Will you afford to retire?

The Real Return of Long-term and Pension Savings

2023 Edition

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Country Case 15

Slovakia

Real returns 2022
Pension funds: -22.58%
Supplementary pension funds: -24.09%

Zhrnutie
Slovenský dôchodkový systém je typickým modelom Svetovej banky založenom na viac-pilierovom (troj-pilierovom) systéme s individuálnymi (osobnými) účtami sporiteľov. V roku 2019 došlo výrazným zmenám v I. pilieri, ktoré boli motivované politickým populizmom pred voľbami. Do dôchodkového systému bol ústavným zákonom zapracovaný dvojpilierový systém a zároveň strop dôchodkového veku. V roku 2021 boli očakávané výrazné reformné zmeny v I. pilieri, ktoré by mali zvýšiť finančnú stabilitu I. piliera a vyriešiť problémy v nastavení súkromných dôchodkových schém. V roku 2022 prebehla zásadná reforma I. piliera (naviazanie dôchodkového veku na strednú dĺžku dožitia) aj II. piliera, kde sa zaviedol automatický vstup, predvolená investičná stratégia, zmena výplatnej fázy, zníženie poplatkov aj zníženie poplatkov v III. pilieri.

Summary The Slovak pension system is a typical World Bank model based on a multi-pillar (three-pillar) system with individual (personal) accounts of savers. In 2019, there were significant changes in Pillar I, which were motivated by political populism before the elections. The two-pillar system was incorporated into the pension system by a constitutional law, as well as a ceiling on the retirement age. Significant reform changes to Pillar I were expected in 2021, which should increase the financial stability of Pillar I and resolve problems in the set-up of private pension schemes. In 2022, there was a major reform of both Pillar I (linking the retirement age to life expectancy) and Pillar II (introducing automatic enrolment, a default investment strategy, a change in the payout phase, a reduction in fees), as well as a reduction in Pillar III fees.

Introduction: The Slovakian pension system

- Year 2022 has brought the major pension reform influencing all pension pillars;
- The reform removed retirement age ceiling and tied the retirement age back to the life expectancy;
- For Pillar II, the reform in 2022 introduced the predefined investment strategy aimed at increasing the performance of pension savings for all non-active savers;
- Starting July 2023, the portfolio of non-active savers should be re-allocated to the index pension funds (100% until the age of 50 years and then adopting the glide path of 4% annually from index funds into bond pension funds) within 30 months;
- For Pillar III, the reform has decreased the fees to the level competitive to the PEPP products (1% of AuM);
- Year 2022 brought the national PEPP legislation with the first PEPP provider on the EU market.

Table SK.1 – Long-term and pension savings vehicles analysed in Slovakia

Product	Pillar	Reporting period	
		Earliest data	*Latest data*
Pension funds	Occupational (II)	2005	2022
Supplementary pension funds	Voluntary (III)	2009	2022

- The pension reform adopted in 2022 as part of the Recovery and Resilience Plan (Component 18) has had some positive features on the overall financial stability of Pillar I. However, further measures on the financial stability of the PAYG scheme are necessary.
- There should be a significant increase in the state support for private pension schemes in order to increase the pension savings ratio which is one of the lowest among the EU countries and spurs the financial problems for the generation retiring in the next 20 years.
- The year 2022 brought the first PEPP products to the Slovak pension market that have the features allowing them to effectively compete the III. pillar pension products. However, tax laws favour the Pillar III products and thus reduce the competitiveness of PEPP products on the market.

Table SK.2 – Annualised real net returns of Slovakian long-term and pension savings vehicles (before tax, % of AuM)

	Pension funds	Supplementary pension funds
Reporting period	2005-2022	2009-2022
1 year (2022)	-22.6%	-24.1%
3 years (2020–2022)	-7.0%	-7.8%
5 years (2018–2022)	-4.0%	-5.0%
7 years (2016–2022)	-2.5%	-3.0%
10 years (2013–2022)	-1.1%	-1.7%
Whole period	-1.2%	-1.3%

Data: oranzovaobalka.sk, 2023; *Calculations:* BETTER FINANCE.

Pension system in Slovakia: An overview

The Slovak old-age pension system is based on the multi-pillar approach, which consists of three main pillars:

- Pillar I – State pension organized as a mandatory PAYG scheme;
- Pillar II – Funded pension organized as voluntary funded DC-based scheme; and
- Pillar III – Supplementary pension organized as a voluntary individual pension DC-based scheme.

Pillar I - State pensions

The Slovakian pension reform started in 1996 with the introduction of Pillar III, which at that time (and until 2009) was organized as voluntary pension pillar offering life insurance contracts and as an occupational pillar as well. Since July 2009, the system was changed to funded saving schemes and voluntary Pillar III pension funds are offered to the savers (members). The organization of Pillar III started to become more personal with the financial support of employers.

The World Bank's approach has been fully implemented by introducing Pillar II at the beginning of 2005, and, from a terminological point of view, it should be called the "1bis pillar", as individual retirement accounts are funded via partial redirection of social security contributions on individual pension savings accounts. For a person who works a full career (42 years) and retires in 2022, the main income stream derives from the PAYG (Pillar I) pension scheme. On average, the individual replacement ratio of such a person could reach 47% of their gross salary. If the person would have participated since 1996 in Pillar III and contributed on average 3% of their salary into a Pillar III pension scheme, having also entered Pillar II (1bis pillar) in 2005, their income stream during retirement would have been slightly different and their replacement ratio would have been a little higher than 60%. However, still more than 90% of the retirement income stream is provided via the PAYG scheme (Pillar I), around 5% from Pillar II (1bis pillar) and 5% from Pillar III.

Pillar I is a state organized PAYG pension scheme, managed by the State Social Insurance Com-

pany. Pensions are funded on an ongoing basis and benefits are calculated based on the number of insured years and paid contributions. The PAYG principle of financing is supplemented by the redistribution principle, where the lowest income groups receive higher replacement ratios and higher income groups (due to the solidarity mechanisms) receive lower replacement ratios.

Pillar I is closely connected to the economic activity and income of the citizens. This pillar is financed by contributions of economically active individuals, amounting to 12.5% (18% if an individual is not participating in Pillar II) of their base income (gross salary). These contributions are directed to the Social Insurance Company, which distributes the allowance to the beneficiaries (current pensioners).

An individual is entitled to an old-age pension after the statutory retirement age is reached. There are two options for early retirement: 40 years of insurance period or 2 year before retirement age. In both cases, the minimum level of pension (1,6 $\times$ living minimum) should be reached.

Pension insurance is mandatory; statutory insurance and participation in this scheme is a legal obligation for all eligible persons. However, the Act on Social Insurance also enables voluntary pension insurance participation.

Pillar I is a typical PAYG point scheme with a certain income solidarity element. The old-age pension of the insured person depends on three parameters:

1. The insurance period, that is, the number of insured years with active contribution;
2. The average personal wage point, determined as the ratio of the sum of personal wage points calculated for each calendar year of the reference period and the period of pension insurance in the relevant period; and
3. The value of the pension point, that is, the monetary value of one personal wage point. The pension value is adjusted on 1 of January each year through indexation, which is determined as the ratio of the average wage calculated in the third quarter of the previous calendar year and the average wage calculated in the third quarter of the calendar year two years preceding the calendar year on which the pension value is calculated. The value is annually defined by the Slovak Government to mimic the increase in the average salary in Slovakia.

Statutory retirement age is 63 years in 2022, valid for both men and women. For women, the retirement age might be lowered depending on the number of raised children. For each raised child the retirement age is lowered by 6 months up to three children. For the birth years 1968 and younger, a new pension reform in 2022 re-introduced the retirement age tied to the life expectancy.

To illustrate the calculation of an old-age pension, let us assume an individual who reached the statutory retirement age of 63 years in 2022 and has following characteristics:

1. Number of insured years (N) = 42 (full working career);
2. Average personal wage point (APWP) = 1 (for the entire working career, an individual has been earning on average 100% of average salary in Slovakia)

3. Value of pension unit (VPU) = €151 300 (for persons retiring in the year 2022).

The old-age pension is then calculated using the following formula: N $\times$ APWP $\times$ VPU. Therefore, considering the above-mentioned individual parameters of a person claiming old-age pension, he/she will be entitled to a monthly pension equal to: $42 \times 1 \times$ €151 300 $=$ €635. If an individual has earned on average 100% of an average salary during their entire working career and the average salary in 2022 was €1 304, then the gross individual replacement ratio of such an individual would be: €635 / €1 304 $=$ 48.70%.

Pillar II - Funded pensions

The Slovak Pillar II was established as a DC pension saving scheme in 2005. The principle of funded pension is based on the accumulation of savings during employment and investing savings in financial markets via special purpose vehicles—pension funds, which are managed and administrated by Pension Assets Management Companies (PAMCs), licensed by the National Bank of Slovakia.

During the period from September 2012 until May 2022, the enrolment was voluntary and eligible for persons up to 35 years of age. Since May 2022, the automatic enrolment with opt-out option is applied for all workers under the 40 years entering the labour market for the first time. In general, pension fund members (Pillar II savers) are free to choose pension funds provided by the same PAMC. Each saver has an IRA. Their contributions (savings) are redirected from the Social Insurance Company to the chosen Supplementary Pension Assets Management Company (SPAMC) on their IRA at a rate of 5.5% of gross salary in 2022. The contributions increase by 0.25% biennially until they reach the final level of 6% in 2027.

With the possibility to save in one or two pension funds at the same time, it is completely up to a saver how much of their own savings would be invested in one pension fund or another. They can invest, for example, 70% in a Bond guaranteed pension fund and another part (30%) in an Index non-guaranteed pension fund. There is no fee or charge to change ttheir allocation ratio or switch pension funds managed by the same PAMC—even on a daily basis. Switching providers (PAMCs) for free is possible for savers if the change is made after one year, otherwise a fee of €16 is applied.

Pillar III - Supplementary pensions

The Supplementary pension is a voluntary funded DC-based pension saving scheme in which the funds of the participants are administered by SPAMCs. The SPAMCs are private joint stock companies established under the Slovak law and able to only provide services tied to the management of supplementary pension funds. SPAMCs and their supplementary pension funds are supervised and regulated by the National Bank of Slovakia.

The purpose of supplementary pension saving is to allow participants to obtain supplementary pension income in old-age and the whole Pillar is mostly oriented towards employers and their employees. However, the coverage ratio is rather low (29% in 2022).

Both employers and employees can contribute to the individual retirement account with no limits. The following benefits are paid from the supplementary pension saving upon the completion of the saving period:

- supplementary old-age pension in the form of lifelong or temporary supplementary annuity;
- supplementary pension in the form of programmed withdrawal;
- lump-sum settlement;
- redundancy pay.

The year 2022 has brought major pension reform with the objective to financially stabilize the Pillar I and support the funded pension schemes – Pillar II and Pillar III. Key changes in the Slovak pension system in 2022 included:

1. First pillar (state pensions)
    - Flexible statutory retirement age tied to the life-expectancy (longer working career) for people born after 1967;
    - Early retirement (2 years before statutory retirement age or after 40 working years regardless the age) = risk of losing employees (lowered fine for early retirement 3,6% annually) effective since January 2023;
    - Reduced pension point increase (0,95 $\times$ average wage increase) $=$ lower replacement rates in future, effective since January 2023;
    - Introduction of parental bonus (1,5% of child's wage, maximum 1,2 $\times$ average wage) effective since January 2023;
2. Second pillar (funded DC scheme)
    - Decreased fees (removing the performance fee 10% of new highs and 0,4% p.a. of accumulated savings + 1,25% of new contributions), effective since January 2023;
    - Predefined saving strategy (life-cycle strategy with glide path starting at 50 years, 4% annually equity share decrease), effective since May 2023;
    - Automatic enrolment for the new workers entering labour market, effective since May 2023;
    - Major changes in payout phase (programmed withdrawal for the first half of life expectancy and annuity for the remaining life expectancy)—one-off withdrawal possible for above average earners, effective since January 2025;
3. Third pillar and PEPP (voluntary occupational and personal pensions)
    - Introduction of PEPP legislature (tax benefits for employee contributions similar to the III. pillar, no tax benefits for employer's contributions, more relaxed payout phase compared to the III. pillar, 5 years of programmed withdrawal or up to statutory age + 5 years), effective since January 2022;
    - Decreased fees for III. pillar (max 1% p.a. of accumulated savings), effective since January 2023.]

Table SK.3 – Overview of the Slovakian pension system

Social Insurance Company	National Bank of Slovakia	
Pillar I	**Pillar II**	**Pillar III**
State pension	Funded pension	Voluntary pension
Mandatory	Mandatory	Voluntary
State management	Pension Assets Management Companies (PAMCs)	Supplementary Pension Assets Management Companies (SPAMCs)
PAYG	Funded	Funded
DB Point scheme	DC Individual personal pension accounts	DC Individual personal pension accounts
Retirement Age: 63 years and tied to the increase in life expectancy	Withdrawal allowed if Pillar I pension is granted	Individual as well as employer can contribute with no limits (indirect fiscal support provided for the individual as well as employer)
Early retirement possible after 40 years of service or 2 years before retirement age	Withdrawal options: phased withdrawal for the first half of life expectancy + single annuity for the second half (since 2025); lump-sum if the Pillar I pension is higher than average pension	Withdrawal options: lifetime annuity; phased withdrawal for minimum of 10 years; lump-sum if the value of savings is less than 4-times the average wage; combination of phased withdrawal and annuity
Contributions: 18% (if participating only in Pillar I) or 12,5% (if participating in Pillar I and Pillar II)	Contributions: 5.5% in 2022 - 2024; 5.75% in 2025 - 2026; 6% afterwards (derived from the paid social insurance contributions)	
Quick facts		
Number of old-age pensioners: 1.1 mil. Coverage (active population): 2.75 mil.	Administrators: 5	Administrators: 4
Average old-age pension: €516	Funds: 17	Funds: 19
Average salary (gross): €1304	AuM €11 754 bln.	AuM €2.93 bln.
Average replacement ratio: 39.78 %	Participants: 1.7 mil.	Participants: 0.9 mil.

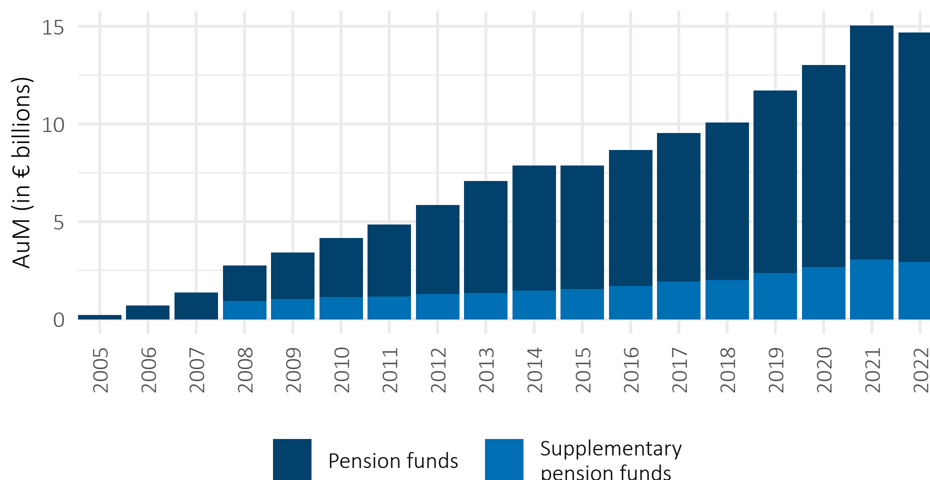
Source: Social Insurance Company, 2023, https://www.socpoist.sk/sp-transparentne/statistiky.

Long-term and pension savings vehicles in Slovakia

There are five providers—PAMCs—operating on the Pillar II (funded pension) market. According to the AuM measure, the two biggest providers, Allianz and UNIQA, represent nearly 55.16% of the market.

There are four providers—SPAMCs—operating on the Pillar III market. According to Assets under management, the two biggest, NN and DDS Tatra banky, represent nearly 70.98% of the whole market.

Figure SK.1 – AuM of Slovakian long-term and pension savings vehicles



Data: oranzovaobalka.sk, 2023; *Calculations:* BETTER FINANCE; *Note:* data as of December 31, 2022.

Second pillar: Pension funds

The Pillar II market is fairly concentrated. Each saver can choose one out of six currently existing providers (PAMCs) on the Slovak market. The PAMCs are private joint-stock companies with a minimum capital requirement of €10 million and established in the territory of the Slovak Republic. Their exclusive business is the creation and administration of pension funds. As a further condition, they must attain at least 50 000 members within a period of 18 months from the establishment of the pension fund.

According to the applicable law (the Act on Old-Age Saving), each PAMC is obligated to operate at least two pension funds. We can divide these pension funds into two main groups:

1. Bond guaranteed pension fund (Guaranteed scheme);
2. Equity non-guaranteed pension fund (Non-guaranteed scheme).

Each PAMC is free to choose (mostly based on their business model) whether it operates additional pension funds, which are optional. These legislative changes entered into force on April 30, 2013. Before date, each PAMC had to operate three (respectively four) obligatory pension funds:

1. Bond (Conservative) pension fund (since March 2005);
2. Mixed (Balanced) pension fund (since March 2005);
3. Equity (Growth) pension fund (since March 2005);
4. Index pension fund (since April 2012).

After the legislative changes became effective in May 2013, mixed and index pension funds became optional, and some of PAMCs merged these pension funds with obligatory Equity non-guaranteed pension funds. It is important to say that the first three categories of pension funds are (from an asset management point of view) actively managed pension funds, and Index pension funds are the only funds managed entirely passively. However, changes in the fee policy (strictly regulated) forced providers to change the investment strategy of pension funds towards being passively managed using mostly ETFs as main financial instruments.

PAMCs are subject to a variety of regulations. The Old-age Pension Savings Act defines the range of allowed investment instruments and sets maximum limits for portfolio allocations (quantitative limits). Investment procedures and valuation of investments (daily at market prices) are also regulated. Thus, each category of pension funds has their own investment strategy, as well as general or special quantitative limits and operating conditions. PAMCs and managed pension funds are supervised by the National Bank of Slovakia.

The year 2019 brought an introduction of Pension Benefit Statement with pension benefits projections also into the II. pillar. The providers are obliged to send the pension benefit statements to all savers since January 2021.

The reform of the pay-out phase, introduced in 2022 and effective from 2025, stipulates the following pay-out phase rules:

1. Half of the savings have to be used to buy programmed withdrawals lasting half of the life expectancy of the retiring person;
2. The second half of the savings is invested using the predefined investment strategy and used to buy the single nominal annuity once the retired person survives to the age expected in the first point.
3. Programmed withdrawal (phased withdrawal) with no limitations if the retired persons benefits are higher than the average pension benefits;
4. Perpetuity (withdrawal of only annual returns).

Products 1, 2 and 3 are provided by insurance companies, products 4 and 5 by PAMCs.

Market structure of providers and pension funds shows the dominant role of 3 players and one pension product—bond pension funds.

Table SK.5 presents the market share of Pillar II pension funds according to their dominant investment strategy and asset allocation. The dominant part of savings is allocated into bond pension funds that invest conservatively.

Table SK.4 – **Pension Assets Management Companies market shares (Pillar II)**

PAMC	Assets under management (in € million)	Market share based on AuM
Allianz – Slovenska	3 408.21	29.00%
UNIQA (AXA before 2021)	3 075.31	26.16%
DSS Postovej banky	556.13	4.73%
NN (ING before 2015)	2 499.27	21.26%
VUB - Generali	2 215.02	18.84%
TOTAL	*11 753.94*	*100.00%*

Data: oranzovaobalka.sk, 2023 (data as of December 31, 2022.

Table SK.5 – **Pillar II market share by group of pension funds**

Scheme	Type of voluntary pension fund	Assets under management (in millions €)	Market share based on AuM
Guaranteed PFs	Bond guaranteed pension funds (5) - obligatory	6 939.40	59.04%
Nonguaranteed PFs	Mixed nonguaranteed pension funds (2) - optional	143.02	1.22%
	Equity nonguaranteed pension funds (5) - obligatory	1 739.65	14.80%
	Index nonguaranteed pension funds (5) - optional	2 931.88	24.94%
TOTAL	*17 Pension funds*	*11 753.94*	*100.00%*

Data: oranzovaobalka.sk, 2023 (data as of December 31, 2022.

The increase in AuM was caused mainly by the stabilization of the market and higher returns of Index pension funds. We see increased number of savers, who mix two funds on their individual retirement savings accounts.

However, the structure of investments does not match the age profile of Slovak savers and thus increases the risk of lower replacement ratio for most of the savers in the future. After the Governmental intervention in 2013, the number of savers in equity pension funds has dropped significantly. Currently, still almost 60% of all savings in Pillar II are allocated into the Bond guaranteed pension funds and it does not correspond to the age profile of savers. This fact might cause more problems and increase the political risk in the future, as many savers still believe that they save in equity pension funds.

The reform in 2022 introduced the predefined investment strategy for all non-active savers who made no active choice during May 2013 and January 2023. Starting July 2023, the portfolio of these savers should be gradually re-allocated to the index pension funds (100% until the age of 50 years and then adopting the glide path of 4% annually from index funds into bond pension

funds).

Asset allocation of Pillar II pension funds is regulated by law (Act on Old-Age Saving), laying down the general quantitative investment limits on all pension funds – for example:

- max. 3% of AuM into one financial instrument (does not apply on bond investments or in case of passively managed pension funds);
- max. 10% of AuM into one UCITS fund;
- max. 15% of the whole pension fund portfolio into one issuer (does not apply on bond investments or in case of passive managed pension funds);
- bond investments must have investment grade rating (does not apply in case of passively managed pension funds).

Pillar II savers can choose from two main types of obligatory and two types of optional voluntary pension funds.

Obligatory - Bond guaranteed pension funds are actively managed pension funds and are obliged to invest 100% of the assets into bonds, money market instruments, deposits, investment funds in which assets must be invested in the above securities and deposits and other similar assets. Bond guaranteed pension funds are not allowed to invest in equities and real estate, nor respective investment funds. This conservative strategy focuses on bonds, and its objective is the preservation of capital and moderate growth primarily on shorter horizons. Bond guaranteed pension funds are obliged to hedge at least 95% of the whole portfolio against currency exposure. That means that if the pension fund allocates the assets into the financial instruments that are denominated in a currency other than Euro, fund managers must open the position (usually swaps or other hedging instrument) that fixes the value of such investment in Euro.

Obligatory - Equity non-guaranteed pension funds are actively managed pension funds and proceed in investing in different types of assets from the objective under quantitative limits:

- up to 80% of the assets of the funds can be invested in equities, equity funds and other instruments similar to equity;
- at least 20% of the whole portfolio has to be hedged against currency risks;
- max. 20% of the whole portfolio can be invested in precious metals.

Optional – Mixed non-guaranteed pension funds are actively managed pension funds and they invest in different types of assets, according to their objective and under general quantitative limits. There are no specific limitations applicable.

Optional – Index non-guaranteed pension funds, introduced in April 2012, are the only passively managed pension funds in Slovak pillar II. There are no general nor specific quantitative limits, because of the nature of investing. Slovak Index non-guaranteed pension funds track respective stock market benchmarks (such as MSCI World, Eurostoxx 50, MSCI ACWI, MSCI Euro).

Third pillar: Supplementary pension funds

Currently, there are four providers (SPAMCs) operating on the market, which could be considered concentrated. Each SPAMC is obliged by law to operate at least one contributory and one "pay-out" supplementary pension fund. The legislation does not determine specific types of contributory pension funds; however, we can divide all existing contributory pension funds according to the portfolio structure into three main groups:

- Conservative supplementary pension funds (no equity investments);
- Balanced supplementary pension funds (small portions of equity investments);
- Growth supplementary pension funds (highest portions of equity investments).

Company "NN" and later on "Axa (UNIQA since January 2021)" have launched the first passively managed equity fund within the Pillar III. There are no specific investment restrictions regarding asset classes in supplementary pension funds, but there are some general quantitative limits to restrict the concentration risk of the fund.

DDS Tatra banky has introduced target date funds (TDFs) in 2015, with the aim to provide age specific investment strategy for its members saving for retirement.

Table SK.6 – **Supplementary Pension Assets Management Companies market shares (Pillar III)**

Supplementary Pension Company	Assets under management (in millions €)	Market share based on AuM
DDS Tatra banky	964.60	32.95%
UNIQA (AXA before 2021)	445.16	15.21%
NN	1 113.20	38.03%
STABILITA	404.46	13.82%
TOTAL	*2 927.42*	*100.00%*

Data: oranzovaobalka.sk, 2023 (data as of December 31, 2022.

For supplementary pension funds, there are no special investment restrictions regarding asset classes, but there are some general quantitative limits, i.e. no more than:

- max. 5% of AuM in one financial instrument;
- max. 30% of AuM in securities and money market financial instruments from one issuer (does not apply to instruments issued by the EU Member States);
- max. 35% of AuM in securities and money market financial instruments issued by the EU Member State, the EU, ECB, IMF or World bank;
- max. 20% of AuM in one standard mutual fund (UCITS-compliant);
- max. 10% of AuM in one AIF;
- max. 40% of AuM in mutual funds.

Table SK.7 – Supplementary vehicles' market share by group of pension funds

Type	Supplementary pension vehicles	Assets under management (in millions €)	Market share based on AuM
Contributory	Conservative supplementary pension funds (4)	774.83	26.47%
	Balanced supplementary pension funds (2)	1 018.77	34.81%
	Growth supplementary pension funds (9)	1 017.17	34.75%
PAY-OUT	Pay-out supplementary pension funds (4)	116.17	3.97%
TOTAL	*19 Pension funds*	*2 927.41*	*100.00%*

Data: oranzovaobalka.sk, 2023 (data as of December 31, 2022.

In general, the Pillar III scheme covers less than 29% of economically active population, while only 70% of them actively contribute to the scheme. At the same, most of the retirement savings are directed into balanced supplementary pension funds, which apply rather conservative investment strategy with limited long-term investments.

Charges

Pension products for both pillars have seen continual decrease in costs and charges over the period of their existence. However, it is obvious that both pillars do have different fee structures that reflects the features of the pillars and duties of the asset managers and administrators.

The year 2022 has brought significant fee structure changes for Pillar II products where two fees has been abandoned (entry fee as well as performance fee) and the administration fee has been slightly increased. Pillar III products have also seen some changes in fee policy as the law required the providers to continually decrease the asset management fee towards the 1% cap within 4 years.

Charges of pension funds (Pillar II)

Charges are highly regulated and capped in the Pillar II scheme by the Old-Age Pension Saving Act. In 2022, PAMCs can apply the following types of charges at the expense of the pension funds:

- Management fee (as percentage of NAV in respective pension fund);
- Performance fee charged as percentage of new highs reached in performance of respective pension fund – High Water Mark (HWM) principle (Slovak legislation defines the HWM method for calculating the success fee as a comparison of new highs of respective pension fund to its historical performance achieved within last 3 years. If today's closing price is higher than historical highs achieved within last 3 years, the provider has the right to charge 10% success fee from the difference between today's pension unit price and high-

est historical price. If the difference is negative no success fee can be charged.);

- Administration fee – Administration of Personal pension account (as percentage of new contributions);
- Depository fee (as percentage of NAV in the respective pension fund); and
- Other charges (mostly trading charges).

It must be mentioned that on top of these charges, each saver in Slovak Pillar II also has to pay an Administration fee to the Social Insurance Company that administers the central collection system, central information, and offering system for annuities. The Social Insurance Company collects the social security contributions and transfers part of savers' contributions to their personal pension account managed by the PAMC.

Table SK.8 compares applied charges for Pillar II pension funds and the evolution of fee policy over the analysed period.]

Table SK.8 – **Costs and charges of Slovakian pension funds (% of assets unless otherwise specified)**

Year	Entry fees*	Admin. and mgt. fees	Other ongoing fees	Performance fees†
2005	1.50%	0.80%	0.04%	5.60%
2006	1.50%	0.80%	0.04%	5.60%
2007	1.50%	0.80%	0.04%	5.60%
2008	1.50%	0.80%	0.04%	5.60%
2009	1.50%	0.80%	0.04%	5.60%
2010	1.50%	0.80%	0.04%	5.60%
2011	1.50%	0.80%	0.04%	5.60%
2012	1.50%	0.80%	0.04%	5.60%
2013	1.25%	0.30%	0.04%	10.00%
2014	1.25%	0.30%	0.04%	10.00%
2015	1.25%	0.30%	0.04%	10.00%
2016	1.25%	0.30%	0.04%	10.00%
2017	1.25%	0.30%	0.04%	10.00%
2018	1.25%	0.30%	0.04%	10.00%
2019	1.25%	0.30%	0.04%	10.00%
2020	1.25%	0.30%	0.04%	10.00%
2021	1.25%	0.30%	0.04%	10.00%
2022	1.25%	0.30%	0.04%	10.00%

Data: Own research; *Note:* data as of December 31, 2022.
* % of contributions † % of overperformance

Charges of supplementary pension funds (Pillar III)

Charges in Pillar III are capped by law. Supplementary Pension Fund Management Companies are (since 1 January 2014) allowed to apply the following types of charges:

- Management fee (as percentage of AuM in a respective supplementary pension fund),

- Performance fee (as percentage of new highs reached in performance of a respective supplementary pension fund – HWM),
- Depository fee (as percentage of AuM in a respective pension fund),
- Other charges (Switching fee).

Table SK.9 compares charges applied in the Pillar III.

Table SK.9 – **Costs and charges of Slovakian supplementary pension funds (% of assets unless otherwise specified)**

Year	Admin. and mgt. fees	Other ongoing fees	Performance fees†
2009	2.50%	0.04%	10.00%
2010	2.50%	0.04%	10.00%
2011	2.50%	0.04%	10.00%
2012	2.50%	0.04%	11.00%
2013	2.40%	0.04%	12.00%
2014	2.30%	0.04%	13.00%
2015	1.80%	0.04%	10.00%
2016	1.70%	0.04%	10.00%
2017	1.60%	0.04%	10.00%
2018	1.50%	0.04%	10.00%
2019	1.40%	0.04%	10.00%
2020	1.30%	0.04%	10.00%
2021	1.20%	0.04%	10.00%
2022	1.20%	0.04%	10.00%

Data: Own research based on Supplementary pension saving Act; *Note:* data as of December 31, 2022. † % of overperformance

It should be noted that the pension reform in 2022 has changed the fee structure and reduced the overall cost ratio starting the year 2023.

Taxation

The Act on Income Tax recognizes two different of income tax rates in Slovakia that apply to pension saving schemes.

Personal income tax rate has been set at 19% since 2005. Since 2013, there is higher tax rate of 25% for higher earners, whose monthly income in 2022 was higher than €3 212.75 (around 7% of working population in 2022).

Corporate income tax rate for 2021 was 21%.

Pillar II

Pillar II should be viewed as a 1bis pension pillar that is basically a derivative of the basic old-age security scheme, as a part (5.25% in 2021) of the overall (18%) old-age social insurance contributions are diverted from a PAYG pillar into funded DC scheme. Understanding this principle, Pillar

Table SK.10 – Taxation of pension savings in Slovakia

Product	Phase			Regime
	Contributions	*Investment returns*	*Payouts*	
Pension funds	Exempted	Exempted	Exempted	EEE
Supplementary pension funds	Exempted	Exempted	Taxed	EET

Data: Own elaboration, 2023.

II taxation is similar to the PAYG pillar, meaning that an "EEE" taxation regime is applied.

Taxation of contributions

Contributions paid to Pillar II are tax deductible. However, a saver can add voluntary contributions on top of the 5.25% contributions redirected from PAYG pillar. Since 2017, voluntary contributions on top of redirected social insurance contributions are subject to the personal income tax (19%) as well as social and health insurance. Thus, the "T" regime applies for voluntary contributions.

Taxation of the Fund

Fund returns are not subject to Slovak income taxes at the fund level.

Taxation of pay-out phase income

Income generated via purchased pillar II pay-out phase products (annuity, perpetuity, programmed withdrawal) are not subject to personal income tax. In case of heritage, the amount the successor receives as inherited (accumulated) savings is not subject to personal income tax.

Thus, we can say that for Pillar II the "EEE" taxation regime applies in general. However, for voluntary contributions, the "TEE" regime applies.

Pillar III

Taxation of Pillar III differs from the Pillar II taxation approach significantly. There are different taxation treatments of contributions as well as different treatments of the pay-out phase. It is rather difficult to generalize the regime. However, the "EET" regime can be used with several exceptions and specifications.

Taxation of contributions

When considering the taxation treatment of contributions, a slightly different regime is used for savers' (employees') contributions and a different regime for employer's contributions.

Generally, both contributions are income-tax deductible; however, for employees (savers) there is a ceiling of €180 per year. This means that the monthly contributions to the Pillar III supplementary pension fund up to €15 are income tax base deductible. Above this amount, the contributions made to the individual saving account are subject to personal income tax. Consid-

ering that the average salary (€1 304 in 2022), employee contributions up to 1.15% of the gross average salary can be deducted from the personal income tax base.

Employer contributions are treated in a slightly different way. Contributions are tied to the monthly salary of employees. Employer's contributions up to 6% of monthly salary are treated as tax expenses. Therefore, employers are motivated to contribute on behalf of employees up to this tax favourable ceiling. Taking into account the average salary in Slovakia, contributions up to €78.24 per employee per month are considered as tax expenses for contributing employers in 2022. Taking into account the poor supplementary pension funds' performance and the relatively high level of charges, favourable tax treatment of employer's contributions are the key drivers for the participants. At the same time, this favourable treatment of employer's contributions paid on behalf of its employees exclusively in the Pillar III scheme creates an administrative monopoly in form of preferred supplementary retirement product in Slovakia.

Taxation of the Fund returns

Fund returns are exempt from income taxes at the fund level.

Taxation of pay-out phase

There are three different types of products used for the Pillar III pay-out phase (according to the Act on Supplementary Pension Saving):

1. Lump-sum –- paid out through SPAMC at maximum of 50% of accumulated savings;

2. Annuities -– paid out through insurance company in form of a single annuity;

3. Phased (Programmed) withdrawal – paid out through SPAMC for at least 5 years.

There are 3 general conditions, where at least one should be met when entering the pay-out phase in order to achieve more favourable tax treatment of income stream from Pillar III savings. They concern the member's age, the entitlement for state retirement pension benefits or the entitlement for early state retirement pension benefits.

When considering the tax treatment of the pay-out phase income stream from the saver's point of view, there is a possible way to adjust the personal income tax base. The Act on Income Tax stipulates that the deduction from income tax base will be applied to the income stream from Pillar III benefits and life insurance contracts. Personal income tax base shall be lowered by the paid contributions (Pillar III) or paid premiums (life insurance contract). The Act on Income Tax also defines the income tax base adjustments in case of paid monthly benefits according to the following formulas:

- In the case of temporary annuity, the income tax base is calculated as positive balance between sum of already received benefits and sum of paid contributions;

- In the case of single annuity, the income tax base is calculated as paid monthly benefits and total paid contributions (or premium) divided by the number of remaining years calculated as life expectancy and the age of the taxpayer (beneficiary) at the moment of the first paid benefit.

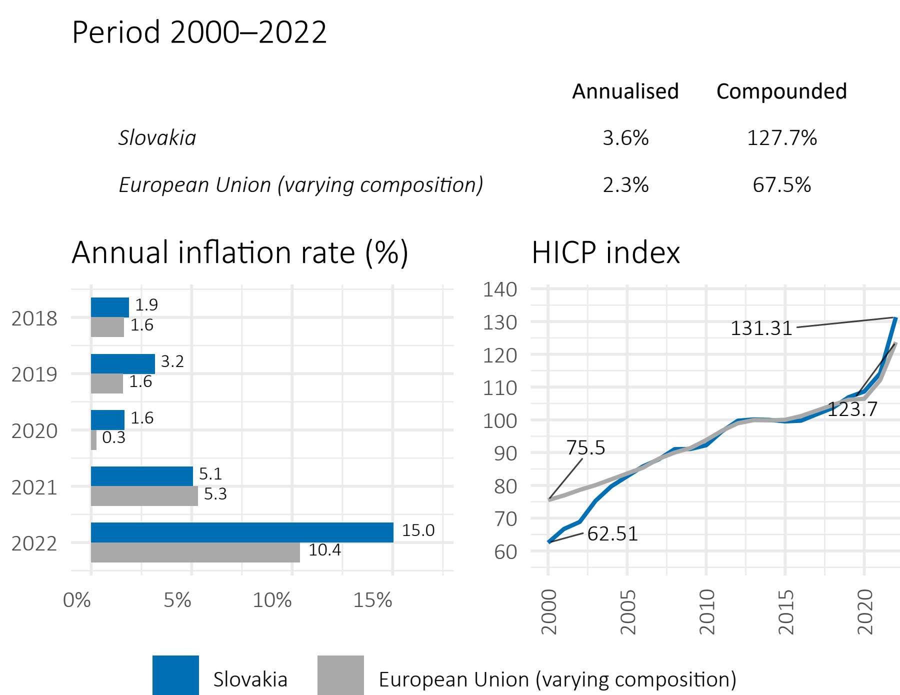
Therefore, we can conclude that the income tax treatment of pay-out phase is, in fact, a deferred taxation of investment returns applied not to the supplementary pension fund, but directly to the saver during the pay-out phase. In general, we can say, that the tax regime for Pillar III is "EET".

Performance of Slovakian long-term and pension savings

Real net returns of Slovakian long-term and pension savings

The year 2022 brought negative returns on both equity and bond markets for both pension pillars across all types of pension funds regardless the portfolio structure, which together with the high inflation have negatively influenced the performance of all pension funds.

Figure SK.2 – Inflation in Slovakia

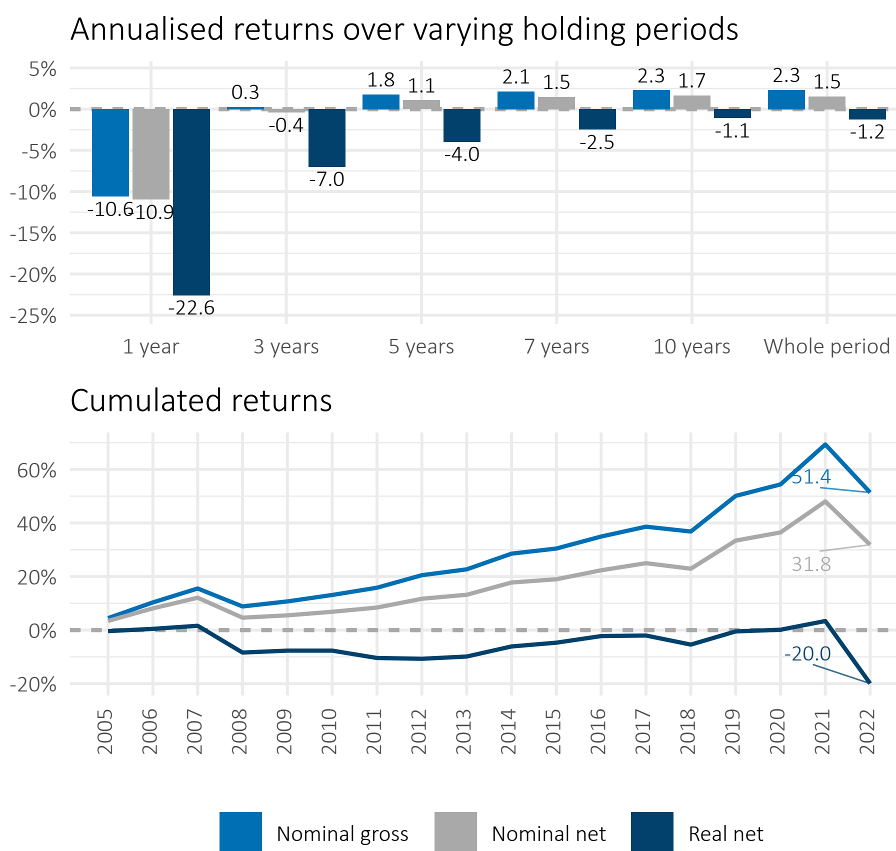

Period 2000–2022

	Annualised	Compounded
Slovakia	3.6%	127.7%
European Union (varying composition)	2.3%	67.5%

Data: Eurostat, HICP monthly index (2015 = 100); *Calculations:* BETTER FINANCE

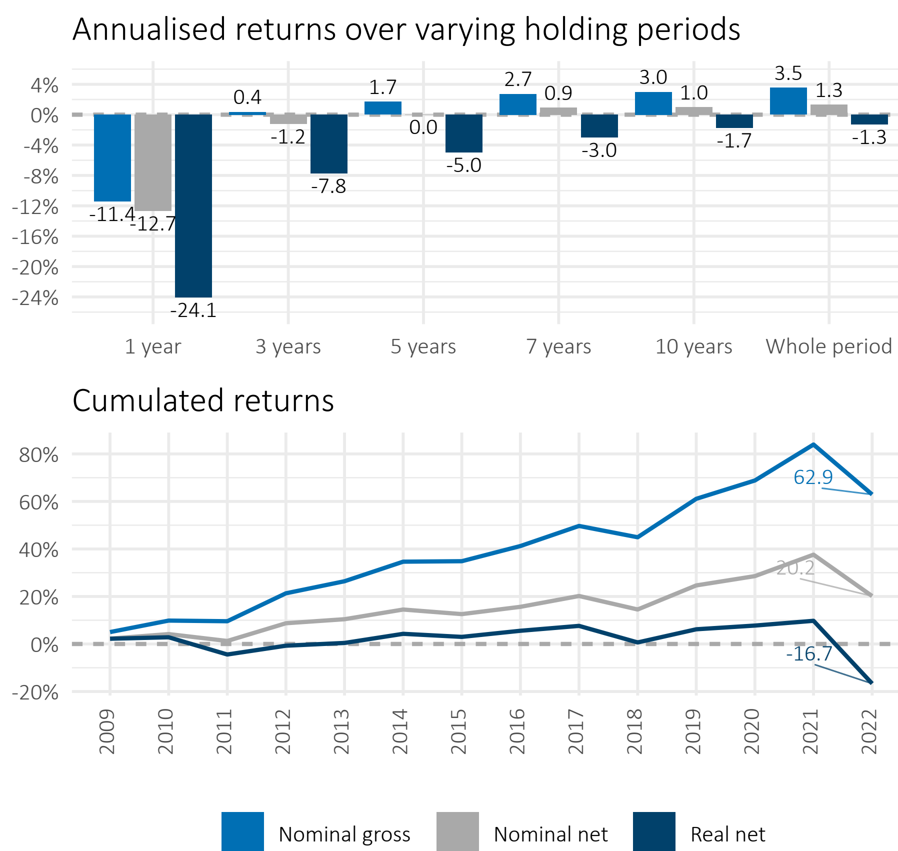
The performance (returns and respective volatility) differs in all types of pension funds. This is caused by the portfolio structure and different investment strategies. Bond guaranteed pension funds do not invest in equity investments. Mixed non-guaranteed pension funds invest a small portion in equity investments (currently less than 40% of AuM on average) and equity non-guaranteed pension funds invest higher portion in equity investments (currently more than 50% of AuM on average). Optional Index non-guaranteed pension funds possess the highest level of equity investments (nearly 100% of AuM), because their fully passive investment strategy focusing on the replication of benchmark (various equity market index) performance. The following figure presents the performance of Pillar II Pension Funds over various holding periods.

Figure SK.3 – Returns of Slovakian IORPs (before tax, % of AuM)



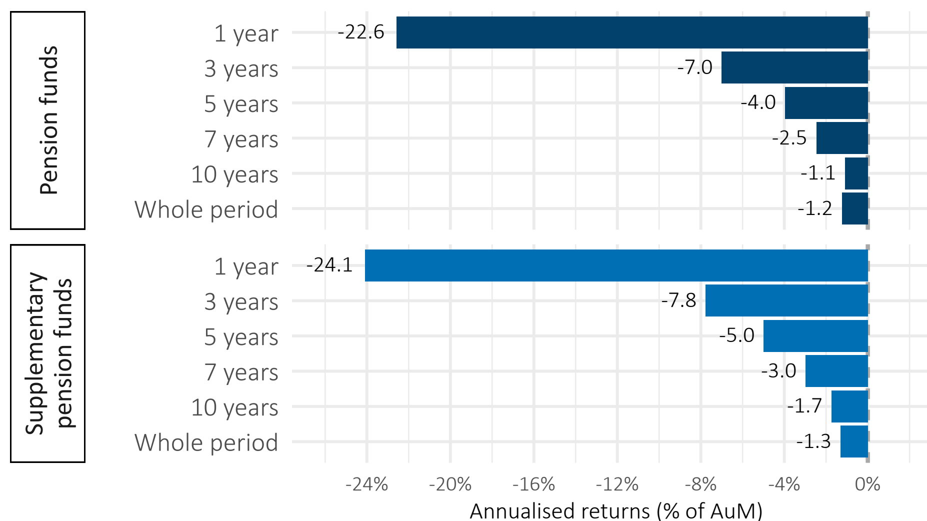
Data: Orange Envelope, 2023, Eurostat; *Calculations:* BETTER FINANCE.

Figure SK.4 – Returns of Slovakian pension savings products (before tax, % of AuM)



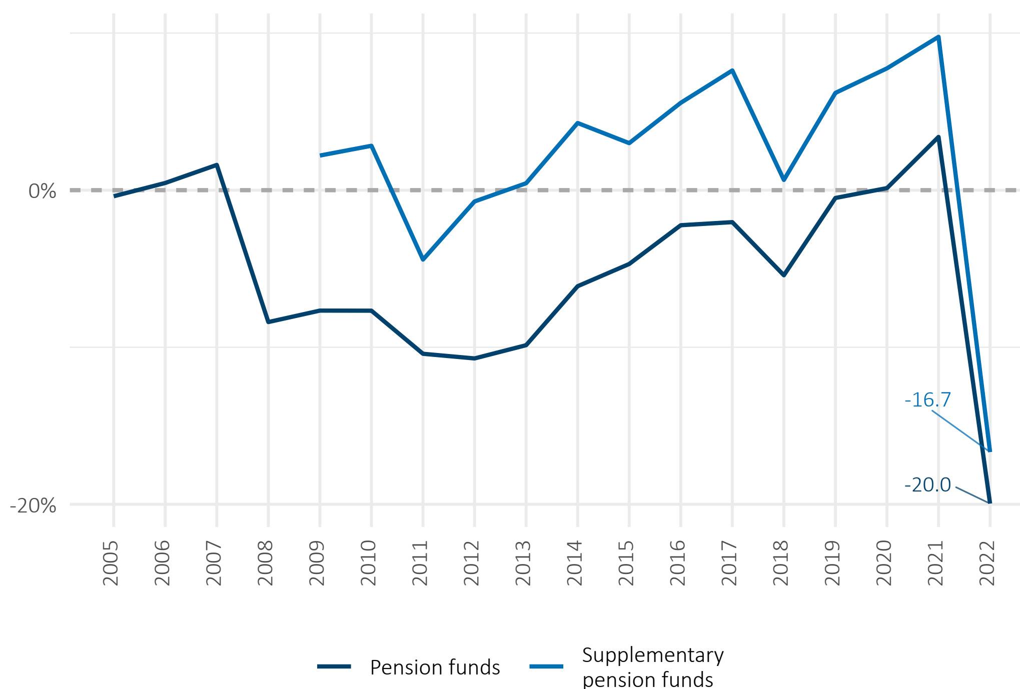
Data: Orange Envelope, 2023, Eurostat; *Calculations:* BETTER FINANCE.

Figure SK.5 – Annualised returns of Slovakian long-term and pension vehicles over varying holding periods (before tax, % of AuM)



Data: Orange Envelope, 2023, Eurostat; *Calculations:* BETTER FINANCE.

Figure SK.6 – Cumulated returns of Slovakian long-term and pension savings vehicles (2000–2022, before tax, % of AuM)



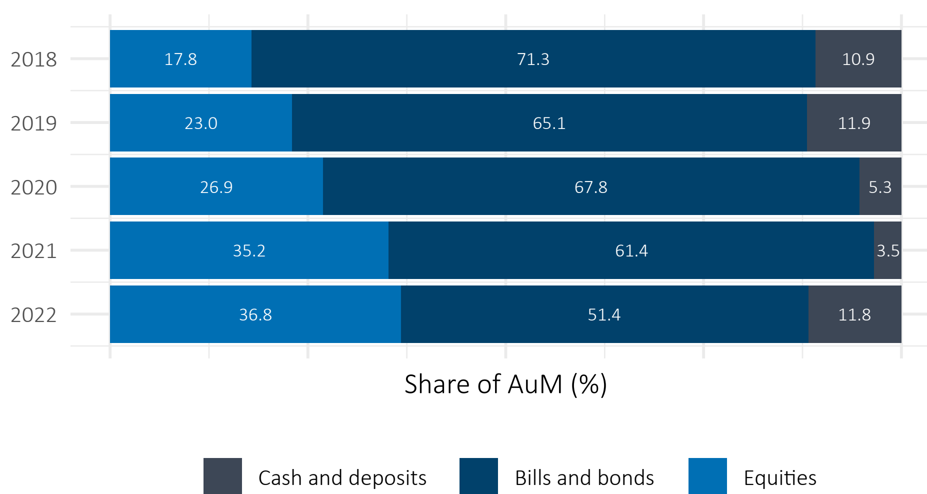
Data: Orange Envelope, 2023, Eurostat; *Calculations:* BETTER FINANCE.

Do Slovakian savings products beat capital markets?

Before comparing the performance of savings products against relevant market benchmarks, portfolio structure of pension products should be understood.

For pillar II pension funds, most of the savings have been invested into money market instruments and later in bond investments due to the legislative ruling and started to invest more into equities starting 2015 (see Figure SK.8).

Figure SK.7 – Global allocation of Slovakian pension funds' assets



Data: Orange Envelope, 2023, data as of December 31, 2022; *Calculations:* BETTER FINANCE.

Pillar III products have allocated savings into the equities and bonds, so the performance of the vehicles has been more volatile compared to the Pillar II pension funds. The portfolio structure of Pillar III Supplementary Pension funds is presented below.

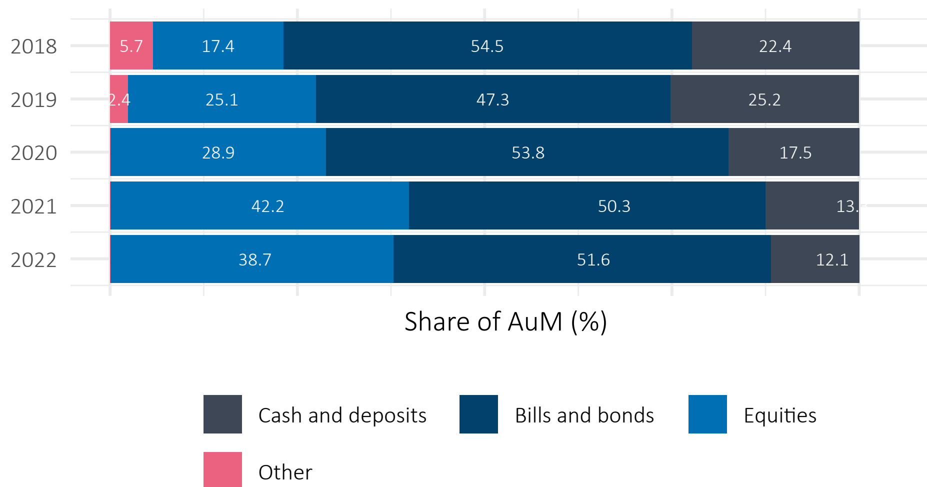
In order to compare the performance, we set the weight for two key classes (equities and bonds) based on the respective portfolio structures of pension vehicles in both pillars (see Table SK.11).

Table SK.11 – Capital market benchmarks to assess the performance of Slovakian pension vehicles

Product	Equity index	Bonds index	Allocation
Pension funds	STOXX All Europe Total Market	Barclays Pan-European Aggregate Index	10.0%–90.0%
Supplementary pension funds	STOXX All Europe Total Market	Barclays Pan-European Aggregate Index	25.0%–75.0%

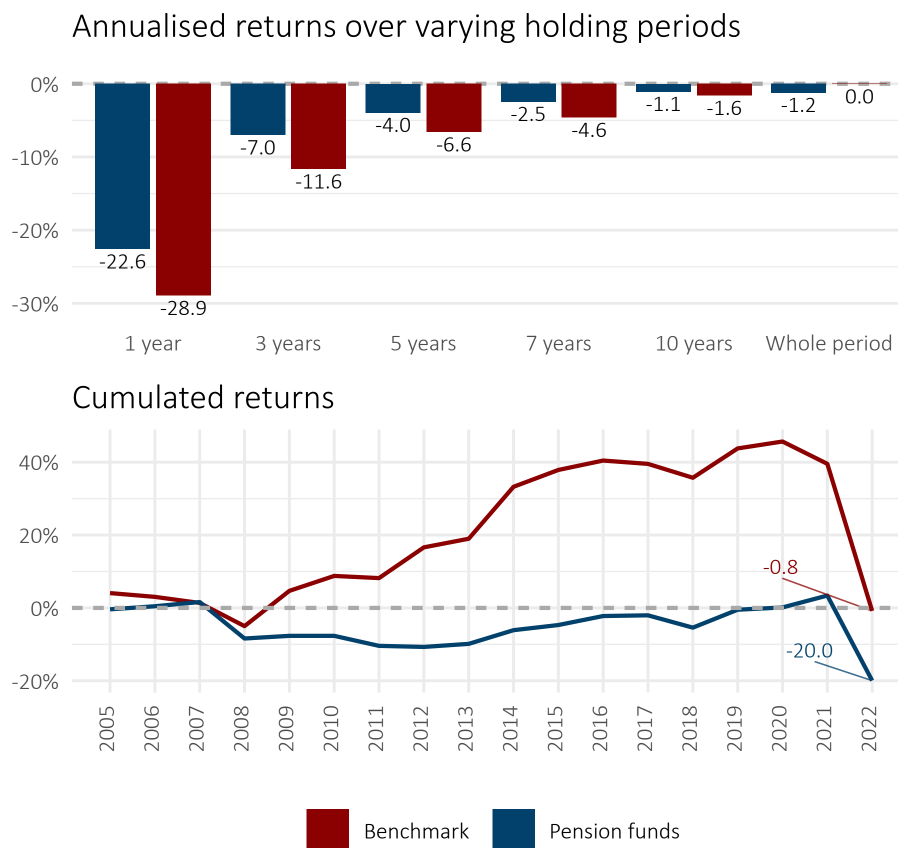
Note: Benchmark porfolios are rebalanced annually.

Figure SK.8 – Global allocation of Slovakian pension funds' assets



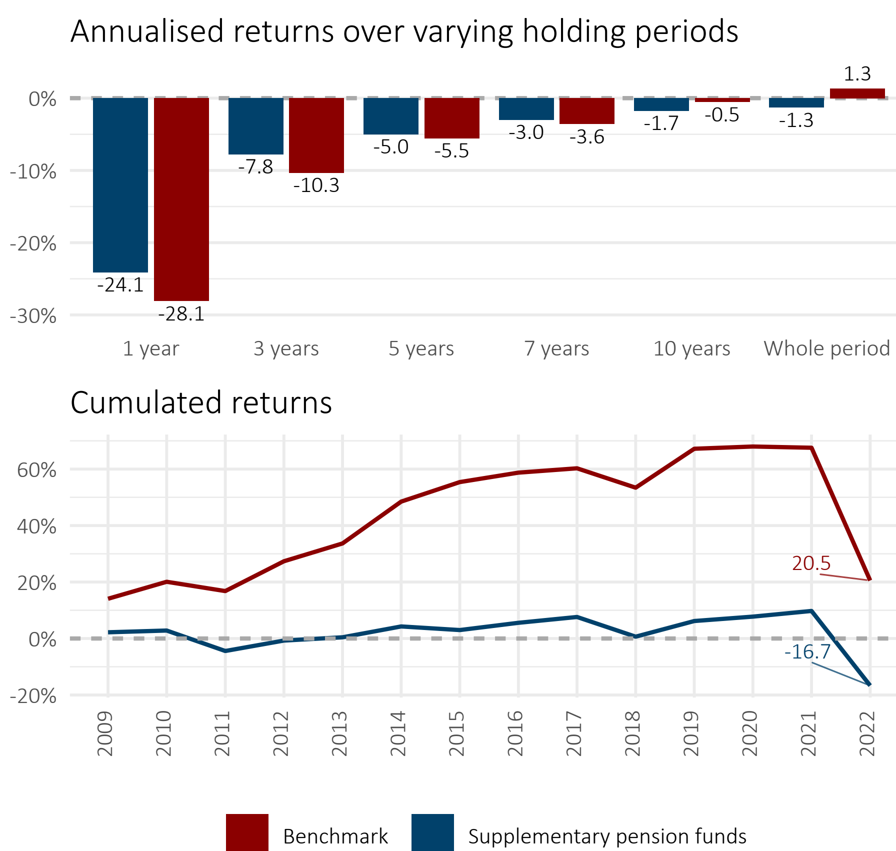
Data: Orange Envelope, 2023, data as of December 31, 2022; *Calculations:* BETTER FINANCE.

Figure SK.9 – Real performance of Slovakian Pillar II pension funds vs. capital markets (returns before tax, after inflation, % of AuM)



Data: Orange Envelope, 2023, Eurostat; *Calculations:* BETTER FINANCE.

Figure SK.10 – Real performance of Slovakian Pillar II pension funds vs. capital markets (returns before tax, after inflation, % of AuM)



Data: Orange Envelope, 2023, Eurostat; *Calculations:* BETTER FINANCE.

Conclusions

The Slovak multi-pillar pension system is not quite favourable for savers. Pillar II suffers from constant changes and significant political risk therefore not only arises from diverging political opinions on the pension system. The new phenomena in Slovak pension system is the pension populism, where political parties reverted stabilization features and decreased the financial stability and trustworthiness of the PAYG scheme. The year 2022 could be viewed as a year of major reform changes in Slovak pension pillar. However, it combines recommended positive changes (retirement age tied to the life expectancy, lowering fees for pension funds, introduction of predefined investment strategy) with the populistic features (new parental bonus, new early retirement rules, low state support for private savings).

The unprofessional move of transferring savers' assets from equity-based pension funds into bond ones in 2013 had detrimental effect on savings, which could lead to low pension pots and further political pressures on decreasing importance of private pension savings in Slovakia. The reform in 2022 with the introduction of predefined investment strategy for all inactive savers could improve the situation and expected pension benefits in future.

Pillar III pension vehicles are generally poorly performing, costly and without significant tax benefits for employees' contributions; Pillar III would never survive competition from Pillar II pension funds and typical investment funds. The debate on finding an appropriate regime for the Pillar III scheme is still ongoing, while there are several different views on how to make Pillar III more favourable for savers. Major governmental spending review in this area is expected to provide a clearer way forward.

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