



# Hong Kong

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## **PENSION REFORM IN ARMENIA**

### **Challenges and Opportunities**

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# AGENDA

Demographic and Economic Environment

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Armenian Pension Law

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Reaction to the Law

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Pension Reform Challenges

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Cost Projections

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Questions & Answers

# DEMOGRAPHIC AND ECONOMIC ENVIRONMENT

Economic and demographic issues posed serious threat in the long-term viability of the prior pension system.



**Radical measures were needed to reform the pension law in Armenia.**

# ARMENIAN PENSION LAW: THE FOUNDATION

## Multi Pillar System

### Pillars 0 and I: State Pension

#### Social pensions:

- Age of 65+ and not eligible for a labor pension.
- Low-value flat dollar benefit.

#### Labor pensions:

- Pensions to individuals as prescribed by law at the cost of the State budget.
- Pension equal to flat dollar plus supplement due to years of employment.

#### Solidarity of generations:

- Pay As You Go
- Not viable as proportion of workforce to retirees changes.

Prior pension law

### Pillar II: Mandatory Funded Pension

#### Provides funded pension benefits

- Funded from mandatory state/employee contributions and return on investment.
- Size of pension tied to income level and market performance.

#### Guiding principles:

- Current employees pay for themselves.
- Employer-employee sharing the cost of retirement.
- Higher contributions required from higher earners.

Additions from new pension law

### Pillar III: Voluntary Funded Pension

#### Provides supplementary pension

- Funded from voluntary employer/employee contributions and return on investment.
- Offered by insurance companies, banks and pension funds.

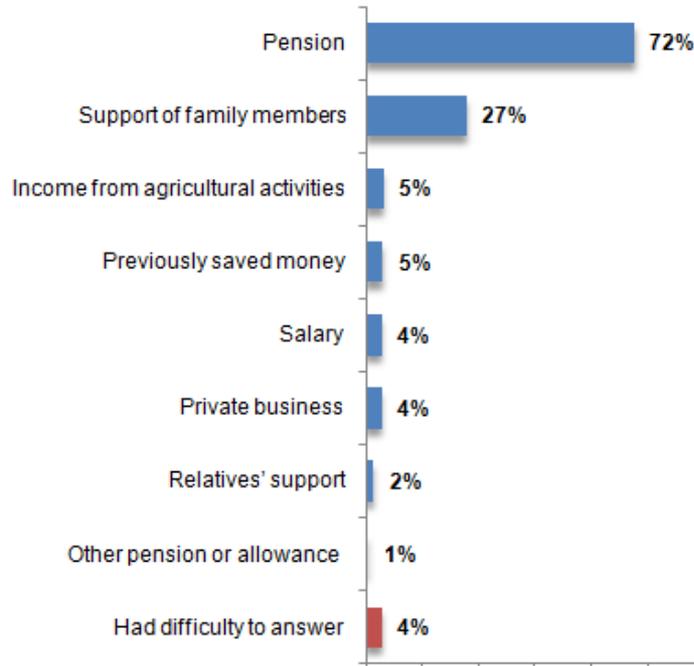
# ARMENIAN PENSION LAW: BEFORE AND AFTER REFORM

The Pension Reform radically shifted the responsibility for securing retirement income to the employers, employees, and the market, while minimizing the role of the State.

	Before	After
<b>Pension Funding</b>	State budget	State budget, employers, & employees
<b>Type of Benefit</b>	Flat dollar and service-based	Flat dollar basic level plus investment account(s)
<b>Level of Pensions</b>	Based on years of service and level set by the government	Tied to level of contributions and market performance; basic level still set by the government
<b>Optional Forms</b>	Same for all	Varies by pillar

# REACTION TO THE LAW: PUBLIC INTEREST

***What will be (or what is) your main source of income at the retirement age?***



***Population's concerns about the current pension system***

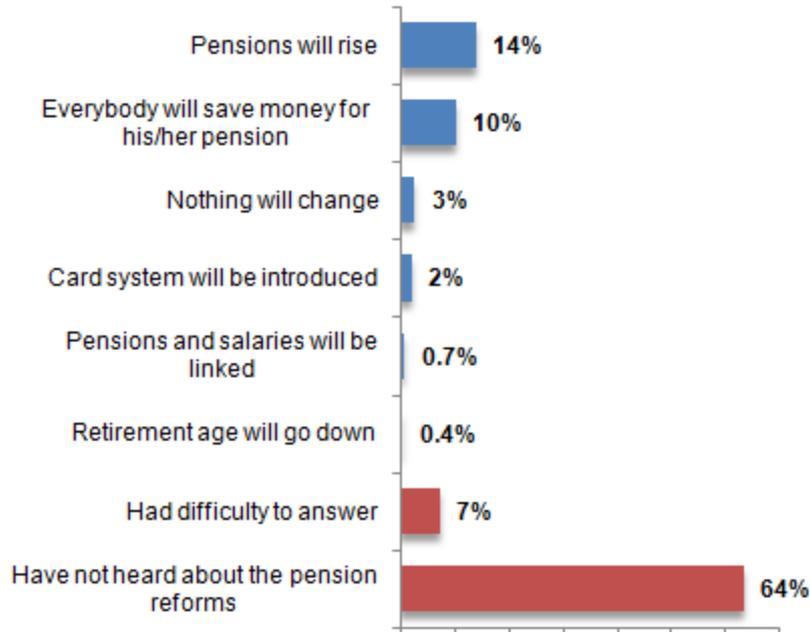
Problems of the pension system	Share of respondents
Pensions are low	81%
Retirement age is high	27%
There are problems connected with documents and receiving pension	3%
There are no problems in the pension system	2%
Other	14%

**Statistics show lack of knowledge for the current problems of the pension system; yet many list pension as their main source of funding in retirement.**

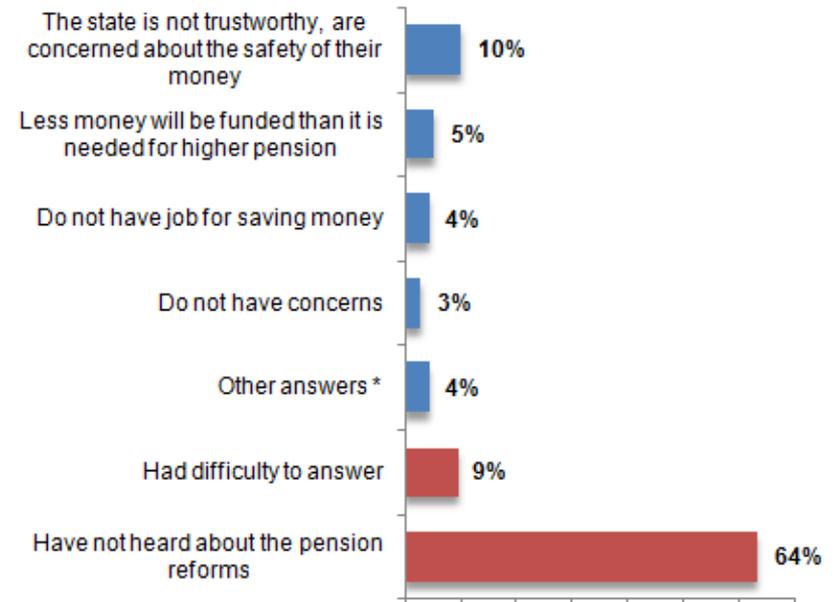
Source: Baseline Survey of General Population Awareness of the Government Proposed Pension Reform, USAID, 2011

# REACTION TO THE LAW: EXPECTATIONS

## What changes do you expect from the Reform?



## Population's concerns about the reformed pension system



**Public attitude is split.  
Current inadequate level of pensions drives expectation of higher benefits.  
At the same time, negative attitude correlates with lack of information.**

Source: Baseline Survey of General Population Awareness of the Government Proposed Pension Reform, USAID, 2011

# PENSION REFORM CHALLENGES

## Public Awareness and Education

- Much of the population has no financial education.
- Could poverty increase due to poor investment decisions?
- Reform itself is not well understood.
- Tradition of reliance on the State, but Reform could require people to manage own retirement income.

## Investment Market

- Local capital market is shallow.
- Investing in foreign securities creates political friction.
  - Also creates foreign exchange risk
- Appropriate custodian and asset managers have not been identified.

## Payout Phase

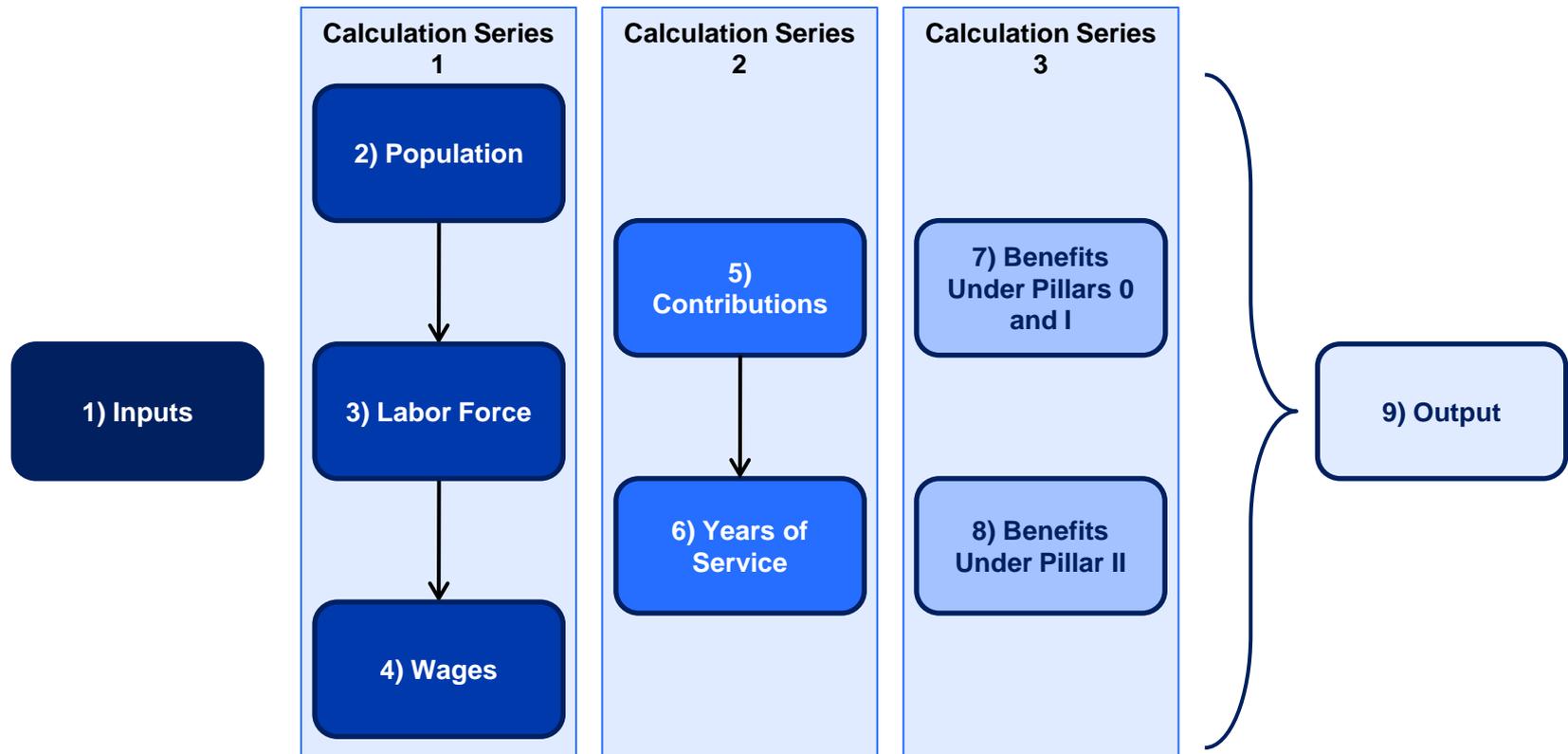
- Annuities, lump sums, and programmed withdrawals will be available, but regulations are still vague.
- Who should assume what type of risk? e.g. longevity and capital market
- A life insurance market has not yet been developed.

# COST PROJECTIONS: OVERVIEW

The Risk Assessment Tool projects likely evolution of the pension system given changes in:

- Demographic assumptions: fertility, mortality, migration, etc.
- Economic assumptions: employment, wages, the mandatory social contribution compliance rate, etc.
- Level/richness of pension benefits

Consists of 12 linked Excel workbooks to allow use without special software



# COST PROJECTIONS: RISK ASSESSMENT

Type	Entries	Sample Analysis
Population	<ul style="list-style-type: none"> <li>• Counts/distribution</li> <li>• Mortality (current future)</li> <li>• Migration (internal and international)</li> <li>• Fertility and gender distribution</li> </ul>	<ul style="list-style-type: none"> <li>• Mortality is expected to improve at a slower pace in the next 10 years. Can we decrease the pension budget over the next 10 years?</li> <li>• Higher than average migration to Western Europe is expected particularly among younger citizens. When will future pension payments likely be affected?</li> <li>• More females are expected to enter the workforce over the next 5 years than we have previously seen. How would the level of participant contributions change?</li> </ul>
Labor Force	<ul style="list-style-type: none"> <li>• Unemployment</li> <li>• Employment by industry</li> </ul>	<ul style="list-style-type: none"> <li>• Unemployment rate was recently re-measured using more reliable methods and is much higher than previously thought. How would this affect the pension budget?</li> <li>• The tourism industry is expected to grow in the next 3-5 years. How would this affect unemployment and the amount of Pillar 0 benefits?</li> </ul>
Wages	<ul style="list-style-type: none"> <li>• GDP growth &amp; inflation</li> <li>• Taxation</li> <li>• Wage disparity (industry, urban/rural, male/female)</li> </ul>	<ul style="list-style-type: none"> <li>• Inflation is approaching 30%, but is expected to stabilize within 3 years. How might the pension-to-wage replacement ratio be impacted?</li> <li>• Direct foreign investment is expected to increase the real GDP growth to 12% over each of the following 5 years. How might this impact the level of government contributions to Pillar II benefits?</li> </ul>
Contributions and Benefits	<ul style="list-style-type: none"> <li>• Compliance with contribution requirement</li> <li>• Level of benefits offered</li> <li>• Years of service earned</li> </ul>	<ul style="list-style-type: none"> <li>• Compliance with pension contribution requirement is expected to improve by 10% on average starting next year. Could the pension budget be reduced?</li> </ul>
Investment	<ul style="list-style-type: none"> <li>• Portfolio allocations</li> <li>• Investment elections</li> <li>• Expected returns &amp; fees</li> </ul>	<ul style="list-style-type: none"> <li>• How sensitive are Pillar II balances to asset management fees?</li> <li>• How will retirement income be affected if fixed income assets are scarcer?</li> </ul>

# QUESTIONS AND ANSWERS

