

**DR. OEC. EDGARS VOLSKIS**

**PENSION SYSTEM OF LATVIA**

**JOURNEY TO  
SUCEESSES AND CHALLENGES  
IN TWELVE YEARS**

VIENNA  
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DR. OEC. EDGARS VOLSKIS

## PENSION SYSTEM OF LATVIA: SUCCESS AND CHALLENGES

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### Why pension system had to be reformed?

- ⦿ Robust reform started 1995, - implemented 2001
- ⦿ Shortening of Job Service Period vs Retirement Period;
- ⦿ Growing Demographic Risks;
- ⦿ EU preaccession;
- ⦿ Growing Fiscal Burden of PAYG Systems;
- ⦿ Risk of Raise of Inequality of Incomes.



## PENSION SYSTEM OF LATVIA: SUCCESS AND CHALLENGES

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### The first 7 years of success:

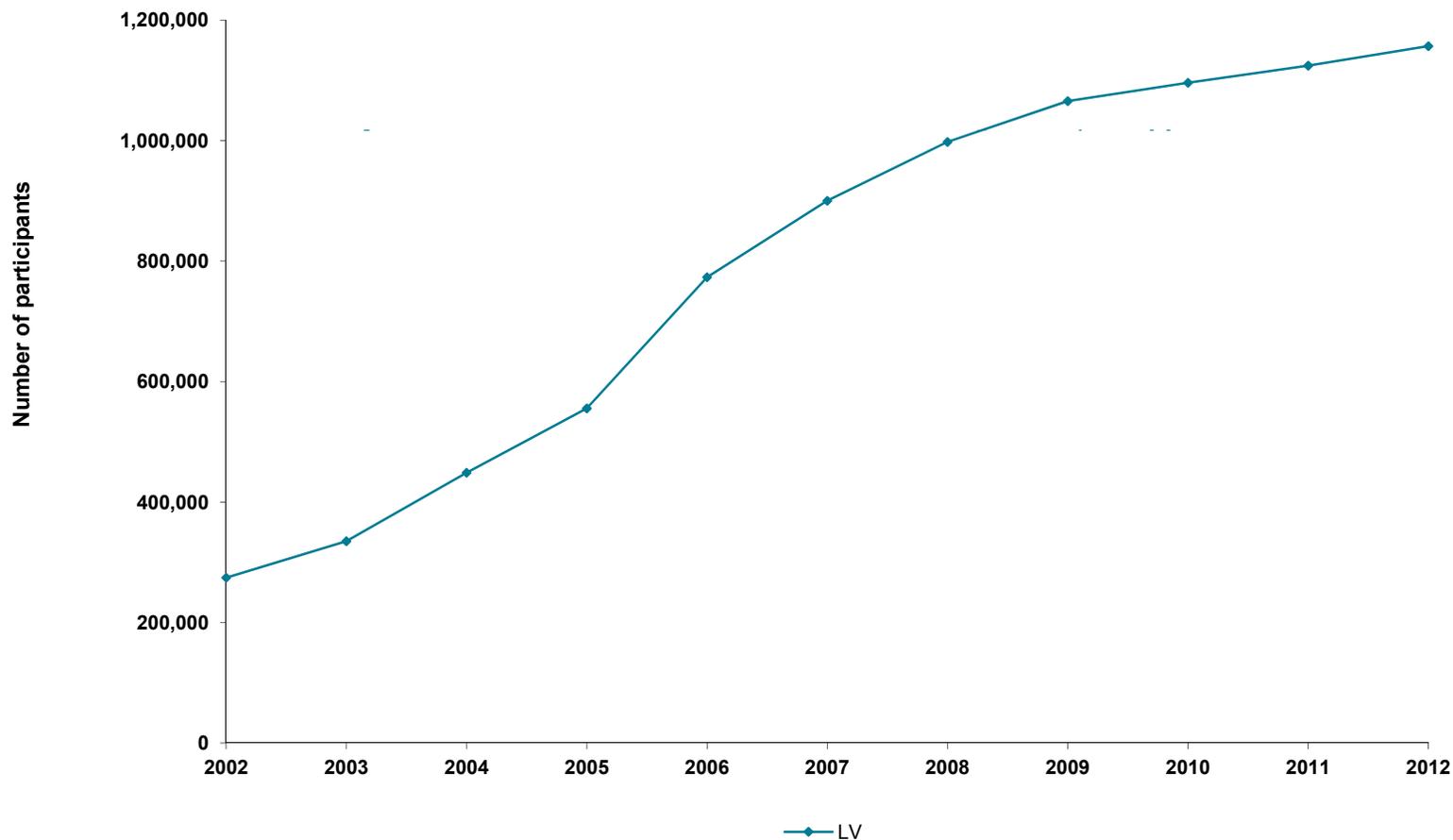
- ◉ Positive public government social campaign;
- ◉ Introduction coincided with period of the high rates of return;
- ◉ The number of people joining to the system and starting job service was increasing (born in 70s and 80s);
- ◉ Fast growth of wages as result of EU pre and post EU accession;
- ◉ Increase of 2<sup>nd</sup> pension pillar contribution rates, which increased from 2% to 8%.

## Failure of 2nd pension pillars after financial crisis:

- ⦿ Involvement of people in higher risk pension plans;
- ⦿ Limited local capital market opportunities as well regulatory restrictions for the investments diversification;
- ⦿ Lack of preventive financial and legal measures that would limit or even cancel pension plans' rewards (administration fees) in case of negative returns reported;
- ⦿ Inconsistency, non-transparency, short view of political decisions

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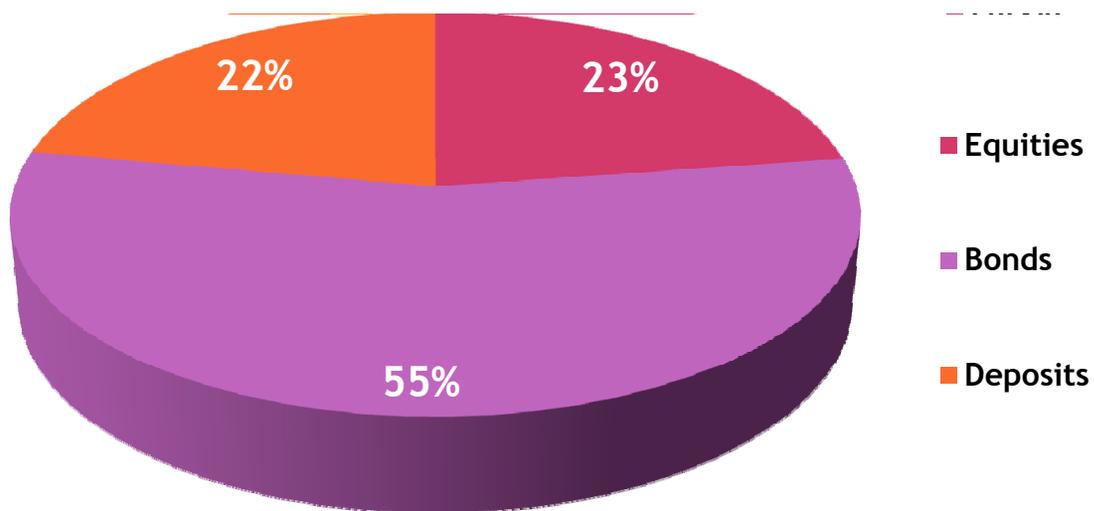
### Funded pension schemes performance in numbers (10 years after the reform)



## PENSION SYSTEM OF LATVIA: SUCCESS AND CHALLENGES

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Funded pension schemes performance in numbers  
(After 12 years after the reform - 31/12/2012)



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### Remaining 5 years challenges of pension system:

- ◉ Consistent and non-recoverable trend on decrease of returns on Euribor related financial instruments;
- ◉ Consistently high unemployment rates had still retained in Latvia and EU (LV 15%, EU 11%);
- ◉ Low returns on investments and trend to remain them low (below wage growth rates);
- ◉ Low participation in voluntary schemes due to lack of financial literacy of pension accounts holders;
- ◉ Lead to low replacement rates (40-50%)

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### Remaining 5 years challenges of pension system (cont'd):

- ◉ Lack of Political Championship and Enhanced Regulations;
- ◉ Limits on diversified long term investments from Regulators;
- ◉ No performance based, flat rate management fees charged by fund managers;
- ◉ Separate systems and policies on social insurance health insurance.

## Allocation limits to funded pension schemes :

- Latvia: Current 2012 - 2%, Expected 4% from 2013, 6% - 2016;  
Total rate on social contributions 35.09%;

## High Management and Admin Fees

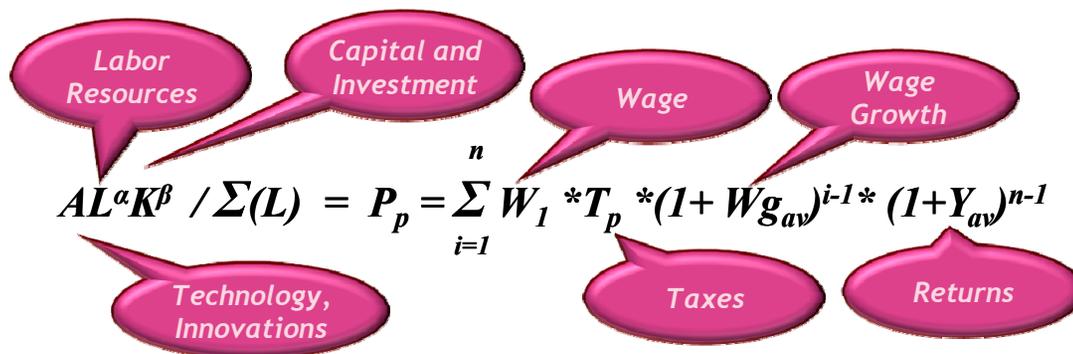
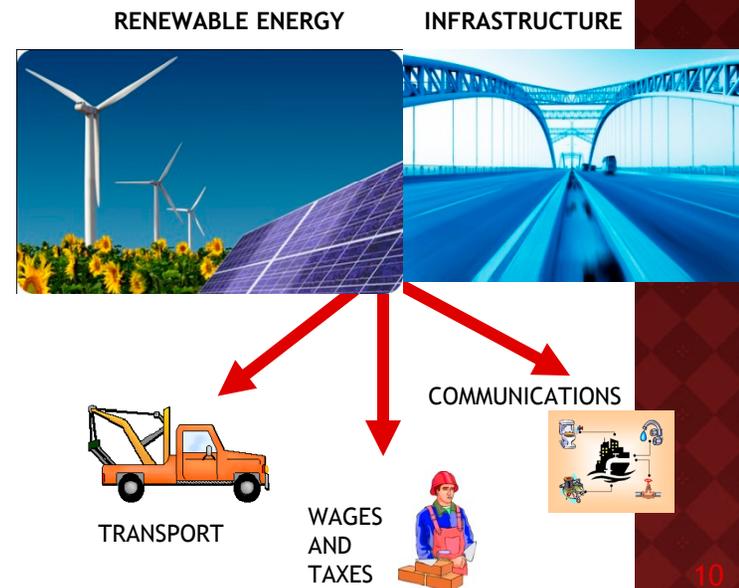
Administration fees in Latvia 0.75 % - 1.90%

## PENSION SYSTEM OF LATVIA: SUCCESS AND CHALLENGES

### Proposed solutions for next 12 years:

Governments should politically enhance and support *Long Term Financial* initiatives by promoting more investments of funded pension assets into *Real Economy Sectors* with sustainable growth of capacity and value of pension assets and welfare of the country:

- ◉ Infrastructure Development projects;
- ◉ Renewable Energy and Natural Resources;
- ◉ Risk and Venture Capital Investments.



$$AL^{\alpha}K^{\beta} / \Sigma(L) = P_p = \sum_{i=1}^n W_1 * T_p * (1 + Wg_{av})^{i-1} * (1 + Y_{av})^{n-1}$$

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THANK YOU

Q & A