VALSTYBĖS KONTROLĖ
PUBLIC AUDIT

PUBLIC AUDIT REPORT

RESULTS OF THE FINANCIAL AUDIT OF THE 2022 SET OF ACCOUNTS OF THE PENSION ANNUITIES FUND

30 May 2023

No FAE-2

The main function of the National Audit Office of Lithuania is to supervise the lawfulness and effectiveness of the management and the use of State property and execution of the State budget. By providing audit observations and recommendations, the National Audit Office promotes positive and effective public audit impact on public finance management and control system and public management oriented towards results and public needs. For more information on the activities of the National Audit Office and the results of the public audit, see www.valstybeskontrole.lt.

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Public Audit Report has been submitted to the Seimas of the Republic of Lithuania, the Government of the Republic of Lithuania, the Ministry of Social Security and Labour, the State Social Insurance Fund Board under the Ministry of Social Security and Labour

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INTRODUCTION

Objective and Scope of the Audit

In accordance with the Law on the Accumulation of Pensions and the Law on National Audit Office[1], we have carried out the financial audit of the regularity of the 2022 set of accounts of the Pension Annuities Fund. The audit has been performed in accordance with International Standards on Auditing and International Standards of Supreme Audit Institutions. The audit report includes only the matters identified during the audit, and the independent opinion on the Fund's set of annual accounts is issued in the Auditor's Report. The scope and methods of the audit are described in greater detail in Annex "Audit Scope and Methods" (p. 8–10).

Purpose of the Pension Annuities Fund

Starting from 1 July 2020, the Pension Annuities Fund has started its activity after the Board of the State Social Insurance Fund (hereinafter – VSDF) became centralised payer of pension annuities. The resources of this fund include lump-sum contributions of the participants, income from the investment of the Fund's resources, borrowed funds, and other funds legally received. The Pension Annuities Fund resources may be used only for the payment of pension annuity benefits, for the management and administration costs of the Fund, for investment activities, and for making other payments as provided in the legislation approved by the payer of pension annuities.

The objective of the pension annuities payer is to ensure that pension annuities are paid to beneficiaries for life, for their maximum benefit, and that the Pension Annuities Fund assets are managed in a transparent and sustainable manner[2]. The Pension Annuities Board[3], acting in a collegial capacity, oversees how the payer of pension annuities meets this objective.

The Pension Annuity Fund is accounted for and reported by the SSIF Board separately from its own accounting as a budgetary institution. Pursuant to the Law on the Accumulation of Pensions[4], the budget of the Pension Annuities Fund is approved by the Law on the Approval of the Budget Indicators of the Pension Annuities Fund for the respective year.

[1] Law on the Accumulation of Pensions, Article 35(10)(4) and Law on National Audit Office, Article 8(2)(4).

[2] Ibid., Article 35(1)(1)

[3] Ibid., Article 35(1), and Article 35(2).

[4] Ibid., Article 35(10)(1)

The set of annual accounts of the Pension Annuities Fund with the Opinion of the National Audit Office on that set of accounts are published on the website of the payer of pension annuities no later than on June 1 of the following accounting year[5].

[5] Ibid., Article 35(11)(1)

AUDIT RESULTS

1. THE SET OF ANNUAL ACCOUNTS OF THE PENSION ANNUITIES FUND IS CORRECT IN ALL MATERIAL RESPECTS

1. Pension Annuities Fund' set of annual accounts is drawn up in accordance with the Law on Accumulation of Pensions[6], the Law on Public Sector Accountability and the public sector accounting and financial reporting standards. We have not identified any data misstatements in the Fund's 2022 set of accounts, which are correct in all material respects, but we note that the set does not include, as required by the provisions of the Law on Accumulation of Pensions[7], information on pension annuity payment objectives and their implementation[8].

2. The coverage of technical provisions with assets is the key indicator in assessing the sustainability of the activity of the pension annuity payer. According to the data of the 2022 set of accounts of the Pension Annuities Fund[9], the Fund's assets cover 97% of the established technical provisions (110% in the previous reporting period) and do not meet the requirement, set in the Law on the Accumulation of Pensions, which specifies that the pension annuity payer is obliged to ensure that the Fund's assets would not have a lower value than the sum of the established technical provisions[10]. As a result of such circumstances[11], in accordance with established procedures, the pension annuity payer prepared and submitted a recovery plan to the responsible institutions[12]. The plan states that such a situation is due to the fact that the Fund's main assets are equity securities (shares), and the price of shares in world markets significantly fell in the first half of 2022. This has led to a decrease in the value of the assets of the Growth Portfolio, while the value of the remaining assets is not decreasing or consistently rising. The plan also foresees that the continued implementation of the approved investment strategy of

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[6] Law on the Accumulation of Pensions, Article 35(10)(2)

[7] Ibid., Article 35(11)(1) The Fund's set of annual accounts contains information on the main objectives of the pension annuity payment and their implementation, the performance and financial position of the Fund, the adequacy of technical provisions and their coverage by assets.

[8] Activity plan for pension annuity payment for 2022 (with set strategic objectives for the period of 2021–2024 and set measures and tasks for their implementation for 2022) was approved by Order No V-635 of the Director of the Board of the VSDF of 16 December 2021. Information about the achievement of the objectives of the activity is disclosed in the 2022 activity report of the pension annuity payment published on the VSDF website.

[9] Annex No P3 to the Explanatory Note "Technical provisions of the Pension Annuities Fund by the type of pension annuity based on the data of 13 December 2022".

[10] Law on the Accumulation of Pensions, Article 35(7)(1)

[11] If the value of the Fund's assets becomes lower than the sum of the established technical provisions, the pension annuity payer is obliged to prepare a recovery plan for the period of seven years, in accordance with the procedures and within the deadlines established by the supervisory institution (the Bank of Lithuania). If a recovery plan predicts that the situation will be resolved, the pension annuity payer must implement the measures foreseen in this plan. If a recovery plan does not predict that the situation will be resolved, the pension annuity payer must specify the need for the money necessary to cover the technical provisions. This money is foreseen in the budgets of the State and Pension Annuities Fund for the next budget year. The recovery plan and information about its implementation are submitted to the Bank of Lithuania, the Ministry of Social Security and Labour, and the Ministry of Finance.

[12] Order No V-361 of the Director of the Board of the VSDF of 23 September 2022 "On the approval of the recovery plan of the Pension Annuities Fund".

Pension Annuities Fund assets is sufficient to restore the situation. The report[13] on the implementation of the recovery plan of the Pension Annuities Fund of 31 December 2022 contains a seven-year projection of the Fund's activity, which concludes that the future investment return over the next seven years will be greater than the return needed to cover the Fund's asset deficit. Thus, the pension annuity payer assesses that the current situation does not pose a threat to the long-term sustainability of the fund.

2. MORE THAN A THIRD OF PEOPLE POSTPONE THEIR DECISION TO BUY A PENSION ANNUITY

3. One of the continuous objectives of the activity plan of the pension annuity payment is to "Encourage potential beneficiaries of pension annuities to choose to purchase a pension annuity (rather than leave money in a pension fund) and to understand the benefits provided by the pension annuities". In implementing set objectives, the pension annuity payer tries to fully inform the population on issues related to the selection of the annuity: besides other applied measures pension annuity calculator has been created[14], a pension annuity selection test has been operating since 2022[15], and a new measure, designed to inform the people of pre-retirement age participating in the pension funds about the pension annuities and their acquisition, has been included in the 2023 activity plan[16].

4. The number of individuals that postponed their decision to buy a pension annuity, when compared to the number of people that bought annuities, is relatively high (1 943 annuitants at the end of 2022, while 1 074 individuals, or 36% of the total number of those that may buy an annuity, postponed their purchase), however, there are no measures targeting the group of individuals that postpone the purchase of annuities. The number of potential annuitants is important in planning the activity of fund: forecasting of management and administration costs, revenue, cash flows, liabilities, and investment strategy.

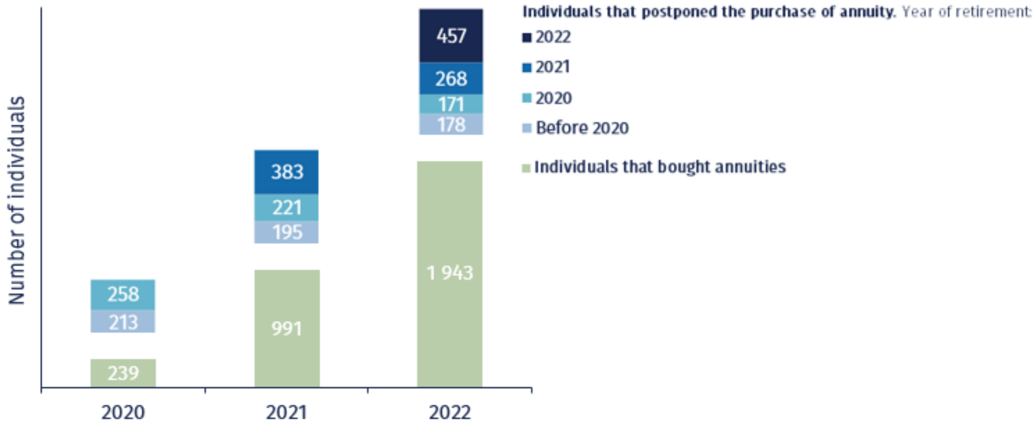
[13] Order No V-118 of the Director of the Board of the VSDF of 30/03/2023 "On the Execution Reports of the recovery plan of the Pension Annuities Fund of 31 December 2022".

[14] Available at: Pension annuity calculator | www.sodra.lt, referred to on 03 May 2023.

[15] Available at: Test | www.sodra.lt, referred to on 03 May 2023.

[16] The measure is to be implemented through the installation of software which selects individuals and sends automated notifications (the planned date of implementation is 30 June 2023).

Figure 1. Individuals that bought an annuity and postponed the purchase



Source - National Audit Office based on the data provided by the VSDF Board and data from the 2020-2022 activity reports of the pension annuity payment.

5. An individual that has acquired a right to a pension annuity[17] has a right to indefinitely postpone the decision to buy, remaining a participant in a pension fund and continuing to accumulate assets in the pension saving companies. Fluctuations in the financial markets cause the value of a participant's accumulated assets in the pension fund to constantly change. When buying a pension annuity[18], the value of a participant's unit in the pension fund shall be calculated on the basis of the participant's data presented during the application date for the pension benefit contract. To receive higher pension annuity benefits for the rest of the life, a participant has the option to postpone the decision to buy an annuity, i.e., not to apply to the pension company for the conclusion of a contract for the pension benefit, by taking into account whether the current situation in the financial markets is favourable to buy a pension annuity and other individual circumstances. The reasons why people decide to postpone the purchase of an annuity may vary: some people continue to work and accumulate the funds in the second pension pillar even after reaching retirement age, some are influenced by general anxiety, related to the changes in the pension system, others are reacting to the situation on the financial market and are waiting for a more favourable time to buy an annuity, and some others do not plan to buy an annuity and leave their accumulated assets for their inheritors in such a way.

6. We have found that the pension annuity payer does not collect information about the reasons why the people that were supposed to buy the annuity postponed the purchase and the extent of these reasons. We believe that such information (without increasing the administrative burden for its collection and applying existing tools) would help to select

[17] The participants of the second pillar pension funds acquire a right to a pension benefit only when they reach the retirement age (except the cases, when an advance pension has been awarded to the participant). When a participant becomes entitled to and decides to receive the accumulated assets in the pension fund on his/her behalf, depending on the size of accumulated assets, these pension benefits may be payable: a lump sum, a periodic benefit, or a pension annuity. When the mentioned pension assets are below EUR 10 000 (EUR 10 807 from 2023), the purchase of the pension annuity is not mandatory, however, when the pension assets have been accumulated up to or above this amount, the accumulated pension assets will be paid out only after the purchase of the pension annuity from the pension annuity payer.

[18] The annuity shall be bought on the basis of a pension benefit agreement and shall be paid with a lump sum from the total pension assets accumulated in the pension fund on behalf of the participant, which shall become the property of the pension annuity fund. Annuity is bought for a share of the assets accumulated in the pension funds on the behalf of the participant only in the case of a deferred pension annuity and when the accumulated assets exceed EUR 60 000 (more than EUR 64 841 starting from 2023), when the share exceeding this sum may be received as a lump sum from the pension accumulation companies.

universal measures for the implementation of the objective foreseen in the activity plan, in the context of planning the Fund's income and more effective ways of attracting new participants. In response to the proposal to collect such information, the Ministry of the Social Security and Labour has indicated[19] that it has taken steps to address this by contacting the Lithuanian Investment and Pension Funds Association about the possibility of submitting a survey to the people that have reached retirement age on whether they plan to buy an annuity when they reach the retirement age and, if not, reasons behind the intent to postpone the purchase.

Auditor General Mindaugas Macijauskas

[19] Letter No (24.2Mr -56) SD-2188 of 29 May 2023.