentioned, these data are encouraging. Nevertheless, we note that the current environment is not conducive to the take up of this product, despite its intrinsic qualities from the point of view of retail investors:

- As noted by EIOPA:

  > [t]he higher costs of products considered "competitors" to PEPP may diminish its appeal to potential providers. [...] Offering a cheaper enquotecompetitor product might raise concerns about the risk of product cannibalisation, potentially resulting in a loss of sales and revenue from existing products4 (EIOPA, 2024).

  Shielded from competition by the opacity of costs and performance disclosures, and the dominant inducements-based distribution system that biases "enquote" towards high-fee products, incumbent providers have little incentives to add a low-cost product to their range of personal pension products.

- Member State governments have generally failed to ensure that PEPP competes on a level playing field with existing personal pension products: rules on tax rebates and subsidies applicable to equivalent personal pension products have only in a few cases been extended to the PEPP, and transferability of accrued personal pension benefits from existing products to PEPP is only possible in a handful of Member States (EIOPA Occupational Pensions Stakeholder Group [OPSG], 2024).

BETTER FINANCE urges policy-makers not to give in to industry pressures to delete the 1% fee cap for the Basic PEPP. Instead,

- Member States should amend their respective legislations to ensure that PEPP receives the same treatment as any other personal pension product marketed in their jurisdiction.

- EU and Member State authorities must further explore the suggestions put forward by EIOPA in its recent paper to expand the target market for PEPP with a view to offer potential PEPP providers the perspective of greater economies of scale.

Policy recommendation 8 — Auto-enrolment

Introduce auto-enrolment in occupational pensions.

The active labour force should be automatically enrolled in a default pension fund, with the option to withdraw or switch provider at no additional cost. Romania, Sweden, Slovakia and other serve as best practice examples: This auto-enrolment ensures that working individuals start saving early and consistently for their retirement, reducing the risk of insufficient income in retirement. This was also a recommendation of the HLF CMU.

In this regard, we consider with interest EIOPA's suggestion, in its paper from September 11, 2024 to enable the use of PEPP as an occupational pension product, in which employers could then automatically enrol their workforce (EIOPA, 2024).

Policy recommendation 9 — Suspensions

Allow savers to defer contributions to pensions without penalties.

Savers should be allowed to suspend payments into a pension savings or life insurance plan without incurring a penalty. In an era characterised by uncertainty, it can never be assumed that an individual will always have an income sufficient to cover their immediate needs as well as pay their premium or set contribution towards their pension plan.

When an individual, for whatever reason, cannot, for a short period of time, contribute to their pension product, they should not be faced with the choice between foregoing their pension plan or paying a penalty. Instead, they should be able to suspend payments and resume as soon as they have a new income stream.

Policy recommendation 10 — Insurance guarantee schemes

Urgently establish harmonised insurance guarantee schemes in the EU.

EU citizens are partially covered against the default of product manufacturers through

Directive 2014/49/EU on deposit guarantee schemes (DGSs) and Directive 97/9/EC on investor compensation schemes (ICSs). However, many pension savers across the EU lack an appropriate protection for insurance-based investment products (IBIPs), a shortcoming of the EU's protection regime that is particularly problematic as IBIPs (such as life insurance) are predominant in some pensions systems in the EU (e.g., in France).

BETTER FINANCE calls on the EU legislator to revamp the project for a Regulation on insurance guarantee schemes (IGSs), which should mimic the rules of the DGS Directive, and urgently harmonise protection against defaults at a minimum level across the EU.

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Country Case 9

Lithuania

Santrauka

Lietuva priėmė tipišką Pasaulio banko daugiapakopę sistemą, kurioje pay-as-you-go (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 0,45 proc. 2023 m. Turto išsaugojimo fonde valdymo mokestis bus tik 0,2 %. Apskritai 2023 m. pensijų fondų veiklos rezultatai abiejose pakopose buvo iš esmės teigiami visose turto klasėse. Teigiama 2023 m. grąža bendrą privalomosios II pakopos pensijų fondų veiklos rezultatą vėl perkėlė į teigiamos realiosios grąžos teritoriją per analizuojamą laikotarpį. Savanoriškoji III pakopa išlieka neigiamos realiosios grąžos teritorijoje daugiausia dėl didesnių mokesčių.

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 0.45% in 2023. For the asset preservation fund, the management fee will be just 0.2%. Overall, pension funds' performance in both pillars was broadly positive in 2023 across all asset classes. Positive returns in 2023 have moved the overall performance of mandatory Pillar II back into the positive real returns territory over the analysed period. Voluntary Pillar III stays in negative real returns territory mainly due to the higher fees.

Introduction: The Lithuanian pension system

There have been no major changes in the pension system in Lithuania announced in 2023. The key changes did occur in the state pensions due to the elevated 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 2023, pensions were increased by 11%. The average old-age pension increased to EUR 537.9, and the average old-age pension with the required length of service increased from EUR 513 to EUR 574.[1]

The performance of private pensions (mandatory as well as voluntary) was positive in 2023 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*	*Latest data*
Pillar II Funded pensions	Occupational (II)	2004	2023
Pillar III Voluntary private pensions	Voluntary (III)	2004	2023

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
1 year (2023)	12.5%	10.7%
3 years (2021–2023)	-5.1%	-7.1%
5 years (2019–2023)	0.6%	-1.8%
7 years (2017–2023)	-0.3%	-2.0%
10 years (2014–2023)	1.2%	-0.3%
Whole period	0.7%	-0.1%

Data: Bank of 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.

[1]https://www.sodra.lt/lt/situacijos/statistika/pensijos?lang=en

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 2023, 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.

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

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: 619 400	Administrators: 6	Administrators: 4
Average old-age pension: EUR 537.9	Funds: 48	Funds: 21
Average income (gross): EUR 1 716.8	AuM: EUR 7 125.8 mln.	AuM: EUR 293.71 mln.
Average replacement ratio: 31.33%	Participants: 1 418 472	Participants: 118 066
Nb. of insured persons: 1 518 500	Coverage ratio: 93.41%	Coverage ratio: 12.04%

Data: SoDra, Bank of Lithuania and Official Statistics Portal, 2024; *Calculations:* BETTER FINANCE.

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 6 months for men and 64 years for women in 2023). 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 2023, the mandatory record is at least 33 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 EUR).

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 EUR).

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, EUR 10, then the individual part of old-age pension is: 40 $\times$ 10 = EUR 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,[2] where an individual can

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

assess his projected old-age pension including the expected (projected) Pillar II savings.

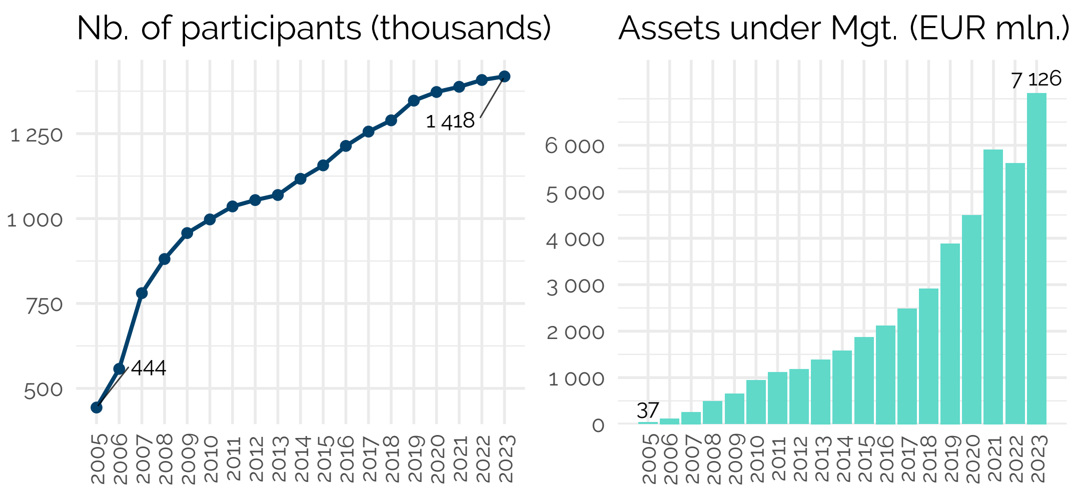
Second pillar: Funded pensions

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 Pension Accumulation Companies (PACs) (see Figure LT.1).

Figure LT.1 – Pillar II – Number of participants and AuM

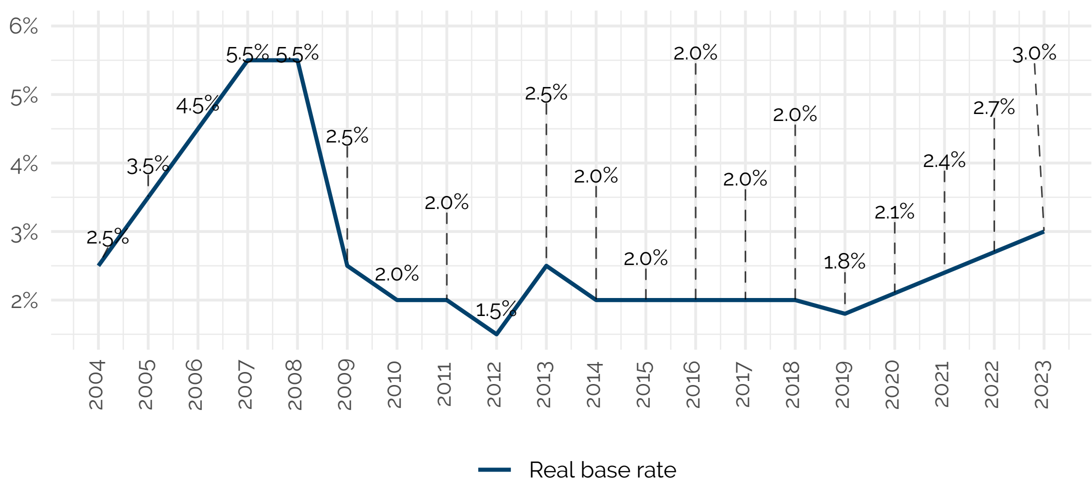


Data: Bank of Lithuania, 2024.

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 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.2 – **Level of "base rate" contributions towards Pillar II**



Source: Own elaboration based on the Law on Reform of the Pension System and SoDra data, 2024.

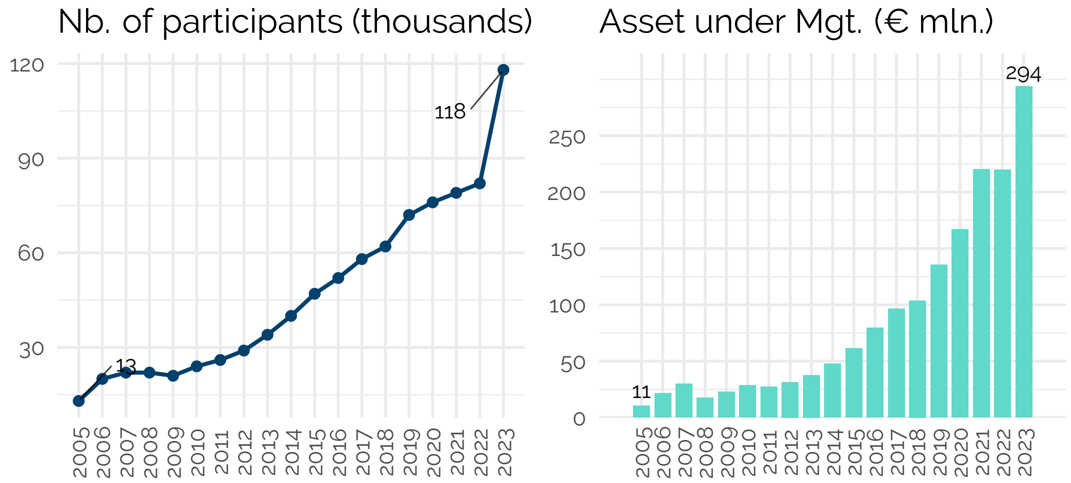
The contributions to Pillar II are recorded on individual personal pension account at selected providers — PACs. Contributions and accumulated savings are invested by the companies into managed pension funds. PACs can manage multiple pension fund based on a "life-cycle" approach. PACs must obtain licenses 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.3.

Figure LT.3 – Pillar III – Number of participants and AuM



Data: Bank of Lithuania, 2024.

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 EUR 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

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

Fund name	Inception date
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
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.

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.4).

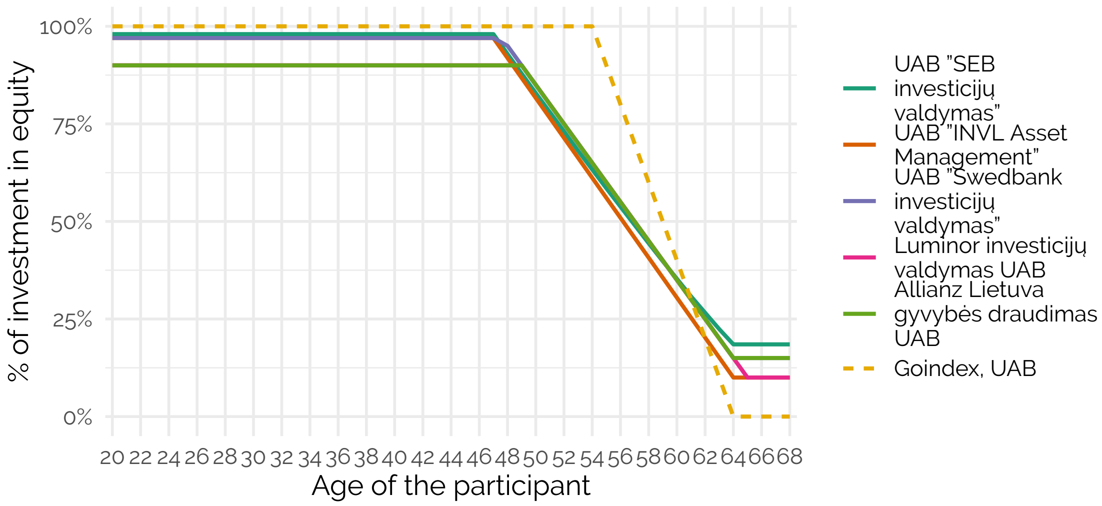
The portfolio structure of Pillar II pension funds is presented in Figure LT.6. The reform in 2019 delivered significant increase of equities in pension funds' portfolios due to the introduction of "life-cycle" strategies via target-date funds.

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 2023), there are 5 providers offering 21 voluntary pension funds.

Figure LT.4 – **Life-cycle investment strategy of Pillar II pension funds**



Data: Bank of Lithuania, 2023.

The market share according to the AuM and number of participants is presented in Table LT.5.

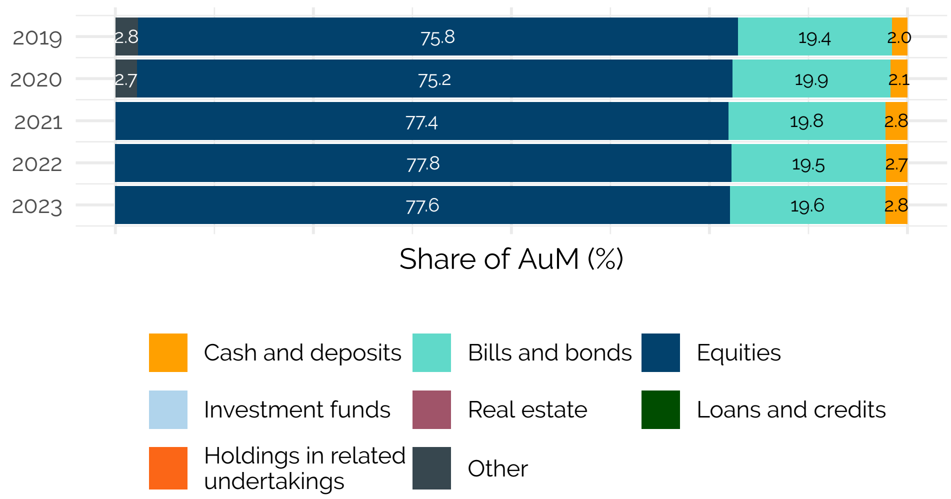
There are no specific quantitative limitations on financial classes or instruments. However, the investment strategy of the pension fund must include the procedure and areas for investment of pension assets, risk assessment methods, risk management principles, risk management procedures and methods used, 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 in **??** (data available since 2013). Unfortunately, the Lithuanian national bank do not provide data on individual Pillar III

Table LT.5 – **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	32.34	11%	9	13.9%
Mixed Investment Pension Fund	87.43	30%	43	65.8%
Equity Pension Fund	173.95	59%	40	61.0%
TOTAL	293.71	100%	66	100.0%

Data: Bank of Lithuania, 2023.

Figure LT.5 – **Allocation of Lithuanian Pillar II funded pensions' assets**

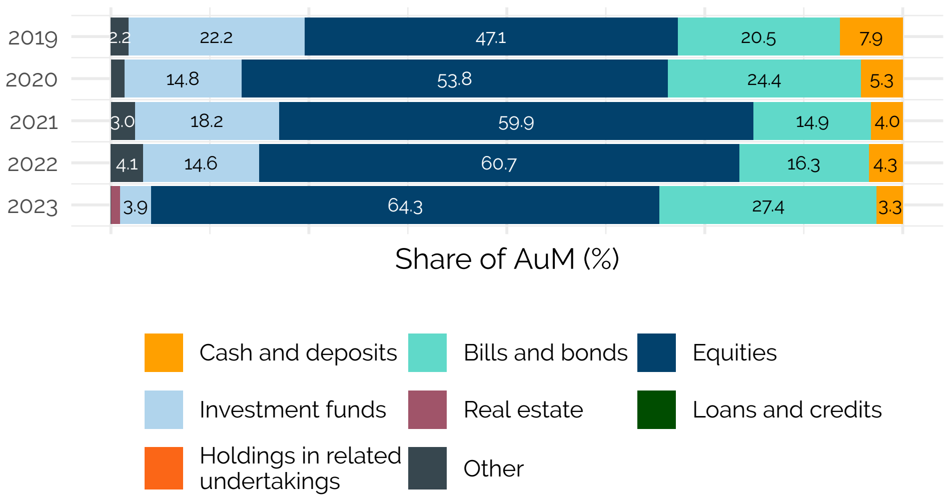


Data: Bank of Bank of Lithuania; *Calculations:* BETTER FINANCE.

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

Equities and equity based UCITS account for 64% of the Pillar III pension funds' portfolios, while the government bonds account for 27%. Pillar III pension funds can be therefore characterized as a fund-of-funds.

Figure LT.6 – Allocation of Lithuanian Pillar III voluntary private pensions' assets



Data: Bank of Bank of Lithuania; *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. compares effective charges of Pillar II pension funds in Lithuania in 2019.

The year 2023 brought further decrease 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 and the year 2023 did bring further 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.7 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.6 – 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%
2023	0.45%

Data: Funds' documentation; *Calculations:* BF.

Table LT.7 – **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%
2023	1.05%

Data: Official Statistics Portal; *Calculations:* BF.

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); 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).

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

Table LT.8 – 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

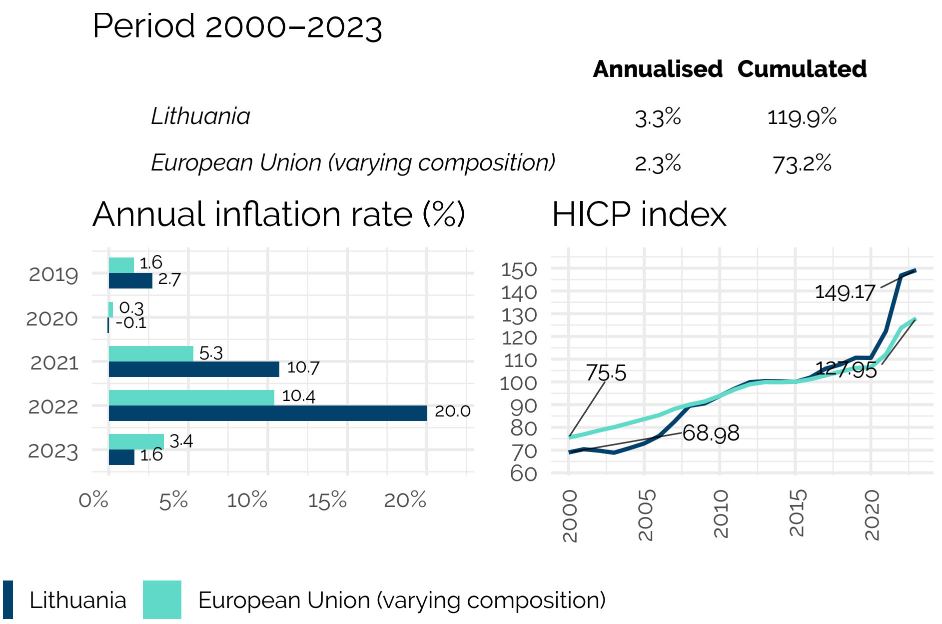
Source: INSERT NAME.

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 25 years is presented on the figure below. The inflation has doubled the price level during the last 25 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 analysed period.

Figure LT.7 – Inflation in Lithuania



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.

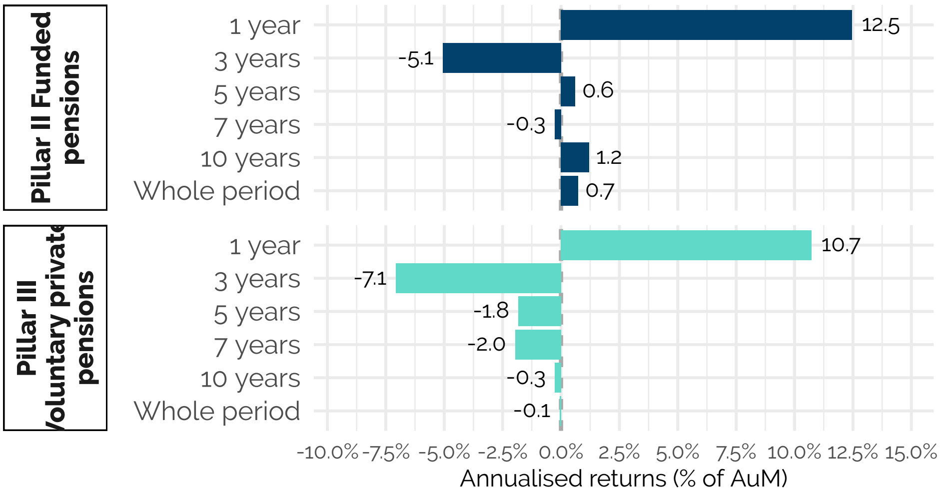
When inspecting particular pension funds within each group, only minor changes in performance were observed between the years 2019 and 2023.

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.8 and LT.9.

Performance of Pillar II and Pillar III pension funds is quite similar, while the higher

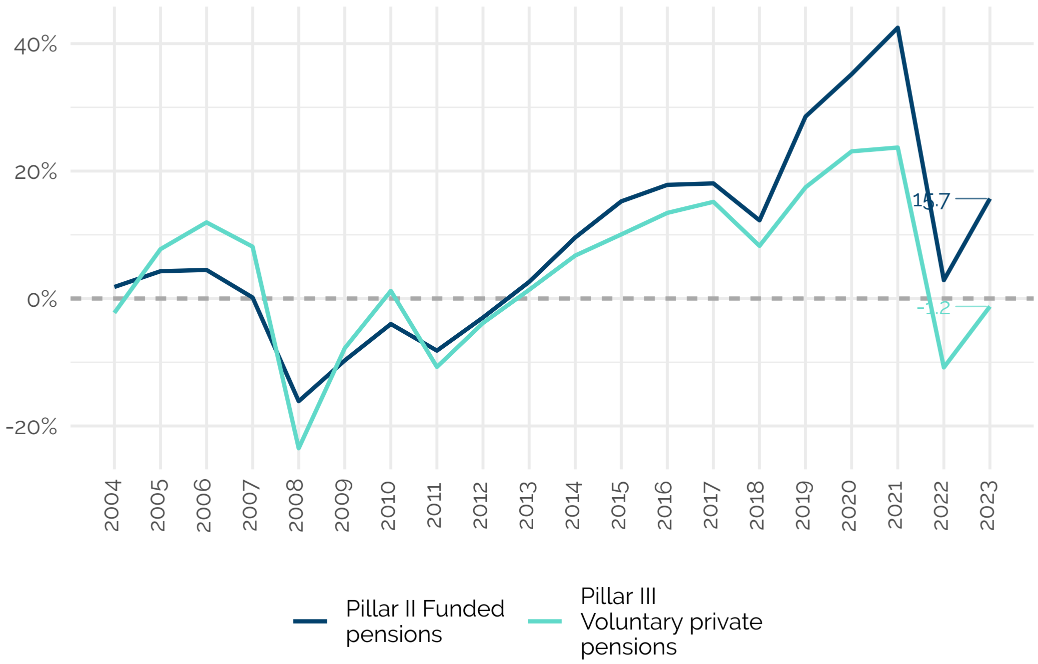
Figure LT.8 – **Annualised returns of Lithuanian long-term and pension vehicles over varying holding periods (before tax, % of AuM)**



Data: Bank of Bank of Lithuania, Official Statistics Portal, Eurostat;
Calculations: BETTER FINANCE, holding periods to end-2023.

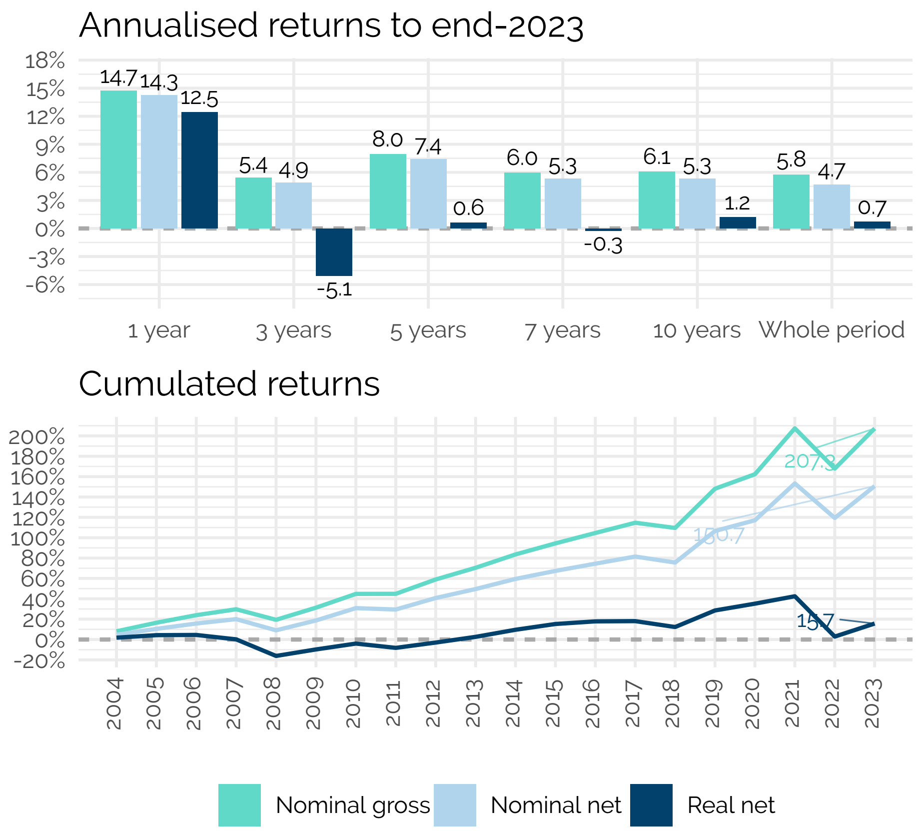
fees of Pillar III pension funds drags the after fees returns lower and into negative territory in real terms.

Figure LT.9 – **Cumulated returns of Lithuanian long-term and pension savings vehicles (2003–2023, before tax, % of AuM)**



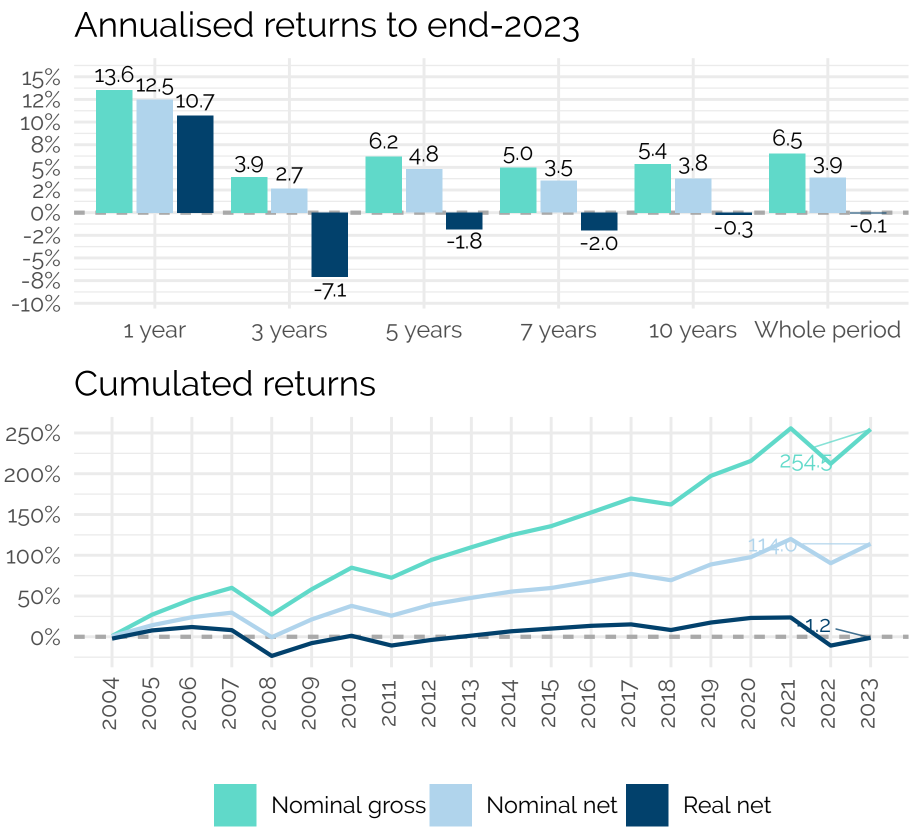
Data: Bank of Bank of Lithuania, Official Statistics Portal, Eurostat;
Calculations: BETTER FINANCE.

Figure LT.10 – **Returns of Lithuanian Pillar II funded pensions (before tax, % of AuM)**



Data: Bank of Bank of Lithuania, Official Statistics Portal, Eurostat;
Calculations: BETTER FINANCE, holding periods to end-2023.

Figure LT.11 – **Returns of Lithuanian Pillar III voluntary private pensions (before tax, % of AuM)**



Data: Bank of Bank of Lithuania, Official Statistics Portal, Eurostat;
Calculations: BETTER FINANCE, holding periods to end-2023.

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 analysing the portfolio structure of pension funds, we have selected the a balanced benchmark portfolio (50% equity-50% bonds) based on two pan-European indices.

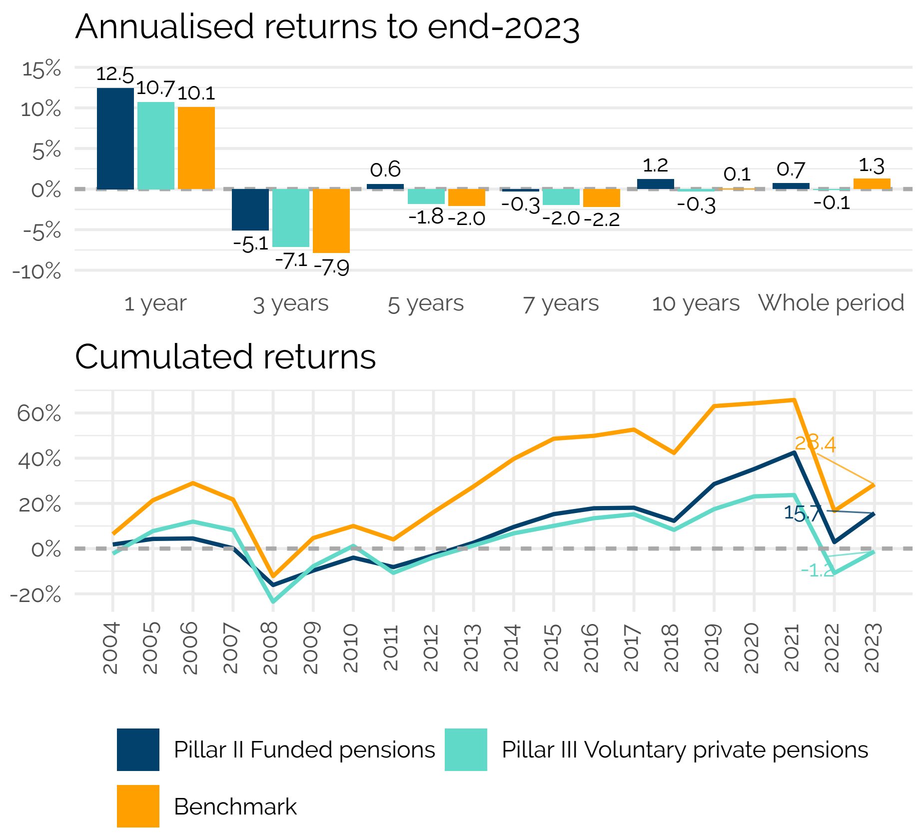
Table LT.9 – Capital market benchmarks to assess the performance of Lithuanian pension vehicles

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 analysed period.

Figure LT.12 – **Performance of Lithuanian mandatory pension funds against a capital market benchmark (returns before tax, after inflation, % of AuM)**



Data: Bank of Lithuania, Eurostat, Eurostat; *Calculations:* BETTER FINANCE, holding per to end-2023.

Conclusions

Considering the wider factors, it is safe to say that the decreasing labour 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 were overall positive in 2023. Pillar II stayed in positive real return territory over the entire analysed period. However, Pillar III scheme, which cannot compete to the similar and cheaper peers in Pillar II slipped to negative territory over the analysed period.

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 favourable tax treatment of private pension savings, where in both cases an “EEE” tax regime is applied.

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