Reformation of Pension system in Russian Federation

STRATEGY AND PROPOSALS FOR THE ENHANCEMENT OF VOLUNTARY PENSION SAVINGS SYSTEM

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Current Pension System in Russia

- The Russian pension system contains three components:
  - 1) Social pension
  - 2) Insurance pension (Points) + basic/flat part + pension savings (DC)
  - 3) Voluntary part

- At retirement, at age 60 for men and 55 for women, the amount standing to the individual’s account is annuitized using a factor based on life expectancy. The same annuity factor is used for both men and women: 228 months (19 years) which it did in 2013.
Economical situation in Russia

• The population – 146.5 million (2015)
• GDP - US $ 1,86 trillion (2015)
• GDP per capita US$ 25 k (2015)
• In late 2014-2016 Russia went in crisis due to fall in the prices of the oil. The crisis led to fall in the exchange rate of the national currency by 2 times against the main foreign currencies. Also the inflation went up to ~15% in 2015. In 2016 the budget deficit will be at least 3% of GDP.
• The crisis also led to the increased deficit of US$47 billion (~40%) of the Pension Fund of Russia which pays the social and insurance pensions.
Demographical situation in Russia

- Life expectancy at birth: 72 years (Men - 67, Women - 77).

- The age structure of the population:
  - 0-14 years 16.4%,
  - 15-64 years 70.5%,
  - 65 and over years 13.1%.

- The rate of population growth for 2015 is positive - 0.19%
Reform needs

- Falling replacement rates (~35% in average now and 25% in the future) and low differentiation of savings pensions (replacement rates fall from 50% for lower income workers to less than 20% for higher income workers)
- Low diversification of sources of pension income
- High dependence on government budget
- Low coverage by supplementary schemes (6% of labor force)
Basic challenges

• Low trust in financial institutions (especially, in pension funds)
  ○ Institutions and the system as a whole are not transparent enough
  ○ Corporate governance in many funds seems to be not as efficient as it must be
  ○ Investment policies lead to suboptimal investment decisions
  ○ There are also many bad practices (related party investments, misleading marketing) that are employed in the activities of pension funds

• Though, the savings in mandatory DC level are still the property of people and despite the moratorium on new contributions they were not nationalized (as it was in some Eastern European countries) so they are safe enough and can be the basis for the advanced system
Reform objectives

• Develop the following issues by creating standard guidelines:
  ○ Transparency
  ○ Investment policy and asset management
  ○ Corporate governance + fiduciary duty
• Incite the development of culture of savings
• Give people more options in defining their pension

Finally: people will regard the system as well-functioning, safe and transparent so that pension savings will become attractive to vast majority of individuals
Reform options: automatic enrollment

People tend to make biased decisions on the savings (especially pension savings)
Automatic enrollment lets people start saving without difficult actions. Contributions are transferred by the employer on behalf of employees

Pros
• High coverage ratio
• Simple in use and contributing

Cons
• Perception of quasi-voluntary scheme by the population
• Infrastructure for opting out is not in place in some regions
Reform options: tax incentives

Now there exists a system of tax incentives: the person should make an application to FTS to get tax exemption.

The idea is to enlarge the maximum sum that can be subject to exemption and simplify the system of getting the exemption.

Pros
- Opting in is own decision of a person, nobody “enrolls” them.

Cons
- Low coverage rates
- Person needs to take some actions to opt in.
Technical enhancement

- Infrastructure (IT + personnel + physical sites) to manage the system properly all along the country
- Supervision: extra education for regulators of needed
- Development of investment instruments (bonds, annuities)
Automatic enrollment

- All the employees are enrolled
- Default option: default fund + default stakes
- Possible to switch
- Possible to opt out
Reform and social protection and growth objectives

• Additional funding source for the growth of economy (financing infrastructural projects and other long-term investments)
• Higher pensions lead to more sound social stability
Communication and public information strategy

- The main point of communications - to tell people about things as they are and be as much transparent as possible
- Different communicational strategies for all the age groups (IT, TV, radio, mail, newspapers)
- Communication strategies of the CBR and pension funds should be coordinated and not controversial
- That is why there is a strong need in cooperative policy held by the regulator and the market
- Marketing is not enough, both the CBR and the market should provide educational opportunities
- There is a need in a transitional period (1-2 years) for people to get familiar with the system
Summary and conclusions

• Low replacement rates lead to the necessity of some supplementary pension provision
• As contribution rates are relatively high it should be voluntary and funded mostly by employees
• People tend to make biased decisions so the system has to provide some incentives along with soft compulsion
• Automatic enrollment with tax incentives could be a solution
• There is a need in the improvement in corporate governance, investment policies and level of transparency in pension funds
• The regulator may have to revise supervisory practices
• Cooperative communicational and educational strategies are strongly needed