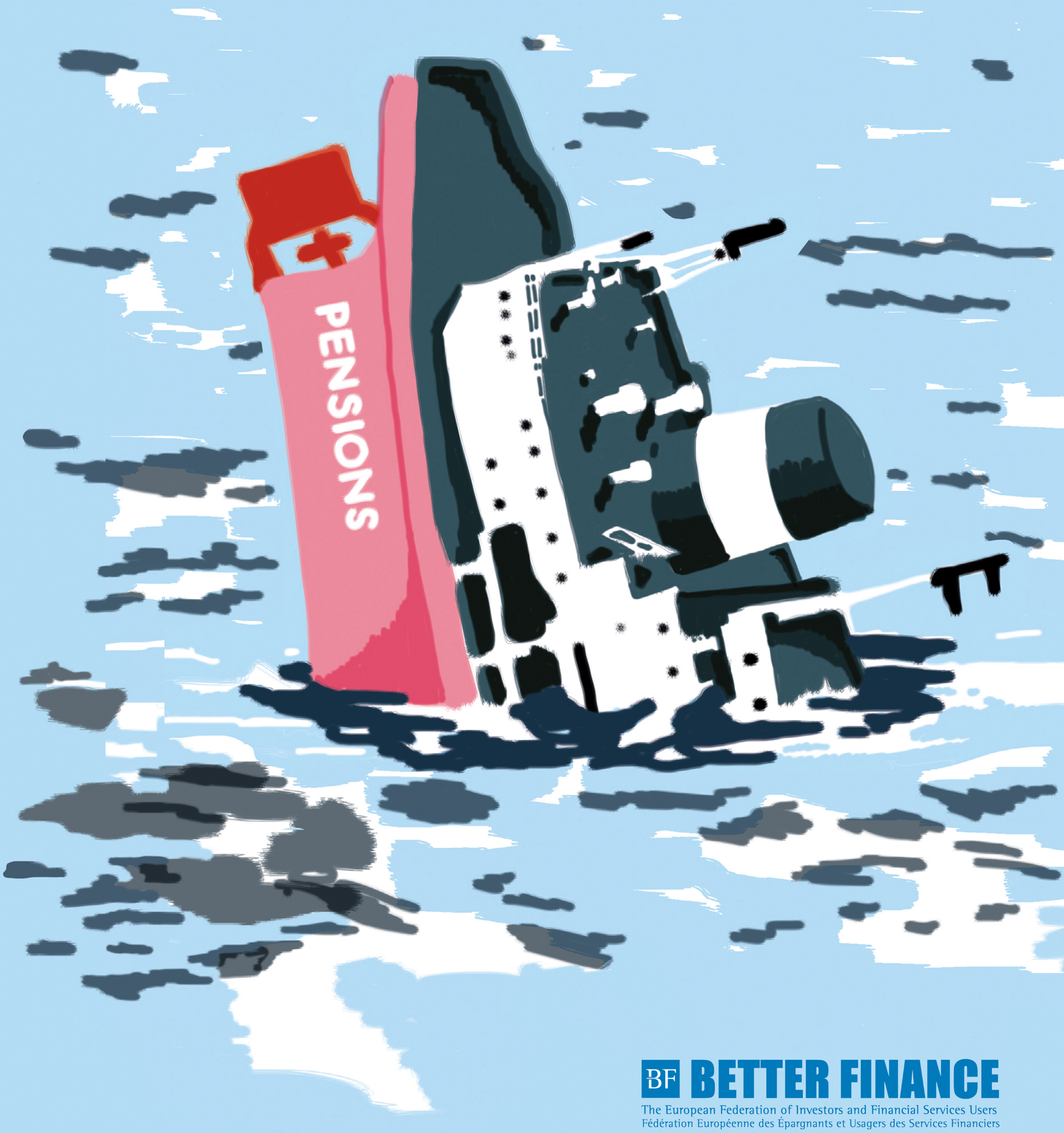
Long-Term and Pension Savings

The Real Return

2020 Edition



BETTER FINANCE

The European Federation of Investors and Financial Services Users
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Pension Savings: The Real Return
2020 Edition

A Research Report by BETTER FINANCE

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Acronyms

AIF	Alternative Investment Fund
AMC	Annual Management Charges
AuM	Assets under Management
BE	Belgium
BG	Bulgaria
Bln	Billion
BPETR	'Barclay's Pan-European High Yield Total Return' Index
CAC 40	'Cotation Assistée en Continu 40' Index
CMU	Capital Markets Union
DAX 30	'Deutsche Aktieindex 30' Index
DB	Defined Benefit plan
DC	Defined Contribution plan
DE	Germany
DG	Directorate General of the Commission of the European Union
DK	Denmark
DWP	United Kingdom's Governmental Agency Department for Work and Pensions
EBA	European Banking Authority
EE	Estonia
EEE	Exempt-Exempt-Exempt Regime
EET	Exempt-Exempt-Tax Regime
ETF	Exchange-Traded Fund
EIOPA	European Insurance and Occupational Pensions Authority
ES	Spain
ESAs	European Supervisory Authorities
ESMA	European Securities and Markets Authority
EU	European Union
EURIBOR	Euro InterBank Offered Rate
EX	Executive Summary
FR	France
FSMA	Financial Services and Market Authority (Belgium)
FSUG	Financial Services Users Group - European Commission's Expert Group
FTSE 100	The Financial Times Stock Exchange 100 Index
FW	Foreword
GDP	Gross Domestic Product
HICP	Harmonised Indices of Consumer Prices
IBEX 35	Índice Bursátil Español 35 Index
IKZE	'Indywidualne konto zabezpieczenia emerytalnego' – Polish specific Individual pension savings account
IRA	United States specific Individual Retirement Account

IT	Italy
JPM	J&P Morgan Indices
KIID	Key Investor Information Document
LV	Latvia
NAV	Net Asset Value
Mln	Million
MSCI	Morgan Stanley Capital International Indices
NL	Netherlands
OECD	The Organisation for Economic Co-Operation and Development
OFT	United Kingdom's Office for Fair Trading
PAYG	Pay-As-You-Go Principle
PIP	Italian specific 'Individual Investment Plan'
PL	Poland
PRIIP(s)	Packaged Retail and Insurance-Based Investment Products
RO	Romania
S&P	Standard & Poor Indexes
SE	Sweden
SK	Slovakia
SME	Small and Medium-sized Enterprise
SPIVA Scorecard	Standard & Poor Dow Jones' Indices Research Report on Active Management performances
TEE	Tax-Exempt-Exempt Regime
TCR/TER	Total Cost Ratio/ Total Expense Ratio
UCITS	Undertakings for the Collective Investment of Transferable Securities
UK	United Kingdom

Pension Savings: The Real Return

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Country Case: Italy

Sommario

Il sistema pensionistico italiano attualmente ha una spesa pubblica del 16,2% del PIL. La riforma del sistema pensionistico italiano nel 2011 ha creato un forte regime per il primo pilastro (Pillar 1), con un rapporto di sostituzione del reddito prepensinistico netto del 92% per i lavoratori con retribuzione media in piena carriera nel 2018, uno dei più alti tra i paesi in esame in questo rapporto. Considerando anche il tasso di partecipazione relativamente basso delle famiglie italiane nel mercato dei capitali, l'incentivo a indirizzare il reddito disponibile verso il risparmio previdenziale privato o prodotti di investimento è basso. Ciò diventa evidente se si guarda alla percentuale del patrimonio dei fondi pensione italiani, pari al 10% del PIL, nonché al coefficiente di copertura del secondo pilastro del 20% e del terzo pilastro del 14,2% della forza lavoro.

Per quanto riguarda la performance, i fondi pensione contrattuali hanno reso mediamente l'1,4% annuo negli ultimi 20 anni (2000-2019). I fondi pensione aperti hanno restituito in media lo 0,3% annuo nello stesso periodo., PIP (Piani Individuali Pensionistici) con profitti ha registrato una media annua dell'1,4% negli ultimi 12 anni, mentre i PIP unit linked hanno registrato una media annua dello 0,98% nello stesso periodo. Tutti i rendimenti sono espressi al netto di oneri e inflazione.

Summary

The Italian Pension System currently has a public expenditure of 16.2% of GDP. The Italian pension system reform in 2011 created a strong Pillar I scheme, with a pension net pre-retirement income replacement ratio of 92% for full-career average-wage workers in 2018, one of the highest among the country cases under review in this Report. Considering also the relatively low participation rate of Italian households in capital markets, the incentive to direct available income to the private retirement savings or investment products is low. This becomes apparent when looking at the percentage of Italian pension funds' assets, of 10% of GDP, as well as the coverage ratio for Pillar II of 20% and Pillar III of 14.2% of the labor force.

With regards to performances, contractual pension funds returned 1.4% annually on average over the past 20 years (2000-2019). Open pension funds returned 0.3% annually on average over the same period. PIP (*Piani Individuali Pensionistici*) with-profits experienced 1.4% annually on average over the past 12 years, while PIP unit-linked experienced 0.98% annually on average over the same period. All returns are expressed net of charges and inflation.

Introduction

The Italian Pension System is divided into three pillars:

- Pillar I – the public (state) pension scheme;
- Pillar II – the occupational (mandatory) pension arrangements;
- Pillar III – the individual (voluntary) pension schemes.

Pillar I – State Pension

The Italian pension system used to be a Defined Benefit system. Since 1995, it is based on a Notional Defined Contribution system. The Italian state pension system went through intensive reforms. The year 1995 can be seen as a turning point, moving from a defined benefits system towards a defined contribution system. The Dini reform (law 335/1995) is one of the most important laws towards the restructuring of the Italian pension system. As a result, all workers entering the job market after 1995 have been accruing their pension entitlements according to a defined contributions method, while before 1995, pension entitlements were computed according to an earnings-related system.

The first pillar (state and mandatory) is the main pension vehicle in Italy and is made up of two tiers: the zero and first tiers. The zero tier consists of a social pension ensuring a minimum level of income for the elderly. The first tier covers employed individuals and it constitutes a notional defined contribution system for all future generations.[217]

Italy spent 16.2% of its GDP on public pensions, while the average of OECD countries was 8% in 2018[218]. This is the second highest level of all OECD countries. Pensions, therefore, represent a massive share of the GDP in the country. Italy faces a huge demographic challenge. The number of retirees, unemployed individuals or individuals outside of the labour force together constitute over 80% of the number of employed people (referred to the highest old-age dependency ratio in Europe, which reached 36.057%[219] in 2019).

In 2050, the population aged 65 years or more will represent 70% compared to the population aged 15-64, the highest percentage across developed countries - on equal footing with Japan.

Given this context, the urgency to reform the pension system was clear. In 2011, the minister of Welfare and Social Policy under the Monti Government, Elsa Fornero, implemented a state pension reform (law n.214) to bring the system closer to equilibrium. Under the new system, pension eligibility is based on working years rather than age. Earlier retirement is possible, but subject to penalties. The public pension system was thus sustainable. Nevertheless, the Italian Constitutional Court stated in April 2015 that the suppression of indexation of pensions on inflation included in the "Fornero law" was unconstitutional. The indexation of pensions on inflation will add unforeseen costs to the first pillar, estimated at €500 millions.

Since January 1st, 2019, a new measure was implemented, known as "Quota 100". It offers the opportunity for workers aged at least 62 with 38 years of contributions to retire earlier than the normal

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[217] Since the structural reform implemented by Minister Dini in 1995, the Italian pension system has been re-designed according to the Notional Defined Contribution system, in order to guarantee the stability of public finances.
[218] Pensions at glance 2019: Country profiles - Italy
[219] https://data.worldbank.org/indicator/SP.POP.DPND.OL?locations=IT

retirement age of 67 years. This possibily will remain available for 3 years, until 2021, in order to see the economic impact, notably on the public expenditures. For the moment, the overall impact of this measure is less than predicted. From January to July 2019, only 154,095 individuals claim an early retirement (full-2019 data not available).

The gross pension replacement rate for an Italian man who had a full career is 79.5%, compared to the OECD average of 49%[220]. With a substantial increase in the pension age (67 years for men and 66.6 years for women compared with the OECD averages of 64.2 and 63.5, respectively), in addition to a high mandatory contributions (33%), the replacement pension rate is the highest in Europe.

Pillar II – Occupational pensions

The second pillar is made up of collective complementary pension plans. These can be contractual occupational pension funds (managed by social partners with CBAs) or open pension funds linked to collective affiliations (managed by financial institutions).[221]

The Trattamento di Fine Rapporto (TFR) is also part of the second pillar. The TFR is a deferred indemnity. Each year the employer has to put aside (by law) part of the worker's salary which will be returned to the employee upon termination of the employment contract.

Pillar III – Voluntary (individual) pension

The third pillar is made up of voluntary contributions to individual complementary pension schemes, *Individual Pension Plans* (PIP). Individuals can also make contributions to open funds in the case of individual affiliations. Given the strong component of mandatory contributions within the state pension system, both collective and individual complementary pension funds play a small role in the financing of future retirees' income. While the savings in collective complementary pension funds are rather small, private savings are still consistent. If all pension contributions and home ownership were transformed into an annuity, the corresponding stream of generated income at retirement would be very high.

Providing a basic overview of the pension system in Italy, the table below presents key data on the multi-pillar pension system.

[220] OECD (2020), Gross pension replacement rates (indicator). doi: 10.1787/3d1afeb1-en (Accessed on 30 June 2020)
[221] Igor Guardiancich, 'Current Pension System: First Assessment of Reform Outcomes and Output' (2009) European Social Observatory Country Report on Italy, 2009
http://www.ose.be/files/publication/2010/country_reports_pension/OSE_2010_CRpension_Italy.pdf

Introductory table. Multi-pillar pension system in Italy		
PILLAR I	PILLAR II	PILLAR III
State Pension	Private, voluntary and collective funded system	Private, voluntary and individual savings
	Legislative Decree 124/93 on complementary pension plans implemented in 1993 Reform on complementary pension (Legislative Decree 252/2005)	
National Social Security Body (INPS)	Pension accumulation companies	Insurance companies
Mandatory	Voluntary	Voluntary
Publicly managed	Privately managed pension funds	Privately managed pension funds
PAYG	Partially or fully funded	Fully Funded
Notional Defined Contribution system (NDC)	DC (Defined Contribution scheme)	
Quick facts		
Number of old-age pensioners: 15,994,782	Funds: 310	Funds (new PIP): 70
Average old-age pension: €1,527.88	AuM: €1142.5 bn.	Old et new PIP, AuM: €42.5 bn.
Monthly household average income (net): €2,500	Participants in 2019: 5.2 million	Participants in 2019 :3.6 million
Men/Women's gross average replacement rate (2018): 79.5%	Coverage ratio (% of labor force)[222]: 20.5%	Coverage ratio (% of labor force): 14.2%

The real net returns (before taxes) of the main retirement provision vehicles in Italy are presented below based on 6 recommended holding periods: 1 year (2019), 3 years (2017-2019), 7 years (2013-2019), 10 years (2010-2019), and since the earliest data available (20 years for pension funds, 2000-2019, and 12 years for PIP, 2008-2019).

Summary Table – Real net returns of Italian pension vehicles				
	Contractual pension funds	Open pension funds	PIP with profits	PIP unit-linked
2019	6.68%	7.78%	1.11%	11.66%
2017-2019	1.46%	2.04%	0.84%	1.45%
2013-2019	3.01%	3.64%	1.71%	3.90%
2010-2019	2.38%	2.75%	1.32%	2.57%
whole reporting period (max available)	1.41%	0.28%	1.32%	0.90%
	2000 - 2019	2000 - 2019	2008 - 2019	2008 - 2019

Source: Table IT4

[222] The economically active population is the sum of employed and unemployed persons. The active population was composed of 25.254 million individuals at the end of 2019 (source Eurostat: https://ec.europa.eu/eurostat/databrowser/view/tipslm15/default/table?lang=en)

Pensions Vehicles

Collective and individual complementary pension funds

Complementary pension funds were introduced in 1993 and are composed of contractual funds, open funds and individual pension plans provided by life insurance companies. The main features of complementary pension plans are:

i. voluntary membership;
ii. funded;
iii. managed by banks, financial institutions and insurance companies;
iv. supervised by Commissione di Vigilanza sui Fondi Pensione (Individual Pension Funds Supervisory Commission - COVIP).

Following the signature of an agreement, all complementary pension funds are managed by an external financial institution that can only be an insurance company, a bank or a registered asset management company (Legislative Decree 252/2005). All complementary pension funds now operate on a defined contribution (DC) basis, as this is the only permitted type of pension plan. Defined benefit (DB) plans are restricted to pre-existing funds.

At the end of 2019, the total workers enrolled into collective and individual pension plans (Pillar II and III) amounted to 8.264 million[223]. Number of individuals covered by a pension plan increased by 4 % with respect to 2018 and it represents 31.4% of the labor force. The increase in membership was driven by an increase in the number of affiliates to all catagories of schemes except pre-existing closed pension funds whose membership remained quite stable in 2019.

Table IT1. Number of subscribers in collective and individual pension plans (in thousands)

	2014	2015	2016	2017	2018	2019
Pillar II: Collective complementary pension plans						
Contractual Pension Funds	1944	2419	2561	2763	2949	3 095
Open Pension funds	1057	1150	1230	1343	1429	1 516
Pre-existing Closed Pension Funds	645	646	620	611	613	618
Pillar III: Private and individual complementary pension plans						
New PIP	2 357	2 601	2,759	2,969	3,130	3,264
Old PIP	467	434	411	390	370	354
Total	**6,585**	**7,235**	**7,786**	**7,585**	**7,953**	**8,264**

Source: COVIP Annual Report 2019The vast majority of the members of the complementary pension funds (Pillar II) are employed in the private sector (about 4 million).

In 2016, the numbers of subscribers to contractual (closed) funds increased due to an automatic enrolment of employees from different sectors. It should be noted, however, that these programmes only marginally increased assets managed by the pension industry, as the automatic enrolment programmes only applied to contributions made by employers. The level of employer contributions is determined by agreement.

Nearly a quarter of subscribers (24,1%) hold accrued benefits less than €1,000 at the end of 2019.

[223] Covip, 2019 Annual Report.

The budget law of 11 December 2016 allows members of complementary defined contribution pension funds, who are close to retirement age, to receive early retirement income from their accumulated savings in a whole or in part. (Rendita integrativa temporanea anticipata or RITA). Eligible employees are those who benefit from a similar provision in the first pillar (Anticipo finanziario a garanzia pensionistica or APE).

To be eligible to RITA, an individual must:

- cease his / her professional activity;
- reach the requirements necessary to receive the old-age pension in their mandatory regime within the next five years or to be unemployed for more than 24 months;
- have contributed at least 20 complete years to the mandatory regime; or / and have completed five years in the pension scheme.

The individual determines the amount of the accrued capital to use until his / her official retirement. In 2019, 8,200 individuals benefitted from RITA: 6,900 individuals drawn out their entire accured position. In 2018, the first year of application of this package 2,200 individuals benefitted from RITA and 400 individuals drawn out their entire accrued position.

Pillar II

Contractual funds or Closed fun*ds* *(Net assets at the end of 2019: €56.136 billion, Net sales at the end of 2019: €5.332 billion)*

Contractual funds are also called closed funds as only certain groups of people can join. These are professional occupational funds. Amongst employees, subscription is reserved only to those whose contracts are regulated by a collective bargaining agreement (CBA). For the self-employed, contractual agreements are usually provided by professional associations. Thus, only their members can subscribe to dedicated contractual pension funds.

Contractual pension funds are defined contribution schemes and the contribution amount is established by the fund's bylaws.[224] These funds are independent legal entities, with their own capital. Their governance is based on the principle of equal representation among employers and employees.

The Board of Directors is responsible for the investment strategies and chooses the investment manager, as well as the depositary bank and the designated entity dealing with administration. The fund must report on an annual basis, at least. Given the long-term characteristic of funds, managers' mandates are usually five years, or even longer for certain types of assets.

Open funds ***(Net assets at the end of 2019: €22.844 billion, Net sales at the end of 2019 €2.212 billion).***

In contrast to closed funds, membership is not restricted to certain groups. An open fund is not a legal entity. They can be established for collective or individual members, or both.

[224] Paci S., P. Contaldo, C. Fiorentino, G. Nocera, L. Spotorno, F. Vallacqua, 'Carefin Report: Pension Funds in Italy' (2010) Bocconi University.

Like contractual funds, open funds are defined contribution funds. Alike closed funds, a depositary bank is required, and administration costs can be outsourced.

The number of subscribers to open funds were 1,515,989. It increased by 6.1% over a yaer with 124,700 new subscribers.

At the end of 2019, assets managed by open funds amounted €22.844 billion with €2.2 billion of contributions.

The TFR, Severance Payment (€27.419 bilion in 2019)

During his/her whole career, an employee perceives severance payments, which are paid upon work termination. The severance payments are collected in a specific vehicle for pension asset accumulation, also known as *Trattamento di Fine Rapporto* (TFR). The TFR is computed on an annual basis and is equal to 6.91% of employee's annual remuneration. The TFR rate of return was 1.5% in 2019. It is mandatorily saved and returned upon termination of employment (such as retirement, the most common form).

The TFR can also be partially drawn on (70%) before the employee ends his / her professional activity, but only under very special circumstances, including health problems, first-house purchases and parental leave. Moreover, the stability law of 2015 enabled employees in the private sector to receive their severance payments in advance with a State guarantee on bank loans to companies.

The TFR represents a huge savings pot and its management underwent heavy changes from January 2007. Each worker can opt to accumulate their TFR by joining a complementary pension fund. If a worker does not make such a decision, tacit consent applies for the TFR to be transferred to a collective contractual pension fund when it exists for specific sectors.

This change represented a small cultural revolution in the Italian pension structure, where pensions had previously been provided by the public sector, with no active role by workers in choosing how much to invest. Workers have mandatorily contributed a conspicuous amount of their income, through the first pillar State system, with no involvement in where to invest their savings. With the TFR law, workers are now offered the possibility to choose to join any complementary pension fund[225] among contractual pension funds, open pension funds or even PIPs (Individual Pension Plans). When opting for PIPs, workers can decide the amount they contribute, a new element in the Italian framework, with no discretion in terms of pension contributions.

If an employee decides to opt-out from complementary pension funds and belongs to a company with more than 50 employees, his / her accumulated amount of severance payments is transferred to INPS (National Institute for Social Security), which manages the severance payment according to the law. For an employee who works in firms with less than 50 employees and who does not opt for complementary pension funds, his / her TFR remains in the firms he / she works in and represents a debt for the company.

In 2019 the overall TFR flow generated was estimated at around 27.4 billion euros. €15.2 billion remained in the books of companies, €6.3 billion were transfered to complementary pension schemes and 5.9 billion were transfered to INPS.

[225] Cannata and Settimo, 2007

Third Pillar

PIP, individual pension funds *(Net assets at the end of 2019: € 35.478 billion, Net sales at the end of 2019: €4.480))*

They are subscribed on an individual basis only, as insurance contracts in the legal framework of complementary pension funds. Within PIPs policies, two types of insurance contracts are offered: with-profits or unit-linked. A combination of the two type of contracts is possible with a more flexible risk-profile.

The with-profits policies guarantee a minimum rate of return (guaranteed and consolidated in the company's accounts) which is added to a quota related to the financial performance. The unit-linked policies do not have a guarantee. Their performance depends on the value of the units in which contributions are invested.

Public employees

The coverage of public employees by specific retirement products is very limited, as the law introducing pension funds excluded them. Contractual pension funds are only possible for individuals working in National Education (Espero), in the National Health and in a regional or local authority (Perseo and Sirio). These contractual pension funds were implemented in 1993.

There are pension funds implemented before 1993 that are semi-autonomous in their management and can collect money directly from subscribers without intermediaries. These pension funds are more numerous than those implemented in 1993.

Asset allocation of complementary pension plans

Law no.703, that regulates complementary pension funds' asset allocation, has been approved at the end of 2014. It allows more flexibility, moving from a quantitative approach to a principle-based one. Short selling remains prohibited and funds should allocate a minimum of 70% to listed products.

Looking at the portfolio composition of the complementary pension system as a whole (both pillar II and III), low-risk assets constituted the majority of holdings. In 2019, Sovereign bonds were still the main investment and their share in total portfolio, however, it decreased sightly at 40.3% (against 41.7% in 2018). The weight of Italian government bonds continued to decrease in 2019 (from 21.2% in 2018 to 20.6%). The share of direct holdings of equities increased from 17.7% in 2018 to 18.9% in 2019.

According to COVIP calculations, considering equities held through investment funds and derivative instruments, the equity exposure increased to 26.7% in 2019 (against 23.4% in 2018).

Table IT2. Asset allocation of pension funds (in %)	2016	2017	2018	2019
Treasury bonds	41.5%	41.5%	41.7%	40.3%
Corporate bonds	16.6%	16.6%	17.1%	17.7%
Equities	17.7%	17.7%	16.5%	18.9%
Mutual funds	14.4%	12.6%	13.8%	14.8%
Real estate	1.6%	1.4%	1.2%	1.0%
Other	0.9%	3.0%	2.6%	0.8%
Cash	7.2%	7.2%	7.1%	6.5%

Source: COVIP Annual Reports

Charges

COVIP calculates a synthetic indicator of cost for a member who contributes €2,500 every year with a theoretical annual return of 4%. The calculation methodology of the indicator was revised by COVIP in order to eliminate distortions between the categories of funds. Since 2014, the tax rates on investment revenues depend on the underlying assets of the funds. Since March 2015, the cost indicator is no longer calculated net but gross of the tax paid by pension funds on their revenues.

In 2019, the average cost indicator remains stable over time and thus is quite similar to that of 2018. It decreases with the membership period, with initial fix costs being progressively amortised.

However, there is a great variation in complementary pension funds costs. In closed pension funds, the indicator cost is 1% for two years of participation, while it drops to 0.3% after 35 years of participation. With respect to PIP, it drops from 3.9% to 1.8%.

There are significant differences between each category of funds, depending on the distribution channels of the products and the fees paid to distributors. Economies of scale lead lower costs for closed funds while no such impact can be observed on new PIP and open funds, according to a review of individual figures by COVIP.

Table IT3 (A). Average costs at the end of 2018 (in %) *	2 years	5 years	10 years	35 years
Closed Funds	1.07	0.57	0.39	0.26
Min	*0.47*	*0.3*	*0.18*	*0.08*
Max	*3.04*	*1.35*	*0.81*	*0.48*
Open Funds	2.37	1.58	1.37	1.24
Min	*0.55*	*0.55*	*0.55*	*0.55*
Max	*5.14*	*3.42*	*2.82*	*2.38*
New PIP	3.87	2.67	2.21	1.83
Min	*1.04*	*0.85*	*0.58*	*0.38*
Max	*6.44*	*4.82*	*4.07*	*3.44*

Source: COVIP Relazione annuale 2018[226]

** Simple arithmetic averages within each category. Costs differ depending on the number of contribution years*

[226] Covip, 2019 Annual Report.

Table IT3 (B). Average costs at the end of 2019 (in %) *				
	2 years	5 years	10 years	35 years
Closed Funds	1.07	0.58	0.4	0.26
Min	*0.43*	*0.26*	*0.16*	*0.07*
Max	*3.04*	*1.35*	*0.81*	*0.49*
Open Funds	2.33	1.56	1.35	1.23
Min	*0.55*	*0.55*	*0.55*	*0.55*
Max	*4.73*	*3.2*	*2.58*	*2.31*
New PIP	3.86	2.67	2.2	1.83
Min	*1.04*	*0.85*	*0.58*	*0.38*
Max	*6.44*	*4.82*	*4.07*	*3.44*

Source: COVIP Relazione annuale 2019

Taxation

The taxation regime of pension savings in Italy is essentially an ETT regime (exemption, taxation, taxation), corresponding to the following three stages over time: contribution, accumulation and payment.

In the first phase, employee contributions to private pension funds benefit from a favourable tax treatment. An employee can deduct his / her contibutions from his / her taxable income up to a ceiling of € 5,164.57 per year. Employer contributions are considered as employment income and are thus subject to tax and social security contributions.

Until 2014, in the second phase a tax rate of 11.5% was applied on the accrued capital gains paid by complementary pension funds. From 1 January 2015, this tax rate increased to 20%, except for accrued capital gains generated by investments in Government Bonds which are taxed at a rate of 12.5%. The difference in taxation rates of bonds and equities is an incentive to change the asset allocation towards the former, a trend that is likely to lower the returns of pension products in the future. The budget law of 31 December 2016 foresaw that assets invested in European equities or European investment funds (up to 5% of the fund's total assets) were exempted from income tax.

In order to avoid double taxation, benefits are taxed only on the corresponding shares that were not taxed during the accumulation phase. Contributions that were not deducted, and thus already taxed, won't be taxed again.

In the third phase the corresponding benefits are taxed at a rate varing from 9% to 15% depending on the length of membership in the private pension funds. Income received before retirement age in the framework of the RITA scheme is taxed at 15%, reduced by 0.3% for each year over the fifteenth year of participation in supplementary pension schemes, with a maximum reduction limit of six percentage points. If years of enrolment in the supplementary pension scheme are prior to 2007, those years can be considered up to a maximum of 15 years.

The tax rate of pension benefits that come from TFR varies between 9% and 15%, depending on the length of enrolment in the complementary pension funds.

Pensions Returns

The following table (IT4) provides returns broken down by type of complementary private pension funds. Returns are calculated net of taxes paid by the pension funds on investment revenues.

After the drops in returns since 2015, as a consequence of historically low interest rates paid on bonds, the aggregate returns, net of management costs and taxes, were on average positive for all complementary pension forms and for all types of sector in 2019.

In 2019, complementary pension schemes achieved largely positive results thanks to the sustained rise in equity prices and the rise in bond yields. For each type of pension form, the best results were observed in the sechemes with a greater exposure to equities.

Table IT4. Nominal returns net of charges and taxes on investment revenues by type of funds

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Contractual pension funds	**8.5**	**3.0**	**0.1**	**8.2**	**5.4**	**7.3**	**2.7**	**2.7**	**2.6**	**-2.5**	**7.2**
Guaranteed	4.6	0.2	-0.5	7.7	3.1	4.6	1.9	0.8	0.8	-1.1	2.0
Bonds Only	2.9	0.4	1.7	3.0	1.2	1.2	0.5	0.2	-0.2	-0.6	0.7
Bonds Mixed	8.1	3.6	1.1	8.1	5.0	8.1	2.7	3.2	2.6	-2.4	7.6
Balanced	10.4	3.6	-0.6	9.2	6.6	8.5	3.2	3.2	3.1	-2.8	8.6
Equity	16.1	6.2	-3.0	11.4	12.8	9.8	5.0	4.4	5.9	-5.3	12.2
Open Pension Funds	**11.3**	**4.2**	**-2.4**	**9.1**	**8.1**	**7.5**	**3.0**	**2.2**	**3.3**	**-4.5**	**8.3**
Guaranteed	4.8	0.7	-0.3	6.6	2.0	4.3	0.9	0.7	0.6	-1.8	3.0
Pure Bonds	4.0	1.0	1.0	6.4	0.8	6.9	0.9	1.3	-0.3	-0.8	3.7
Mixed	6.7	2.6	0.4	8.0	3.6	8.0	2.2	1.4	0.4	-1.8	4.2
Balanced	12.6	4.7	-2.3	10.0	8.3	8.7	3.7	2.7	3.7	-4.8	9.2
Equity	17.7	7.2	-5.3	10.8	16.0	8.7	4.2	3.2	7.2	-8.0	14.9
New PIP with profits-Separate management	**3.1**	**3.2**	**3.2**	**3.3**	**3.2**	**2.9**	**2.5**	**2.1**	**1.9**	**1.7**	**1.6**
Unit linked	**14.5**	**4.7**	**-5.2**	**7.9**	**10.9**	**6.8**	**3.2**	**3.6**	**2.2**	**-6.5**	**12**
Bonds	3.7	0.6	0.8	4.9	-0.3	3.3	0.6	0.4	-0.7	-1.4	2.2
Balanced	*7.8*	*2.5*	*-4*	*6.4*	*5.8*	*8.2*	1.9	1.5	2.3	-5.9	9.2
Stocks	*20.6*	*6.7*	*-8*	*9.6*	*17.2*	*7.1*	4.5	6	3.2	-8.9	19.0

Source: COVIP Relazione Annuale 2019

Contractual pension funds

Table IT5 reports the net returns for closed pension funds. Column (2) reflects nominal returns before charges. The synthetic cost indicator for a 35-year subscriber is added to column (3), as reported by COVIP. Until 2014, the cost indicator was calculated net of taxes on investment revenues ("imposta sostitutiva") but the latter was not disclosed in COVIP statistics. Thus, we added 11.5% (the tax rate on investment returns until 2014) to the cost indicator of the positive nominal return before charges. From 2015, as the cost indicator was calculated gross of these taxes, a correction is no longer needed.

Column (3) records the nominal returns after charges and before taxes on investment revenues calculated by COVIP (see table IT4).

Column (4) is equal to column (3) minus the Inflation Rate (as CPI index variation in percentage).

We calculate the average annual rate of investment returns on different holding periods. The average annual real net return after taxation, equal to column (4), once 15% of the return, has been taken out of the nominal return after charges. The tax rate can be reduced by 0.3% for each year after 15 years of contributions, for a maximum of 6 percentage points of reduction in taxation of the benefit.

For a holding period of 20 years (2000-2019), the annual average real return of contractual funds after deduction of charges and inflation was 1.41%. On a more recent period of 10 year holding period (2010-2019), the return increased to 2.38%.

Table IT5.1 Gross, Nominal and Real Returns of contractual pension funds in Italy (%)

2000		3.90			3.60			0.84	
2001		3.70			3.40			1.11	
2002		-3.20			-3.40			-6.21	
2003		5.30			5.00			2.41	
2004		4.91			4.60			2.21	
2005		7.82			7.50			5.34	
2006		4.11			3.80			1.64	
2007		2.41			2.10			-0.66	
2008		-6.02			-6.30			-8.46	
2009	Gross returns	8.72	3.47	Nominal return after charges, before inflation and taxes	8.50	3.20	Real return after charges and inflation and before taxes	7.32	1.41
2010		3.21			3.00			0.92	
2011		0.30			0.10			-3.50	
2012		8.42			8.20			5.49	
2013		5.61			5.40			4.77	
2014		7.52			7.30			7.30	
2015		3.01			2.70			2.60	
2016		3.01			2.70			2.19	
2017		2.91			2.60			1.60	
2018		-2.24			-2.50			-3.63	
2019		7.46			7.20			6.68	

Source: Table IT4

Table IT5.2 Annualised performances of contractual pension funds

Holding Period	Gross returns	Net Nominal Annualized Performance	Real Net Annualized Performance
1-year	7.46%	7.20%	6.68%
3-years	2.63%	2.36%	1.46%
5-years	2.78%	2.49%	1.83%
7-year	3.85%	3.58%	3.01%
10-years	3.87%	3.62%	2.38%
2000-2019	3.47%	3.20%	1.41%

Source: Table IT5.1

According to COVIP, the real net return after taxes, for contractual pension funds averaged in the last 20 years (2000-2019) at 0.9%.

Open pension funds

The same methodology as for contractual pension funds is used to calculate the returns of open funds. The only difference lies in the synthetic cost indicator that is different. For 20-year holding period (2000-2019), the annual average real return of open funds after deduction of charge and inflation was positive at 0.28%. The return is higher and reached 2.75% for 10-year holding period (2010-2019).

Table IT6.1 Gross, Nominal and Real Returns of open pension funds (%)

	Gross returns		Nominal return after charges, before inflation and taxes		Real return after charges and inflation and before taxes	
2000	4.20		3.00		0.26	
2001	-4.70		-5.60		-7.69	
2002	-12.30		-13.10		-15.63	
2003	6.90		5.70		3.09	
2004	5.46		4.30		1.91	
2005	12.74		11.50		9.26	
2006	3.54		2.40		0.27	
2007	0.71		-0.40		-3.09	
2008	-13.04		-14.00		-15.98	
2009	12.54	3.20	11.30	2.05	10.09	0.28
2010	5.36		4.20		2.09	
2011	-1.31		-2.40		-5.91	
2012	10.31		9.10		6.37	
2013	9.30		8.10		7.45	
2014	8.70		7.50		7.50	
2015	4.25		3.00		2.90	
2016	3.44		2.20		1.69	
2017	4.55		3.30		2.29	
2018	-1.28		-2.50		-3.63	
2019	9.65		8.30		7.78	

Source: COVIP Annual Report 2019

Table IT6.2 Annualized performance of open pension funds

Holding Period	Gross returns	Net Nominal Annualized Performance	Real Net Annualized Performance
1-year	9.65%	8.30%	7.78%
3-years	4.21%	2.94%	2.04%
5-years	4.07%	2.80%	2.14%
7-year	5.45%	4.21%	3.64%
10-years	5.22%	4.00%	2.75%
2000-2019	3.20%	2.05%	0.28%

Source: Table IT6.1

The real net return, after taxation, for open pension funds between 2000-2019 stood negative at - 0.03%.

Individual Pension Plans

Individual Pension Plans (PIP) have the highest costs on the pension product market in Italy. The charges applied to PIPs were 1.83% for long-term subscribers in 2019.

The performance of the PIPs depends on the type of contracts. With-profits contracts have a comparable performance to contractual pension funds, while unit-linked PIPs have a lower average return on the market comparable to open pension funds.

However, performances are highly volatile, potentially associated with the relatively short timeframe considered, in fact corresponding to the financial crisis years. Moreover, given the shorter timeframe, the high variability could lead to misleading conclusions. In 2018, the returns of unit-linked PIPs decreased once again and was even negative at -7.6%.

Table IT7.1 Gross, Nominal and Real Returns of PIP with profits (%)

Year	Gross returns		Nominal return after charges, before inflation and taxes		Real return after charges and inflation and before taxes	
2000	-		-		-	
2001	-		-		-	
2002	-		-		-	
2003	-		-		-	
2004	-		-		-	
2005	-		-		-	
2006	-		-		-	
2007	-		-		-	
2008	4.67		3.10		0.72	
2009	4.67	4.34	3.10	2.64	1.98	1.32
2010	4.77		3.20		1.11	
2011	4.77		3.20		-0.51	
2012	4.77		3.20		0.62	
2013	4.77		3.20		2.58	
2014	4.47		2.90		2.90	
2015	4.38		2.50		2.40	
2016	3.97		2.10		1.60	
2017	3.77		1.90		0.90	
2018	3.60		1.70		0.52	
2019	3.49		1.60		1.11	

Source: COVIP Annual Report 2019

Table IT7.2 Annualized performance of PIP with profits

Holding Period	Gross returns	Net Nominal Annualized Performance	Real Net Annualized Performance
1-year	3.49%	1.60%	1.11%
3-years	3.62%	1.73%	0.84%
5-years	3.84%	1.96%	1.30%
7-year	4.06%	2.27%	1.71%
10-years	4.27%	2.55%	1.32%
2008-2019	4.34%	2.64%	1.32%

Source: Table IT7.1

The average real net return, after taxes, of PIP with profits stood at 0.8% in the last 10 years.

The return computations for individual pension plans (unit-linked) are presented in the following Table IT8.1.

IT8.1 Gross, Nominal and Real Returns of PIP unit linked (%)									
2000		-			-			-	
2001		-			-			-	
2002		-			-			-	
2003		-			-			-	
2004		-			-			-	
2005		-			-			-	
2006		-			-			-	
2007		-			-			-	
2008		-20.71			-21.90			-23.70	
2009	Gross returns	16.24	3.9	Nominal return after charges, before inflation and taxes	14.50	2.2	Real return after charges and inflation and before taxes	13.26	0.90
2010		6.29			4.70			2.58	
2011		-3.76			-5.20			-8.61	
2012		9.54			7.90			5.20	
2013		12.59			10.90			10.24	
2014		8.43			6.80			6.80	
2015		5.09			3.20			3.10	
2016		5.50			3.60			3.09	
2017		4.07			2.20			1.20	
2018		-4.76			-6.50			-7.59	
2019		14.29			12.20			11.66	

Source: COVIP Annual Report 2019

Table IT8.2. Annualized performance of PIP unit-linked			
Holding Period	Gross returns	Net Nominal Annualized Performance	Real Net Annualized Performance
1-year	14.29%	12.20%	11.66%
3-years	4.25%	2.35%	1.45%
5-years	4.66%	2.77%	2.11%
7-year	6.30%	4.47%	3.90%
10-years	5.56%	3.81%	2.57%
2008-2019	3.91%	2.21%	0.90%

Source: Table IT8.1

The average real net return, after taxes, of PIP unit-linked pension products in the last 12 years (2008-2019) stood at 0.6%.

Conclusion

The Italian Pension System has a strong State component, which is likely to displace complementary pension funds. The mandatory contribution rate amounts to 33%. As the system is pre-funded, contributions to the pension system will translate one to one to future pension incomes. In this scenario the second and third pillar are likely to only develop slowly. Moreover, Italy has the second highest level of retirement expenses in percentage of the GDP amoung OECD countries (16,2% in 2019). Moreover, the implementation of pre-retirement system as APE and Quota 100 represent an important additional cost and do not provide incentives for employees to save into complementary pension funds for their retirement.

Even if the number of employees enrolled in private pension funds increased, it remained quite low. 8.8 million individuals are enrolled in private pension funds, representing 34.7% of the labor force. Experiences from the automatic enrolment implemented by labour agreements in 2015 and 2016 did not fundamentally change the framework, as employers' contributions were still low, and few employees voluntarily contributed to the new schemes. In addition, women and young people are under-represented in pension funds. The government has to play a role in encouraging all profile among employees to save for the retirement in pension funds.

The complementary pension funds can be of three types: contractual occupational pension funds (managed by Social Partners), open funds managed by financial institutions and Individual Pension Plans (PIP), split into with-profits and unit-linked policies.

Over the period 2000-2019, we calculated the annualized real return associated to open funds and contractual pension funds. Since 2000, contractual pension funds recorded a positive annualized real return (+1.4%), while open pension funds recorded a positive one of 0.3%.

Over the twelve-year period (2008-2019), we calculated the annualized real returns of both unit-linked and with profits PIP contracts, which experienced annualized positive returns respectively 0.98% and 1.4%.

Private pension funds in Italy offer low real returns after inflation and taxation, even negative for open pension funds on a long period (20 years). Sovereign bonds remained the most important assets on average (40.3% in 2019) in the asset allocation of private pension funds. This percentage dropped once again in 2019 while the percentage of theexposure to equities (direct holdings and through investments funds) increased to reached 26.7% of the total asset allocation. The private pension funds have to elaborate other investement strategies which could provide higher returns to pensioners.

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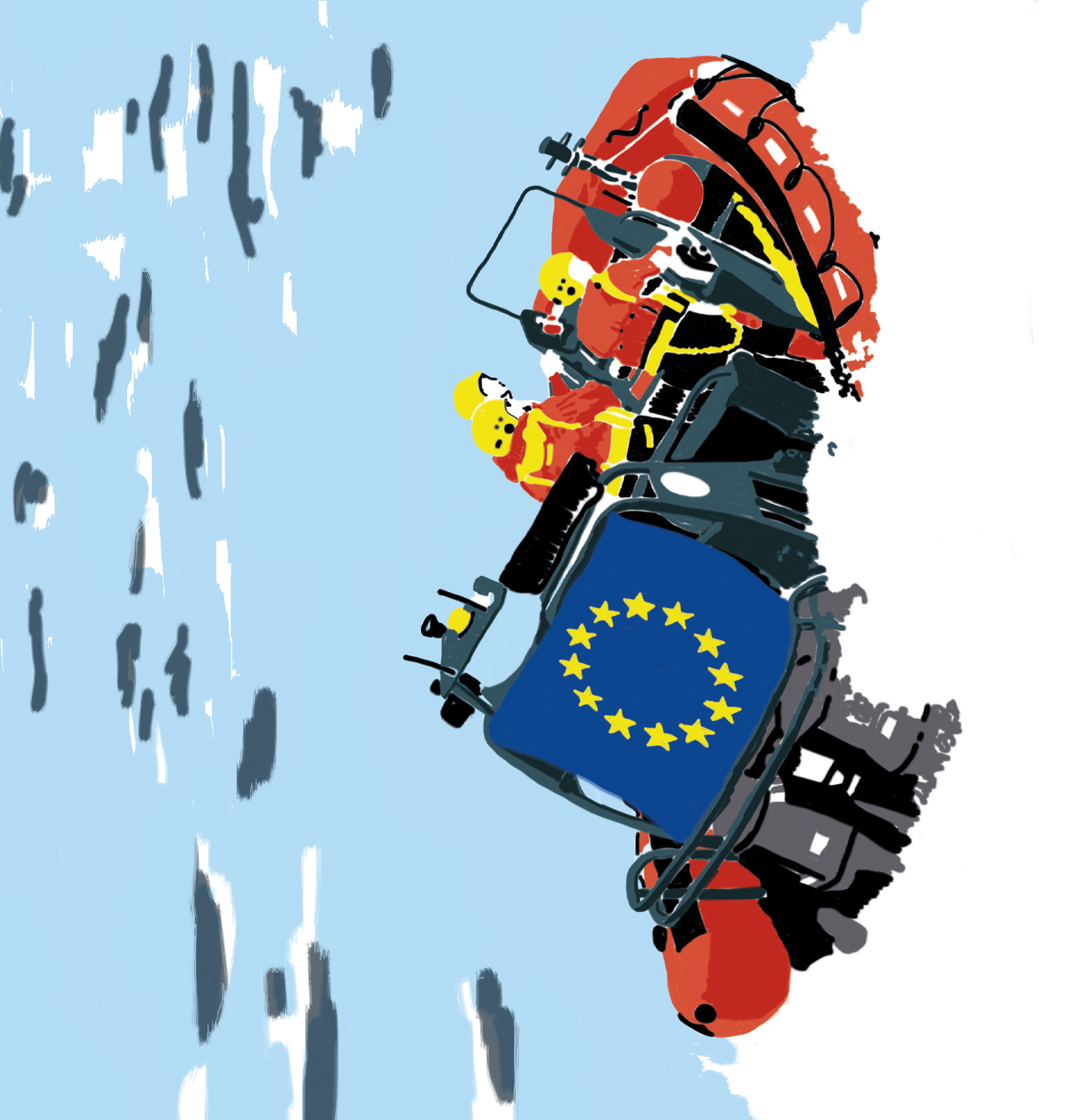

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