PENSION SAVINGS THE REAL RETURN 2018 EDITION

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BF BETTER FINANCE

The European Federation of Investors and Financial Services Users Fédération Européenne des Épargnants et Usagers des Services Financiers

Pension Savings: The Real Return 2018 Edition

A Research Report by BETTER FINANCE

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Table of Contents

Table of Contents1
Acronyms2
Glossary of terms
Contributors13
Foreword15
Executive Summary23
General Report
Country Case: Belgium
Country Case: Bulgaria
Country Case: Denmark
Country Case: Estonia164
Country Case: France
Country Case: Germany219
Country Case: Italy245
Country Case: Latvia
Country Case: Lithuania
Country Case: Poland
Country Case: Romania
Country Case: Slovakia
Country Case: Spain
Country Case: Sweden438
Country Case: The Netherlands461
Country Case: United Kingdom482



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 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	Standard & Poor Dow Jones' Indices Research Report on Active
Scorecard	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



Glossary of terms

Accrued benefits* – is the amount of accumulated pension benefits of a pension plan member on the basis of years of service.

Accumulated assets* - is the total value of assets accumulated in a pension fund.

Active member* – is a pension plan member who is making contributions (and/or on behalf of whom contributions are being made) and is accumulating assets.

AIF(s) – or Alternative Investment Funds are a form of collective investment funds under E.U. law that do not require authorization as a UCITS fund.¹

Annuity* – is a form of financial contract mostly sold by life insurance companies that guarantees a fixed or variable payment of income benefit (monthly, quarterly, half-yearly, or yearly) for the life of a person(s) (the annuitant) or for a specified period of time. It is different than a life insurance contract which provides income to the beneficiary after the death of the insured. An annuity may be bought through instalments or as a single lump sum. Benefits may start immediately or at a pre-defined time in the future or at a specific age.

Annuity rate^{*} – is the present value of a series of payments of unit value per period payable to an individual that is calculated based on factors such as the mortality of the annuitant and the possible investment returns.

Asset allocation* - is the act of investing the pension fund's assets following its investment strategy.

Asset management* – is the act of investing the pension fund's assets following its investment strategy.

Asset manager* – is(are) the individual(s) or entity(ies) endowed with the responsibility to physically invest the pension fund assets. Asset managers may also set out the investment strategy for a pension fund.

Average earnings scheme* – is a scheme where the pension benefits earned for a year depend on how much the member's earnings were for the given year.

Basic state pension* – is a non-earning related pension paid by the State to individuals with a minimum number of service years.

Basis points (bps) – represent the 100th division of 1%.

Benchmark (financial) – is a referential index for a type of security. Its aim is to show, customized for a level and geographic or sectorial focus, the general price or performance of the market for a financial instrument.

Beneficiary* – is an individual who is entitled to a benefit (including the plan member and dependants).

Benefit* - is a payment made to a pension fund member (or dependants) after retirement.

¹ See Article 4(1) of Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010, OJ L 174, 1.7.2011, p. 1–73.



Bonds – are instruments that recognize a debt. Although they deliver the same utility as bank loans, i.e. enabling the temporary transfer of capital from one person to another, with or without a price (interest) attached, bonds can be also be issued by non-financial institutions (States, companies) and by financial non-banking institutions (asset management companies). In essence, bonds are considered more stable (the risk of default is lower) and in theory deliver a lower, but fixed, rate of profit. Nevertheless, Table EX2 of the Executive Summary shows that the aggregated European Bond Index highly overperformed the equity one.

Closed pension funds* – are the funds that support only pension plans that are limited to certain employees. (e.g. those of an employer or group of employers).

Collective investment schemes – are financial products characterised by the pooling of funds (money or asset contributions) of investors and investing the total into different assets (securities) and managed by a common asset manager. Under E.U. law collective investment schemes are regulated under 6 different legal forms: UCITS (see below), the most common for individual investors; AIFs (see above), European Venture Capital funds (EUVECA), European Long-Term Investment Funds (ELTIFs), European Social Entrepreneurship Funds (ESEF) or Money Market Funds.²

Contribution* – is a payment made to a pension plan by a plan sponsor or a plan member.

Contribution base* - is the reference salary used to calculate the contribution.

Contribution rate* – is the amount (typically expressed as a percentage of the contribution base) that is needed to be paid into the pension fund.

Contributory pension scheme* – is a pension scheme where both the employer and the members have to pay into the scheme.

Custodian* – is the entity responsible, as a minimum, for holding the pension fund assets and for ensuring their safekeeping.

Defered member* – is a pension plan member that no longer contributes to or accrues benefits from the plan but has not yet begun to receive retirement benefits from that plan.

Deferred pension* – is a pension arrangement in which a portion of an employee's income is paid out at a date after which that income is actually earned.

Defined benefit (DB) occupational pension plans* – are occupational plans other than defined contributions plans. DB plans generally can be classified into one of three main types, "traditional", "mixed" and "hybrid" plans. These are schemes where "the pension payment is defined as a percentage of income and employment career. The employee receives a thus pre-defined pension and does not bear the risk of longevity and the risk of investment. Defined Benefits schemes may be part of an individual employment contract or collective agreement. Pension contributions are usually paid by the employee and the employeer".³

"Traditional" DB plan* – is a DB plan where benefits are linked through a formula to the members' wages or salaries, length of employment, or other factors.

² See European Commission, 'Investment Funds' (28 August 2018)

https://ec.europa.eu/info/business-economy-euro/growth-and-investment/investment-funds_en.

³ Werner Eichhorst, Maarten Gerard, Michael J. Kendzia, Christine Mayrhruber, Connie Nielsen, Gerhard Runstler, Thomas Url, 'Pension Systems in the EU: Contingent Liabilities and Assets in the Public and Private Sector' EP Directorate General for Internal Policies IP/A/ECON/ST/2010-26.



"Hybrid" DB plan* – is a DB plan where benefits depend on a rate of return credited to contributions, where this rate of return is either specified in the plan rules, independently of the actual return on any supporting assets (e.g. fixed, indexed to a market benchmark, tied to salary or profit growth, etc.), or is calculated with reference to the actual return of any supporting assets and a minimum return guarantee specified in the plan rules.

"Mixed" DB plan* – is a DB plans that has two separate DB and DC components, but which are treated as part of the same plan.

Defined contribution (DC) occupational pension plans* – are occupational pension plans under which the plan sponsor pays fixed contributions and has no legal or constructive obligation to pay further contributions to an ongoing plan in the event of unfavorable plan experience. These are schemes where "the pension payment depends on the level of defined pension contributions, the career and the returns on investments. The employee has to bear the risk of longevity and the risk of investment. Pension contributions can be paid by the employee and/or the employer and/or the state".⁴

Dependency ratio^{*} – are occupational pension plans under which the plan sponsor pays fixed contributions and has no legal or constructive obligation to pay further contributions to an ongoing plan in the event of unfavourable plan experience.

Early retirement* – is a situation when an individual decides to retire earlier later and draw the pension benefits earlier than their normal retirement age.

Economic dependency ratio^{*} – is the division between the number of inactive (dependent) population and the number of active (independent or contributing) population. It ranges from 0% to 100% and it indicates how much of the inactive population's (dependent) consumption is financed from the active population's (independent) contributions.⁵ In general, the inactive (dependent) population is represented by children, retired persons and persons living on social benefits.

EET system* – is a form of taxation of pension plans, whereby contributions are exempt, investment income and capital gains of the pension fund are also exempt, and benefits are taxed from personal income taxation.

Equity (or stocks/shares) – are titles of participation to a publicly listed company's economic activity. With regards to other categorizations, an equity is also a security, a financial asset or, under E.U. law, a transferable security.⁶

ETE system* – is a form of taxation whereby contributions are exempt, investment income and capital gains of the pension fund are taxed, and benefits are also exempt from personal income taxation.

ETF(s) – or Exchange-Traded Funds are investment funds that are sold and bought on the market as an individual security (such as shares, bonds). ETFs are structured financial products, containing a

⁴ Ibid.

⁵ For more detail on the concept, see Elke Loichinger, Bernhard Hammer, Alexia Prskawetz, Michael Freiberger, Joze Sambt, 'Economic Dependency Ratios: Present Situation and Future Scenarios' MS13 Policy Paper on Implications of Population Ageing for Transfer Systems, Working Paper no. 74, 18th December 2014, 3.

⁶ Article 4(44) of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, OJ L 173, p. 349–496 (MiFID II).



basket of underlying assets, and are increasingly more used due to the very low management fees that they entail.

Fund member* – is an individual who is either an active (working or contributing, and hence actively accumulating assets) or passive (retired, and hence receiving benefits), or deferred (holding deferred benefits) participant in a pension plan.

Funded pension plans* – are occupational or personal pension plans that accumulate dedicated assets to cover the plan's liabilities.

Funding ratio (funding level) * – is the relative value of a scheme's assets and liabilities, usually expressed as a percentage figure.

Gross rate of return* – is the rate of return of an asset or portfolio over a specified time period, prior to discounting any fees of commissions.

Gross/net replacement rate – is the ratio between the pre-retirement gross or net income and the amount of pension received by a person after retirement. The calculation methodology may differ from source to source as the average working life monthly gross or net income can used to calculate it (divided by the amount of pension) or the past 5 year's average gross income etc. (see below **OECD net replacement rate**).

Group pension funds* – are multi-employer pension funds that pool the assets of pension plans established for related employers.

Hedging and hedge funds – while hedging is a complex financial technique (most often using derivatives) to protect or reduce exposure to risky financial positions or to financial risks (for instance, currency hedging means reducing exposure to the volatility of a certain currency), a hedge fund is an investment pool that uses complex and varying investment techniques to generate profit.

Indexation* – is the method with which pension benefits are adjusted to take into account changes in the cost of living (e.g. prices and/or earnings).

Individual pension plans* – is a pension fund that comprises the assets of a single member and his/her beneficiaries, usually in the form of an individual account.

Industry pension funds* – are funds that pool the assets of pension plans established for unrelated employers who are involved in the same trade or businesses.

Mandatory contribution* – is the level of contribution the member (or an entity on behalf of the member) is required to pay according to scheme rules.

Mandatory occupational plans* – Participation in these plans is mandatory for employers. Employers are obliged by law to participate in a pension plan. Employers must set up (and make contributions to) occupational pension plans which employees will normally be required to join. Where employers are obliged to offer an occupational pension plan, but the employees' membership is on a voluntary basis, these plans are also considered mandatory.

Mandatory personal pension plans* - are personal plans that individuals must join or which are eligible to receive mandatory pension contributions. Individuals may be required to make pension contributions to a pension plan of their choice normally within a certain range of choices or to a specific pension plan.



Mathematical provisions (insurances) – or *mathematical reserves* or *reserves*, are the value of liquid assets set aside by an insurance company that would be needed to cover all current liabilities (payment obligations), determined using actuarial principles.

Minimum pension* - is the minimum level of pension benefits the plan pays out in all circumstances.

Mixed indexation* – is the method with which pension benefits are adjusted taking into account changes in both wages and prices.

Money market instruments – are short-term financial products or positions (contracts) that are characterized by the very high liquidity rate, such as deposits, shor-term loans, repo-agreements and so on.

MTF – multilateral trading facility, is the term used by the revised Markets in Financial Instruments Directive (MiFID II) to designate securities exchanges that are not a regulated market (such as the London Stock Exchange, for example).

Multi-employer pension funds* – are funds that pool the assets of pension plans established by various plan sponsors. There are three types of multi-employer pension funds:

- a) for related employers i.e. companies that are financially connected or owned by a single holding group (group pension funds);
- b) for unrelated employers who are involved in the same trade or business (industry pension funds);
- c) for unrelated employers that may be in different trades or businesses (collective pension funds).

NAV – Net Asset Value, or the amount to which the market capitalisation of a financial product (for this report, pension funds' or insurance funds' holdings) or a share/unit of it arises at a given point. In general, the Net Asset Value is calculated per unit or share of a collective investment scheme using the daily closing market prices for each type of security in the portfolio.

Net rate of return* – is the rate of return of an asset or portfolio over a specified time period, after discounting any fees of commissions.

Normal retirement age* – is the age from which the individual is eligible for pension benefits.

Non-contributory pension scheme* – is a pension scheme where the members do not have to pay into scheme.

Occupational pension plans* – access to such plans is linked to an employment or professional relationship between the plan member and the entity that establishes the plan (the plan sponsor). Occupational plans may be established by employers or groups of thereof (e.g. industry associations) and labour or professional associations, jointly or separately. The plan may be administrated directly by the plan sponsor or by an independent entity (a pension fund or a financial institution acting as pension provider). In the latter case, the plan sponsor may still have oversight responsibilities over the operation of the plan.

OECD gross replacement rate - is defined as gross pension entitlement divided by gross preretirement earnings. It measures how effectively a pension system provides a retirement income to replace earnings, the main source of income before retirement. This indicator is measured in percentage of pre-retirement earnings by gender.



OECD net replacement rate - is defined as the individual net pension entitlement divided by net preretirement earnings, taking into account personal income taxes and social security contributions paid by workers and pensioners. It measures how effectively a pension system provides a retirement income to replace earnings, the main source of income before retirement. This indicator is measured in percentage of pre-retirement earnings by gender.

Old-age dependency ratio - defined as the ratio between the total number of elderly persons when they are generally economically inactive (aged 65 and above) and the number of persons of working age.⁷ It is a sub-indicator of the economic dependency ratio and focuses on a country's public (state) pension system's reliance on the economically active population's pensions (or social security) contributions. It is a useful indicator to show whether a public (Pillar I) pension scheme is under pressure (when the ratio is high, or the number of retirees and the number of workers tend to be proportionate) or relaxed (when the ratio is low, or the number of retirees and the number of workers tend to be disproportionate). For example, a low old-age dependency ratio is 20%, meaning that 5 working people contribute for one retiree's pension.

Open pension funds* – are funds that support at least one plan with no restriction on membership. **Pension assets*** – are all forms of investment with a value associated to a pension plan.

Pension fund administrator* – is(are) the individual(s) ultimately responsible for the operation and oversight of the pension fud.

Pension fund governance* – is the operation and oversight of a pension fund. The governing body is responsible for administration, but may employ other specialists, such as actuaries, custodians, consultants, asset managers and advisers to carry out specific operational tasks or to advise the plan administration or governing body.

Pension fund managing company* – is a type of administrator in the form of a company whose exclusive activity is the administration of pension funds.

Pension funds* – the pool of assets forming an independent legal entity that are bought with the contributions to a pension plan for the exclusive purpose of financing pension plan benefits. The plan/fund members have a legal or beneficial right or some other contractual claim against the assets of the pension fund. Pension funds take the form of either a special purpose entity with legal personality (such as a trust, foundation, or corporate entity) or a legally separated fund without legal personality managed by a dedicated provider (pension fund management company) or other financial institution on behalf of the plan/fund members.

Pension insurance contracts* – are insurance contracts that specify pension plans contributions to an insurance undertaking in exchange for which the pension plan benefits will be paid when the members reach a specified retirement age or on earlier exit of members from the plan. Most countries limit the integration of pension plans only into pension funds, as the financial vehicle of the pension plan. Other countries also consider the pension insurance contract as the financial vehicle for pension plans.

Pension plan* – is a legally binding contract having an explicit retirement objective (or – in order to satisfy tax-related conditions or contract provisions – the benefits can not be paid at all or without a significant penalty unless the beneficiary is older than a legally defined retirement age). This contract

⁷ See Eurostat definition: <u>http://ec.europa.eu/eurostat/web/products-datasets/product?code=tsdde511</u>.



may be part of a broader employment contract, it may be set forth in the plan rules or documents, or it may be required by law. In addition to having an explicit retirement objective, pension plans may offer additional benefits, such as disability, sickness, and survivors' benefits.

Pension plan sponsor* – is an institution (e.g. company, industry/employment association) that designs, negotiates, and normally helps to administer an occupational pension plan for its employees or members.

Pension regulator* – is a governmental authority with competence over the regulation of pension systems.

Pension supervisor* – is a governmental authority with competence over the supervision of pension systems.

Personal pension plans* - Access to these plans does not have to be linked to an employment relationship. The plans are established and administered directly by a pension fund or a financial institution acting as pension provider without any intervention of employers. Individuals independently purchase and select material aspects of the arrangements. The employer may nonetheless make contributions to personal pension plans. Some personal plans may have restricted membership.

Private pension funds* – is a pension fund that is regulated under private sector law.

Private pension plans* – is a pension plan administered by an institution other than general government. Private pension plans may be administered directly by a private sector employer acting as the plan sponsor, a private pension fund or a private sector provider. Private pension plans may complement or substitute for public pension plans. In some countries, these may include plans for public sector workers.

Public pension plans* – are pensions funds that are regulated under public sector law.

Public pension plans* – are the social security and similar statutory programmes administered by the general government (that is central, state, and local governments, as well as other public sector bodies such as social security institutions). Public pension plans have been traditionally PAYG financed, but some OECD countries have partial funding of public pension liabilities or have replaced these plans by private pension plans.

Rate of return* – is the income earned by holding an asset over a specified period.

REIT(s) or Real Estate Investment Trust(s) is the most common acronym and terminology used to designate special purpose investment vehicles (in short, companies) set up to invest and commercialise immovable goods (real estate) or derived assets. Although the term comes from the U.S. legislation, in the E.U. there are many forms of REITs, depending on the country since the REIT regime is not harmonised at E.U. level.

Replacement ratio* – is the ratio of an individual's (or a given population's) (average) pension in a given time period and the (average) income in a given time period.

Service period* – is the length of time an individual has earned rights to a pension benefits.

Single employer pension funds* – are funds that pool the assets of pension plans established by a single sponsor.

Supervisory board* – is(are) the individual(s) responsible for monitoring the governing body of a pension entity.



System dependency ratio* – typically defined as the ratio of those receiving pension benefits to those accruing pension rights.

TEE system* – is a form of taxation of pension plans whereby contributions are taxed, investment income and capital gains of the pension fund are exempt, and benefits are also exempt from personal income taxation.

Trust* – is a legal scheme, whereby named people (termed trustees) hold property on behalf of other people (termed beneficiaries).

Trustee* – is a legal scheme, whereby named people (termed trustees) hold property on behalf of other people (termed beneficiaries).

UCITS – or Undertakings for Collective Investment in Transferable Securities, is the legal form under E.U. law for mutual investment funds that are open to pool and invest funds from any individual or institutional investor, and are subject to specific authorisation criteria, investment limits and rules. The advantage of UCITS is the general principle of home-state authorisation and mutual recognition that applies to this kind of financial products, meaning that a UCITS fund established and authorised in one E.U. Member State can be freely distributed in any other Member State without any further formalities (also called *E.U. fund passporting*).

Unfunded pension plans* – are plans that are financed directly from contributions from the plan sponsor or provider and/or the plan participant. Unfunded pension plans are said to be paid on a current disbursement method (also known as the pay as you go, PAYG, method). Unfunded plans may still have associated reserves to cover immediate expenses or smooth contributions within given time periods. Most OECD countries do not allow unfunded private pension plans.

Unprotected pension plan* – is a plan (personal pension plan or occupational defined contribution pension plan) where the pension plan/fund itself or the pension provider does not offer any investment return or benefit guarantees or promises covering the whole plan/fund.

Voluntary contribution – is an extra contribution paid in addition to the mandatory contribution a member can pay to the pension fund in order to increase the future pension benefits.

Voluntary occupational pension plans - The establishment of these plans is voluntary for employers (including those in which there is automatic enrolment as part of an employment contract or where the law requires employees to join plans set up on a voluntary basis by their employers). In some countries, employers can on a voluntary basis establish occupational plans that provide benefits that replace at least partly those of the social security system. These plans are classified as voluntary, even though employers must continue sponsoring these plans in order to be exempted (at least partly) from social security contributions.

Voluntary personal pension plans* – Participation in these plans is voluntary for individuals. By law individuals are not obliged to participate in a pension plan. They are not required to make pension contributions to a pension plan. Voluntary personal plans include those plans that individuals must join if they choose to replace part of their social security benefits with those from personal pension plans.

Wage indexation* – is the method with which pension benefits are adjusted taking into account changes in wages.

11 | Page



Waiting period* – is the length of time an individual must be employed by a particular employer before joining the employer's pension scheme.

Winding-up* – is the termination of a pension scheme by either providing (deferred) annuities for all members or by moving all its assets and liabilities into another scheme.

World Bank multi-pillar model – is the recommended design, developed by the World Bank in 1994, for States that had pension systems inadequately equipped to (currently and forthcoming) sustain a post-retirement income stream for future pensioners and alleviate the old-age poverty risk. Simpler, it is a set of guidelines for States to either enact, reform or gather legislation regulating the state pension and other forms of retirement provisions in a form that would allow an increased workers' participation, enhance efficiency for pension savings products and a better allocation of resources under the principle of solidarity between generations.

The standard design of a robust pension system would rely on five pillars:

- a) the non-contributory scheme (pillar 0), through which persons who do not have an income or do not earn enough would have insured a minimum pension when reaching the standard retirement age;
- b) the public mandatory, Pay-As-You-Go (PAYG) scheme (Pillar I), gathering and redistributing pension contributions from the working population to the retirees, while accumulating pension rights (entitlements) for the future retirees;
- c) the mandatory funded and (recommended) privately managed scheme (Pillar II), where workers' contributions are directed to their own accumulation accounts in privately managed investment products;
- d) the voluntary privately managed retirement products (Pillar III), composed of pension savings products to which subscription is universal, contributions and investments are deregulated and tax-incentivised;
- e) the non-financial alternative aid scheme (pillar IV), through which the state can offer different forms of retirement support such as housing or family support. Albeit the abovementioned, the report focuses on the "main pillars", i.e. Pillar I, II and III, since they are the most significant (and present everywhere) in the countries that have adopted the multi-pillar model.

Definitions with "*" are taken from OECD's Pensions Glossary http://www.oecd.org/daf/fin/private-pensions/38356329.pdf.



Contributors

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Pension Savings: The Real Return 2018 Edition

Foreword

One can supervise only what one can measure: Why is this long-term savings performance report (unfortunately) unique?

One of the worst European retail services market

Investment and private pension products are persistently rated among the worst performing retail services markets of all throughout the European Union according to the European Commission's consumer markets scorecards⁸.

The Commission also points out that "other reasons for not saving long-term are the oftenpoor performance of financial intermediaries to deliver reasonable return and costs of intermediation"⁹.

Pension savings also appear to be one of the few retail services where neither the customers nor the public supervisors are properly informed about the real net performance of the services rendered to them.

These features of the pension savings markets may well be connected of course.

The actual performance of this market is unknown to clients and to public supervisors

Indeed, apart from the OECD (the Organisation for Economic Co-operation and Development) publications on the real return of certain "pension funds"¹⁰, the contributors to this research report could not find any other more complete or more recent published comprehensive information on the net real pension savings returns for EU countries. Even the report produced for the European Commission on "the position of savers in private

⁸ Consumer Markets Scoreboard 2016 – Making markets work for consumers, European Commission, 2016

 ⁹ European Commission - Staff Working Document on long term financing of the EU economy (2013)
¹⁰ <u>http://www.oecd.org/finance/private-pensions/oecdpensionsoutlook2012.htm</u> and
<u>http://www.oecd.org/daf/fin/private-pensions/Pension-Markets-in-Focus-2015.pdf</u>



pension products"¹¹ relies only on the above-mentioned OECD report as far as returns and performances are concerned.

Moreover, as analysed in the previous editions of BETTER FINANCE's research on the real return of pension savings, the extremely useful data reported by the OECD¹² are unfortunately quite incomplete:

- The most recent OECD publication on pension returns, "Pension Markets in Focus 2017", provides ten-year returns maximum, which is quite a short time frame for such long-term products, and also the ending time of up to June 2016 is now two years old;
- Only eight of the fifteen EU countries covered by BETTER FINANCE are reported by OECD for its 10-year data; seven are missing including the biggest ones except the UK and Italy: Bulgaria, France, Germany, Poland, Romania, Spain and Sweden;
- A part of occupational pension products, and most if not all individual pension products are missing as well, as OECD performance data include only "pension funds" stricto sensu, and exclude all "pension insurance contracts and funds managed as part of financial institutions (often banks or investment companies), such as the Individual Retirement Accounts (IRAs) in the United States";
- It is questionable that the OECD was able to capture all expenses borne by pension savers - entry fees for example - because the OECD relies mostly on reporting by national authorities and, typically, this is not something covered by them;
- Finally, OECD figures are all before taxes, except for Italy.

This means the European financial supervisors - the European Commission and the European financial supervisory authorities (Securities and Markets, Insurance and Pensions, and Banking) – do not know the actual performance of the services they are supposed to regulate and supervise.

¹¹ Study on the position of savers in private pension products – prepared for the DG Internal Market of the European Commission and the Financial Services User Group (published in August 2013)
¹² Namely the OECD "Pension Markets in Focus 2017" (1-, 5- and 10-year data).



The failure of European supervisors to report "consumer" performance data

However, the European Supervisory Authorities (ESAs) have a legal duty to collect, analyse and report data on "consumer trends" in their respective fields (Article 9(1) of the European Regulations establishing the three ESAs).

To our knowledge, neither the Banking¹³ nor the Insurance and Pensions¹⁴ Authorities provide any reporting on the performance of retail savings products in their fields of competence (respectively bank savings products, and life insurance and pension saving products up to now). The Securities and Markets authority includes "retail investor portfolio returns" in past "Trends, Risks and Vulnerabilities" reports, but stopped doing so in 2016¹⁵. In addition, these data are actually capital markets performance data, not retail investments performance ones, based on 5-year average monthly returns on a portfolio¹⁶ composed of:

- 47% stocks (Stoxx600: large and mid-cap European equities);
- 42% deposits (1-year Euribor);
- and 11% bonds (Barclays Euro Aggregate 7-10Y).

Unfortunately, such a portfolio has little in common with average retail investor portfolios, which - according to ESMA (the European Securities and Markets Authority) itself is composed of¹⁷:

- 31% deposits (but for the vast majority certainly not returning the one-year "interbank" rate -Euribor- and not even benchmarked against it),
- 25% insurance and pension funds;
- 22% stocks (but a majority of unlisted ones);
- 12% mutual funds;
- and 7% bonds.

Performance: capital markets are not a proxy for retail investments

And indeed, our experience and findings clearly confirm that capital market performances have unfortunately very little to do with the performances of the actual savings products

¹⁷ ESMA – Trends, Risks, Vulnerabilities Report Nr. 1, March 2014; this detailed breakdown of EU households' financial assets was not longer published afterwards by ESMA.

¹³ EBA -

http://www.eba.europa.eu/documents/10180/1360107/Consumer+Trends+Report+2016.pdf ¹⁴ EIOPA – <u>https://eiopa.europa.eu/Publications/Reports/EIOPA-BoS-15-233%20-</u> %20EIOPA Fourth Consumer Trends Report.pdf

¹⁵ See for example ESMA – Trends, Risks, Vulnerabilities Report Nr. 1, March 2016 and Nr. 1, March 2015

¹⁶ ESMA – 'Trends, Risks, Vulnarabilities Report Nr. 2, 2017, p.16



distributed to EU citizens. And this is particularly true for long-term and pension savings. The main reason for this is the fact that most EU citizens do not invest the majority of their savings directly into capital market products (such as equities and bonds), but into "packaged products" (such as investment funds, life insurance contracts and pension products).

One could then argue that insurance and pension products have similar returns to a mixed portfolio of equities and bonds, since those are indeed the main underlying investment components of insurance and pension "packaged" products. This is actually how ESMA came up with its "retail investor" portfolio return computation. But this was no more than a "leap of faith", ignoring such realities as fees and commissions charged on retail products, portfolio turnover rates, manager's risks, etc. Charges alone totally invalidate this approach.

The tables below show two striking – but unfortunately not uncommon – real examples of this largely ignored reality: capital market performance is not a valid proxy for retail investment performance and the main reasons for this are the fees and commissions charged directly or indirectly to retail customers. The European Commission itself publicly stressed this fact (see footnote 2 above).

Table FW1. Real case of a Belgian life insurance (branch 23)

Capital markets vs. Belgian Occupational pension insurance 2000-2017* performance

Capital markets (benchmark index**) performance			
Nominal performance	127%		
Real performance (before tax)	59%		
Pension insurance performance (same benchmark**)			
Nominal performance	56%		
Real performance (before tax)	10%		
*To end of 2017			
<u>Sources</u> : BETTER FINANCE, provider			

** Benchmark is composed of 50% bonds (LP06TREU) and 50% equity (2000 - 2017 FTSE AW TRI) Note: LP06TREU is Bloomberg Barclays Pan-European Aggregate Bond Index; FTSE All-World TR EUR Index.

In the real case above, the pension product's nominal return amounted to not even half of the return of its corresponding capital market benchmark.





Graph FW1. Real case of French retail equity fund

In the real case illustrated above, a so-called retail CAC 40 "index" fund¹⁸ actually underperformed the relevant equity index by 80 p.p. after 18 years of existence (loss of 19% instead of a 60% profit in 2000 to 2017), with the performance gap fully attributable to fees. The fund has also massively destroyed the real value of its clients' savings, as inflation has been almost twice as high as its nominal performance. It is quite surprising that with such a huge return gap vis-à-vis its benchmark, this fund is still allowed to portray itself as an "index-tracking" one, and that no warning is to be found in the Key Information Document (KIID) of the fund.

Another issue for European savers revealed in this graph is the use by investment product providers of narrow (large cap only or "blue chip") equity indexes instead of broader ones, although they claim the former to represent "the equity markets" as a whole. This practice has proven detrimental both:

• to investors as this graph shows (the French large cap equity market underperformed the actual global French equity market by 31 percentage points over the last 18 years: 60% versus 91%);

Source: BETTER FINANCE research, fund manager; * 2000-2003 simulated

¹⁸ Wrapped in an insurance contract as suggested by the distributor.



and to European SMEs since a lot of investment inflows are thus directed to large caps only, instead of broader instruments including mid and small caps.

The ESMA approach of mistaking capital market returns for retail investment ones, is unfortunately widespread in available public research. This is, for example, the case of the latest research report published by the European Commission on this topic (see Study on the position of savers in private pension producst, prepared for EC DG MARKT and FISMA, August 2013).

Following BETTER FINANCE's 2015 proposal, the European Union was right to legally require the Supervisory Authorities to collect, analyse and report on European savers "trends". We learn in business schools that one can manage and supervise only what one can measure. And one major legal responsibility assigned to the European supervisory authorities is to "take a leading role in promoting transparency, simplicity and fairness in the market for consumer financial products or services across the internal market, including by... collecting, analysing and reporting on consumer trends..."

2015: The European Commission to require an analysis of the actual net performance of long term and pension savings

On 30 September 2015, the European Commission released its Action Plan on building a Capital Markets Union ("CMU"). BETTER FINANCE was happy to see that the lack of transparency and of analysis of the real net performance of pension savings is addressed in this Action Plan: "To further promote transparency in retail products, the Commission will ask the European Supervisory Authorities (ESAs) to work on the transparency of long-term retail and pension products and an analysis of the actual net performance and fees, as set out in Article 9 of the ESA Regulations".

In October 2017, the EC issued the long-awaited request for "the European Supervisory Authorities (ESAs) to issue the current reports on the costs and past performance of the main categories of retail investment, insurance and pension products". Still, there are important omissions in the request that need to be addressed as soon as possible (for details see our recommendation number 2 on page 70). The first reports from the ESAs are expected by the end of the year (2018).

In addition, in the meantime, the European Commission has eliminated all disclosures on the past performance of investment funds and on their benchmarks in the Key Information Document (KID) in its "PRIIPs"19 delegated act of 8 March 2017. This severe step back in transparency and in investor information is totally inconsistent with the CMU initiative, and

¹⁹ PRIIPs: packaged retail and insurance-based investment products.



it will deprice EU savers from knowing if the investment products have made any money or not in the past and if they had met their manager's investment objectives or not. It will also prevent independent researchers such as BETTER FINANCE to continue to monitor individual products' returns (such as the one illustrated on Graph FW1) in the future.

A customer-based approach to pension savings returns.

It is the ambition and challenge of this research initiated by BETTER FINANCE and its partners to collect, analyse and report on the actual past performance of long-term and pension savings products for the customer.

Our first report in 2013 established the methodology that was updated for this muchexpanded 2018 edition, covering 85% of the EU population.

The net real return of pension saving products should be:

- the long-term return (at least covering two full economic and stock market cycles, since even long-term returns are very sensitive to entry and exit dates. This time, we were able to collect up to 18 years of performance data in most countries covered);
- net of all fees, commissions and charges borne directly or indirectly by the customer;
- net of inflation (since for long-term products only the real return matters; that is the right approach taken by OECD as mentioned above);
- when possible, net of taxes borne by the customer (in the USA it has been mandatory for decades to disclose the past performance of mutual funds after tax in the summary of the prospectus).

Information on the returns of long term and pension savings is deteriorating

The following executive summary, general report and country reports show that finding all the data is not an impossible but a very challenging task for an independent expert centre such as BETTER FINANCE, since quite a lot of data are simply not available at an aggregate and country level, especially for earlier years. The complexity of the taxation of pension savings in EU countries makes it also extremely difficult to compute after tax returns.

In 2018, we find that Information on long term and pension savings returns is actually not improving but still deteriorating:

less information: for example, the Belgian insurance trade organisation Assuralia

²¹ | Page



does not report anymore the returns of insurance-regulated « Branch 21 » occupational and personal pension products since 2014 (and never did for the « Branch 23 products), and the national supervisor FSMA does not do it either.

- later information: at the time of printing (September 2018), still a lot of 2017 return data have not been released by the national trade organisations or other providers.
- Unchecked information: the principal source remains the national trade organisations, their methodology is most often not disclosed, return data do not seem to be checked or audited by any independent party, and sometimes the are only based on sample surveys covering just a portion of the products.
- As already mentioned, the European Commission has eliminated the disclosure of past performance of UCITS investment funds and of their benchmarks in the Key Information Document starting at the latest at the end of 2019.

There is still a long way to go before achieving "transparency, simplicity and fairness in the market for consumer financial products" as engraved in EU Law.



Pension Savings: The Real Return 2018 Edition

Executive Summary

As stated by the European Commission in a 2013 staff working document, "the crisis has increased savers' distrust in financial institutions and markets"²⁰. Similarly, the latest EU Consumer Markets Scorecard²¹ once again ranks pensions and investments as one of the worst consumer markets of all.

Coverage

The present report documents a principal component of, and reason for, the generalised level of distrust of EU citizens in capital markets, namely the frequent poor performance of private pension products, once inflation, charges and (when possible) taxes are deducted from nominal returns, and when compared to the relevant capital market benchmarks. It significantly broadens the geographical coverage of the initial research report by BETTER FINANCE entitled "The Real Return of Private Pensions", first published in June 2013.²² Totaling 16 EU Member States under review, Belgium, Bulgaria, Estonia, Germany, Italy, Latvia, Lithuania, Poland, Romania, Slovakia, Sweden, The Netherlands and the United Kingdom have been added to the initial group composed of Spain, France and Denmark. It also extends the period of time covered in order to now measure performance over the 18-year period ranging from 2000 to 2017, in as far as data was available. As such, the BETTER FINANCE research now covers 87% of the EU population.²³

The countries under review can be divided into four categories:

• At one end, we find countries like the Netherlands, Denmark, Sweden and the United Kingdom, where pension products' assets represent far more than the

 ²⁰ Commission Staff Working Document "Long-Term Financing of the European Economy" accompanying the Green Paper on Long Investment, European Commission, 25 March 2013, page 10: <u>http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=SWD:2013:0076:FIN:EN:PDF</u>.

²¹ Consumer Markets Scoreboard 2016 – Making markets work for consumers, European Commission, 2016

²² EuroFinUse, 'The Real Return of Private Pensions' (June 2013) <u>http://www.betterfinance.eu/fileadmin/user_upload/documents/Research_Reports/en/Pension_St</u> udy EN_website.pdf.

²³ As of January 1st, 2018 – Eurostat, 'Population change - Demographic balance and crude rates at national level [demo_gind]' <u>http://appsso.eurostat.ec.europa.eu/nui/show.do</u>.



annual GDP and where the real return of private pensions is of crucial importance;

- At the opposite end, we find countries like Italy and Spain, Bulgaria, Romania, or France, where pensions mainly depend on the quality and sustainability of the pay-as-you-go (PAYG) schemes;
- The remaining countries, except for Sweden, are in an intermediate position, where the standard of life of retirees depends both on the sustainability of PAYG systems and the returns of private savings;
- Sweden is an original case where the pillar I mandatory pension is now, for a small part, funded instead of PAYG.

Table EX1. Pension assets as % of GDP					
	Assets in % of GDP	Assets (in mil €)	Data source		
Belgium	18%	75,210	BF Report		
Bulgaria	13%	6,475	BF Report		
Denmark	205%	591,255	OECD Data		
Estonia	16%	3,788	BF Report		
France	10%	222,295	OECD Data		
Germany	7%	226,136	OECD Data		
Italy	10%	166,543	OECD Data		
Latvia	14%	3,677	BF Report		
Lithuania	7%	3,008	BF Report		
Netherlands	182%	1,338,100	BF Report		
Poland	9%	42,370	OECD Data		
Romania	5%	8,918	BF Report		
Slovakia	12%	9,943	BF Report		
Spain	14%	158,258	OECD Data		
Sweden	118%	547,654	BF Report		
UK	106%	2,455,755	OECD Data		

Why pension returns are critical for pension savings

Public Authorities involved in pension saving issues typically stress only two requisites for pension savings to achieve "pension adequacy" (i.e. pension income replacing a large part of the income before retirement):

- the need to start saving as early as possible;
- the need to save a significant portion of one's income before retirment activity income: "to support a reasonable level of income in retirement, 10%-15% of an average annual salary needs to be saved",²⁴

²⁴ World Economic Forum White Paper: We'll live to 100 – How can we afford it?, May 2017



For example, according to the OECD, *"In light of the challenges facing pension systems, the only long-term solution for achieving higher retirement income is to contribute more and for longer periods "*²⁵.

BETTER FINANCE has continuously begged to disagree, something which is reiterated in this year's report.

Indeed, contributing more and for longer periods is not enough if a hird and even more crucial requisite is missing: the need to get a positive and decent long-term return (a real net return: after inflation and fees and commissions). The initial BETTER FINANCE report on pension savings on a wider coverage (the 2014 Report)²⁶ first put forward the conclusion that pension savings products' returns are poor compared to their benchmarks (or capital markets in a broader view), mainly due to the high levels of fees or charges that eat into saver's returns. The subsequent four editions, including this one, have confirmed our initial findings, over and over again.

A simple example will illustrate why saving "more and for longer periods" is not sufficient, and too often even detrimental.

Assuming no inflation, saving 10% of the activity income for 30 years (as recommended by Public Authorities, 25-year life expectancy at retirement, and impact of fees, commissions tax excluded, the table below shows that **unless long term net returns are significantly positive (in the upper single digits), saving early and significantly will not provide a decent replacement income through retirement.**

Annual net return	Replacement income
negative 1%	10%
zero	12%
2%	17%
8%	49%

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Positive Capital market returns (1999-2017)

We have chosen a period covering the last 18 years because pension savings returns should be measured over a long-term horizon, and because it includes two market upturns (2003-2006 and 2009-2017) and two downturns (post dot com bubble of 2001-2003 and the 2008 financial crisis). It is on this period that we based our analysis in as far as data were available.

²⁵ OECD Pensions Outlook 2016 (Editorial, page 10, 2016)

²⁶ BETTER FINANCE, Pension Savings: The Real Return (2014 edition)



Since the choice of the time reference has a material impact on real returns, we have paid special attention to our choice of period to cover in order to keep our research objective.²⁷

To illustrate the impact of regular pension savings over 18 years versus a one-shot investment 18 years ago, we also measured the performance of the same investment repeated year after year over the last 18 years for one case (French corporate savings and pension plans; see French case section). However, the two are not fully comparable.

Since the beginning of the 21st century, capital market returns have been positive (moderately for equities while strongly for bonds):

- On a nominal basis (before taking inflation into account), world stock markets have grown in value (in €) by 93%,²⁸ where the US stock market has grown by 108%²⁹ and the European ones by 75%;³⁰
- On a real basis (net of inflation), European stock market (Stoxx All Europe) returned to positive cumulated performances by 2013, and once again reached significant levels by 2017 (+31%) as shown in the graph below. It is important to note, however, that some European countries, such as Greece and Italy, are still in negative territory (-80% and -23% respectively). Several large cap markets also continue to struggle with negative returns, and at the European level, the very narrow "Stoxx 50" index is still in negative territory after inflation (-10%) but includes only 50 European stocks.

²⁷ Ideally, one should look at even <u>longer-term</u> historical returns, but the data are, for the most part, not available for the earlier years.

²⁸ As measured by the MSCI All Country World Index (ACWI) Gross Returns denominated in €.

 $^{^{29}}$ As measured by the MSCI USA Gross Returns Index, calculated in $\pounds.$

 $^{^{\}rm 30}$ As measured by the MSCI Europe Gross Returns Index, denominated in ${\ensuremath{\varepsilon}}$





Graph EX1. Cumulative performance of wide European equity index vs narrow index

* We used the MSCI Europe GR index as a proxy for the 2000 and 2001 performances because we could not find those years for the STOXX All Europe Total Market index (these two indices are broad ones).

Bond markets enjoyed an exceptional phase and have performed extremely well thanks to the continuous decline of interest rates over the last 18 years: +130 % on a nominal basis, and +65% in real terms (inflation deducted).





Graph EX2. Cumulated Performance of European Bond Index

Sources: Barclays Pan-European Total Returns & Eurostat HICP Europe 28 Monthly

Overall, a direct balanced (50% in European equities / 50% in European bonds³¹) investment from a European saver in capital markets at the eve of the century³², would have returned a hefty +130% in nominal terms (gross of fees and taxes) and +60% in real terms, which means an annual average real return of +2.64% (+4.71% annual nominal return).

Most pension products recently improved but underperformed

Our research findings show that most long-term and pension savings products did not, on average, return anything close to those of capital markets, and in too many cases even destroying real value for European pension savers (i.e. provided a negative return after inflation). The returns, however, have improved in recent years, thanks to a long period of bullish capital markets from 2011 onwards, both for bonds and for equities. Of course, the capital market returns mentioned above are not taking any fees and commissions into account. Indeed, the attribution of performance shows that the level of fees and

 ³¹ Indices used are Stoxx All Europe Total Market (MSCI Europe for first 2 years) for equities and Barclays Pan European Aggregate for bonds.
³² Rebalanced every year.



commissions has been the main factor explaining long-term and pension savings' returns in Europe.

Pension returns drivers

Inflation has declined in recent years in a majority of countries, thus reducing the gap between nominal and real performance. The net real returns across countries are driven by:

- the asset allocation of pension products,
- the performance of capital markets into which pension products are invested,
- the asset managers' skills in terms of picking securities and market timing,
- **the fees and commissions** charged by asset managers and other financial intermediaries,
- and ultimately **by inflation** and by the **tax burden**.

There are striking differences between **the asset allocation** of pension funds across countries and products. Mutual funds are the main component of investments in Belgium and in Germany. This is also the case for the United Kingdom, although to a lesser extent, where mutual funds tend to replace direct holdings of shares, whose weight fell from 57% to 20% between 2001 and 2014. Conversely, the preponderance of shares (especially from Danish companies) in Denmark to a large extent explains the good performance of pension products in this country. Equities also dominate in Sweden. Bonds dominate in France (life-insurance and public employee funds), Italy, Poland (employee pension funds), Spain, Romania and Latvia, with investments chiefly consisting of government bonds. Overall, the period 2000-2015 shows a decline of allocations to equities and an increase of public debt in pension funds allocation, a trend that could be said to disadvantage savers as it is likely to diminish return prospects with bond interest rates now at an all time low.

The decrease in government bond interest rates since 1999 has had a positive impact on outstanding assets, especially in countries where this asset class dominates, but it reduces the capacity to offer a good remuneration on new investment flows.

With regards to **asset managers' skills**, a majority of those underpferform their capital market benchmarks over the long-term.

Fees and commissions substantially reduce the performances of pension products, especially for personal "packaged" pension products, and for unit-linked life-insurance in particular. Charges are often complex, opaque and far from being harmonised between different pension providers and products. Some countries have started to impose overall caps on fees for some pension products (UK, Romania, Latvia).



Finally, **taxes** also reduce the performance of investments. The general model applied to pension products is deferred taxation, with contributions being deducted from taxable income and instead taxed as pension pay outs. The accumulated capital can be withdrawn at least partially at retirement as a lump-sum, which is often not taxable. Our calculations of net returns are based on the most favourable case, i.e. assuming that the saver withdraws the maximum lump-sum possible.

You will find a more detailed analysis of return contributions in General Report section of this study.

European Pension returns outlook

The overall mid-term outlook for the adequacy of European pension savings in 2018 is worrying when one analyses it for each of these main return drivers:

- It is unlikely that the European bond markets will come any closer to the extraordinary returns of the last 18 years (as we are already seeing stagnation or even signs of a downward trend), due to the continuous fall of interest rates, currently at rock-bottom levels.
- The negative impact of this foreseeable trend in bond returns on pensions' returns will be reinforced by a higher proportion of bonds in pension products' portfolios in recent years.
- Fees and commissions do not show any significant downward trend, and the transparency of cost disclosures is not improving.³³
- Inflation just like interest rates seems to be picking up from all-time lows, and the consequences of the "non-conventional" monetary policies of central banks on possible market "bubbles" are still unchartered.
- Taxes on long-term and pension savings do not show any significant downward trend either.

Pension returns per country

The best performing national pension products over the last 18 years were the Dutch occupational pension funds (end of 1999 to end of 2017, +2.84% yearly average), even outperforming a direct balanced investment in European capital markets (+47%) at the time. Pension funds in the UK have shown positive returns, net of charges and inflation, over 17 years up to 2016 at an average rate of 3.10% (+68% cumulatively). The portfolio allocation of the British pension funds bears the heaviest weighting in mutual funds (34% in

³³ This has also been confirmed by the 2018 EC study on the distribution systems of retail investment products across the European Union: "some distributors do not display any or only partial information on applicable costs and charges", p5.



2016), followed by securities issued by state authorities (24%, an increase from 2015), shares (16%) and corporate bonds (9%). Thus, this outstanding performance seems due to the high exposure to stock markets, either directly (share of equities) or indirectly through mutual funds.

However, on the full reporting period (2000-2017), Dutch pension funds remain the best performing with the highest average growth rate of 2.89% (+67%), followed by German pension insurances (2.21% annually and +48% cumulative) and Belgian occupational pension funds managed by IORPs (2.10% annually and +43% cumulative).

The average annual real returns of pension funds after charges and tax have slightly increased in Poland from 2016, reaching 4.27% over the period 2002-2017³⁴. The negative real returns in French unit-linked life insurance products have reached a negative real cumulative performance of -14% on 18 years (-0.82% annually). This makes them the worst performing retirement savings products. The pension products that have performed negatively as per our latest data are the Latvian state funded pensions reaching -2.63% and the Dutch life-insurance (-0.11%), but on a much shorter period (2003-2017), which is rather worrying considering that this data excludes the 2001-2003 dotcom bubble and starts with the 2003 market upturn.

The Romanian Pillar II products (occupational pension funds) have continued to increase in NAV, but at a lower rate, achieving a cumulative performance of +64% over 10 years (5.1% average). This is good considering that the launch of these funds coincided with the subprime crisis (2008), when most financial products lost between a third and a half of their cumulative performance, and in particular as it was followed by the sovereign debt crisis (2010).

Unit-linked insurance products seem to struggle to perform everywhere, mainly due to the high (most often undisclosed) overall level of multi-layered fees.

These poor or even negative real returns have led public authorities in some Member States to take measures in order to ensure transparency and cap the fees charged by certain pension providers (in countries such as the UK, Romania and Latvia). The issue is crucial, especially in countries like the United Kingdom where the standard of living of retirees is heavily dependent on pre-funded pension schemes.

The following tables detail the long-term real returns of the main long-term and pension saving product categories in the 16 European countries analysed.

³⁴ However, in both cases returns would most likely have been lower, but we have not been able to find return data for the earlier years, from 2000 to 2002, when equity markets declined strongly.



Graph EX3(A). ANNUALISED REAL RETURNS OF PENSION SAVINGS - AFTER CHARGES & INFLATION - BEFORE TAX -FROM 2000/01



 $\textbf{-2\%-1\%-1\%}\ 0\%\ 1\%\ 1\%\ 2\%\ 2\%\ 3\%\ 3\%\ 4\%$

<u>Source</u>: BETTER FINANCE Research; * Net of taxes, charges and inflation



Graph EX3(B). ANNUALISED REAL RETURNS OF PENSION SAVINGS - AFTER CHARGES & INFLATION - BEFORE TAX -FROM 2002



<u>Source</u>: BETTER FINANCE Research; * Gross of fees



Graph EX3(C). ANNUALISED REAL RETURNS OF PENSION SAVINGS - AFTER CHARGES & INFLATION - BEFORE TAX -LATER STARTING DATES



Source: BETTER FINANCE Research


Pension Savings: The Real Return 2018 Edition

General Report

Introduction

In June 2013, BETTER FINANCE published a research report entitled "<u>Private Pensions: The</u> <u>Real Return</u>" which evaluated the return of private pension products after charges, after inflation ("real" returns) and – where possible – after taxation. This first report furthermore identified the factors affecting these returns in Denmark, France and Spain, including an indepth description of the pension savings vehicles available in these countries.

In September 2014, BETTER FINANCE published the 2014 edition of the "<u>Pension Savings:</u> <u>The Real Return</u>" research report, which included data updates for the three countries covered in the initial study, as well as new in-depth evaluations of pension savings for five new countries: Belgium, Germany, Italy, Poland and the United Kingdom.

The 2015 edition of the BETTER FINANCE research report was aimed at updating the existing country cases and expanding the coverage to 15 European Union countries with the addition of Bulgaria, Estonia, Latvia, the Netherlands, Romania, Sweden and Slovakia. With the inclusion of these countries the research report reached a coverage of approximately 85% of the EU population.

The 2016, 2017 and 2018 editions are updates of the 15 existing country cases, with this year's edition also expanding the geographic scope to include Lithuania. The report is based on the most recent data available at the time of print and includes a wider range of available pension vehicles with the aim of encompassing all financial savings products actually used by EU citizens to save for retirement. Furthermore, overviews on recent trends in the respective long-term savings and pension markets are provided.

The entire series of research reports has illustrated over the years that real returns of retirement savings have been, and still are on average, very low once charges, inflation and taxes have been taken into account. Measuring the impact of all these elements (inflation, charges and taxes) is especially important in a low interest rate environment because the real return for savers can be substantially negative. Since a comprehensive approach to provide this indispensable information to savers is not provided for the time being by Public Authorities or other independent bodies, this research report aims to improve transparency



on the real returns of long-term and pension savings in Europe. This is in line with the European Commission's current "Action" to improve the transparency of performance and fees in this area (as part of its Capital Markets Union – CMU - Action Plan). This CMU Action was proposed by BETTER FINANCE in 2015.

Country profiles

Table GR1 includes some key characteristics of the pension systems in the countries under review in this research report.

Table GR1 - Country Profiles (at the end of 2017)					
Belgium					
Net equity of households in pension funds reserves (in € bn)	100	Net equity of households in pension funds reserves as % of GDP	23%		
Net equity of households in life insurance reserves (in € bn)	201	Net equity of households in life insurance reserves as % of GDP	46%		
Working population	5 m	Old- Age dependency ratio, old (% of working-age population)	28.9%		
Population ageing trend	21%	Projected old-age dependency ratio by 2030	39.8%		
Net pension replacement rat	tes, Men, % d	of pre-retirement earnings, 2016	66.1%		
Bulgaria					
Net equity of households in pension funds reserves (in € bn)	6.39	Net equity of households in pension funds reserves as % of GDP	13%		
Net equity of households in life insurance reserves (in € bn)	0.65	Net equity of households in life insurance reserves as % of GDP	1%		
Working population	3.2 m	Age dependency ratio, old (% of working-age population)	32.0%		
Population ageing trend	20%	Projected old-age dependency ratio by 2030	44.0%		
Net pension replacement rat	tes, Men, % d	of pre-retirement earnings, 2016	88.9%		
Denmark					
Net equity of households in pension funds reserves (in € bn)	187	Net equity of households in pension funds reserves as % of GDP	65%		
Net equity of households in life insurance reserves (in € bn)	259	Net equity of households in life insurance reserves as % of GDP	90%		
Working population	3 m	Age dependency ratio, old (% of working-age population)	30.8%		
Population ageing trend	16%	Projected old-age dependency ratio by 2030	39.2%		
Net pension replacement rat	tes, Men, % d	of pre-retirement earnings, 2016	80.2%		
Estonia					
Net equity of households in pension funds reserves (in € bn)	3.60	Net equity of households in pension funds reserves as % of GDP	16%		
		36 P	age		



Net equity of households in life insurance reserves (in € bn)	0.48	Net equity of households in life insurance reserves as % of GDP	2%
Working population	0.7 m	Age dependency ratio, old (% of working-age population)	30.3%
Population ageing trend	-5%	Projected old-age dependency ratio by 2030	41.4%
Net pension replacement rate	es, Men, % c	of pre-retirement earnings, 2016	57.4%
France			
Net equity of households in pension funds reserves (in € bn)	205	Net equity of households in pension funds reserves as % of GDP	9%
Net equity of households in life insurance reserves (in € bn)	1,724	Net equity of households in life insurance reserves as % of GDP	75%
Working population	30.3 m	Age dependency ratio, old (% of working-age population)	31.7%
Population ageing trend	24%	Projected old-age dependency ratio by 2030	44.4%
Net pension replacement rate	es, Men, % c	of pre-retirement earnings, 2016	74.5%
Germany			
Net equity of households in pension funds reserves (in € bn)	846	Net equity of households in pension funds reserves as % of GDP	26%
Net equity of households in life insurance reserves (in € bn)	980	Net equity of households in life insurance reserves as % of GDP	30%
Working population	43.4 m	Age dependency ratio, old (% of working-age population)	32.8%
Population ageing trend	23%	Projected old-age dependency ratio by 2030	47.1%
Net pension replacement rate	es, Men, % c	of pre-retirement earnings, 2016	50.5%
Italy			
Net equity of households in pension funds reserves (in € bn)	249	Net equity of households in pension funds reserves as % of GDP	15%
Net equity of households in life insurance reserves (in € bn)	714	Net equity of households in life insurance reserves as % of GDP	42%
Working population	25.4 m	Age dependency ratio, old (% of working-age population)	36.3%
Population ageing trend	23.8%	Projected old-age dependency ratio by 2030	48.6%
Net pension replacement rate	es, Men, % o	of pre-retirement earnings, 2016	93.2%
Latvia			
Net equity of households in pension funds reserves (in € bn)	4	Net equity of households in pension funds reserves as % of GDP	14%
Net equity of households in life insurance reserves (in € bn)	0.39	Net equity of households in life insurance reserves as % of GDP	2%
Working population	1 m	Age dependency ratio, old (% of working-age population)	30.5%



i opulation ageing trend	29%	Projected old-age dependency ratio by 2030	47.9%
Net pension replacement rates	, Men, %	of pre-retirement earnings, 2016	59.5%
Lithuania			
Net equity of households in pension funds reserves (in € bn)	3.01	Net equity of households in pension funds reserves as % of GDP	7%
Net equity of households in life insurance reserves (in € bn)	0.84	Net equity of households in life insurance reserves as % of GDP	2%
Working population	1.46 m	Age dependency ratio, old (% of working-age population)	28.7%
Population ageing trend	40%	Projected old-age dependency ratio by 2030	51.1%
Net pension replacement rates	, Men, %	of pre-retirement earnings, 2016	71.2%
Netherlands			
Net equity of households in pension funds reserves (in € bn)	1,437	Net equity of households in pension funds reserves as % of GDP	195%
Net equity of households in life insurance reserves (in € bn)	151	Net equity of households in life insurance reserves as % of GDP	21%
Working population	9.1 m	Age dependency ratio, old (% of working-age population)	29.0%
Population ageing trend	28%	Projected old-age dependency ratio by 2030	42.5%
Net pension replacement rates	, Men, %	of pre-retirement earnings, 2016	100.6%
Poland			
Folaliu			
Net equity of households in pension funds reserves (in € bn)	48	Net equity of households in pension funds reserves as % of GDP	10%
Net equity of households in pension funds reserves (in € bn) Net equity of households in life insurance reserves (in € bn)	48 19	Net equity of households in pension funds reserves as % of GDP Net equity of households in life insurance reserves as % of GDP	10% 4%
Net equity of households in pension funds reserves (in € bn) Net equity of households in life insurance reserves (in € bn) Working population	48 19 18.3 m	Net equity of households in pension funds reserves as % of GDP Net equity of households in life insurance reserves as % of GDP Age dependency ratio, old (% of working-age population)	10% 4% 24.5%
Net equity of households in pension funds reserves (in € bn) Net equity of households in life insurance reserves (in € bn) Working population Population ageing trend	48 19 18.3 m 43%	 Net equity of households in pension funds reserves as % of GDP Net equity of households in life insurance reserves as % of GDP Age dependency ratio, old (% of working-age population) Projected old-age dependency ratio by 2030 	10% 4% 24.5% 40.5%
Net equity of households in pension funds reserves (in € bn) Net equity of households in life insurance reserves (in € bn) Working population Population ageing trend Net pension replacement rates	48 19 18.3 m 43% 5, Men, %	Net equity of households in pension funds reserves as % of GDP Net equity of households in life insurance reserves as % of GDP Age dependency ratio, old (% of working-age population) Projected old-age dependency ratio by 2030 of pre-retirement earnings, 2016	10% 4% 24.5% 40.5% 38.6%
Net equity of households in pension funds reserves (in € bn) Net equity of households in life insurance reserves (in € bn) Working population Population ageing trend Net pension replacement rates Romania	48 19 18.3 m 43%	Net equity of households in pension funds reserves as % of GDP Net equity of households in life insurance reserves as % of GDP Age dependency ratio, old (% of working-age population) Projected old-age dependency ratio by 2030 of pre-retirement earnings, 2016	10% 4% 24.5% 40.5% 38.6%
Net equity of households in pension funds reserves (in € bn) Net equity of households in life insurance reserves (in € bn) Working population Population ageing trend Net pension replacement rates Romania Net equity of households in pension funds reserves (in € bn)	48 19 18.3 m 43% 5, Men, %	Net equity of households in pension funds reserves as % of GDP Net equity of households in life insurance reserves as % of GDP Age dependency ratio, old (% of working-age population) Projected old-age dependency ratio by 2030 of pre-retirement earnings, 2016 Net equity of households in pension funds reserves as % of GDP	10% 4% 24.5% 40.5% 38.6%
Net equity of households in pension funds reserves (in € bn) Net equity of households in life insurance reserves (in € bn) Working population Population ageing trend Net pension replacement rates Romania Net equity of households in life insurance reserves (in € bn) Net equity of households in pension funds reserves (in € bn) Net equity of households in life insurance reserves (in € bn)	48 19 18.3 m 43% 5, Men, % 8.9 1.7	Net equity of households in pension funds reserves as % of GDP Net equity of households in life insurance reserves as % of GDP Age dependency ratio, old (% of working-age population) Projected old-age dependency ratio by 2030 of pre-retirement earnings, 2016 Net equity of households in pension funds reserves as % of GDP Net equity of households in life insurance reserves as % of GDP	10% 4% 24.5% 40.5% 38.6% 4.80%
Net equity of households in pension funds reserves (in € bn) Net equity of households in life insurance reserves (in € bn) Working population Population ageing trend Net equity of households in pension replacement rates Romania Net equity of households in life insurance reserves (in € bn) Net equity of households in pension funds reserves (in € bn) Net equity of households in life insurance reserves (in € bn) Working population	48 19 18.3 m 43% 5, Men, % 8.9 1.7 8.8 m	Net equity of households in pension funds reserves as % of GDP Net equity of households in life insurance reserves as % of GDP Age dependency ratio, old (% of working-age population) Projected old-age dependency ratio by 2030 of pre-retirement earnings, 2016 Net equity of households in pension funds reserves as % of GDP Net equity of households in life insurance reserves as % of GDP Age dependency ratio, old (% of working-age population)	10% 4% 24.5% 40.5% 38.6% 4.80% 0.90% 26.7%
Net equity of households in pension funds reserves (in € bn) Net equity of households in life insurance reserves (in € bn) Working population Population ageing trend Net pension replacement rates Romania Net equity of households in life insurance reserves (in € bn) Working population Population ageing trend Net pension replacement rates Romania Net equity of households in pension funds reserves (in € bn) Net equity of households in life insurance reserves (in € bn) Working population Population ageing trend by 2030	48 19 18.3 m 43% , Men, % 8.9 1.7 8.8 m 25%	Net equity of households in pension funds reserves as % of GDP Net equity of households in life insurance reserves as % of GDP Age dependency ratio, old (% of working-age population) Projected old-age dependency ratio by 2030 of pre-retirement earnings, 2016 Net equity of households in pension funds reserves as % of GDP Net equity of households in life insurance reserves as % of GDP Age dependency ratio, old (% of working-age population) Projected old-age dependency ratio by 2030	10% 4% 24.5% 40.5% 38.6% 4.80% 0.90% 26.7% 37.6%

38 | P a g e



SIOVARIA			
Net equity of households in pension funds reserves (in € bn)	9.5	Net equity of households in pension funds reserves as % of GDP	11%
Net equity of households in life insurance reserves (in € bn)	4.8	Net equity of households in life insurance reserves as % of GDP	6%
Working population	2.8 m	Age dependency ratio, old (% of working-age population)	21.7%
Population ageing trend	44%	Projected old-age dependency ratio by 2030	35.9%
Net pension replacement rate	es, Men, % o	of pre-retirement earnings, 2016	83.8%
Spain			
Net equity of households in pension funds reserves (in € bn)	169	Net equity of households in pension funds reserves as % of GDP	15%
Net equity of households in life insurance reserves (in € bn)	161	Net equity of households in life insurance reserves as % of GDP	14%
Working population	22.9 m	Age dependency ratio, old (% of working-age population)	29.5%
Population ageing trend		Projected old-age dependency ratio by 2030	44.4%
Net pension replacement rate	es, Men, % d	of pre-retirement earnings, 2016	81.8%
Sweden			
Sweden Net equity of households in pension funds reserves (in € bn)	405	Net equity of households in pension funds reserves as % of GDP	87%
Sweden Net equity of households in pension funds reserves (in € bn) Net equity of households in life insurance reserves (in € bn)	405 112	Net equity of households in pension funds reserves as % of GDP Net equity of households in life insurance reserves as % of GDP	87% 24%
Sweden Net equity of households in pension funds reserves (in € bn) Net equity of households in life insurance reserves (in € bn) Working population	405 112 5.3 m	Net equity of households in pension funds reserves as % of GDP Net equity of households in life insurance reserves as % of GDP Age dependency ratio, old (% of working-age population)	87% 24% 32.0%
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Sweden Net equity of households in pension funds reserves (in € bn) Net equity of households in life insurance reserves (in € bn) Working population Population ageing trend Net pension replacement rate United Kingdom Net equity of households in pension funds reserves (in € bn)	405 112 5.3 m 7.3% es, Men, % o	Net equity of households in pension funds reserves as % of GDP Net equity of households in life insurance reserves as % of GDP Age dependency ratio, old (% of working-age population) Projected old-age dependency ratio by 2030 of pre-retirement earnings, 2016 Net equity of households in pension funds reserves as % of GDP	87% 24% 32.0% 38.7% 54.9%
Sweden Net equity of households in pension funds reserves (in € bn) Net equity of households in life insurance reserves (in € bn) Working population Population ageing trend Net pension replacement rate United Kingdom Net equity of households in life insurance reserves (in € bn) Net equity of households in pension funds reserves (in € bn) Net equity of households in life insurance reserves (in € bn)	405 112 5.3 m 7.3% es, Men, % o 3,471 743	Net equity of households in pension funds reserves as % of GDP Net equity of households in life insurance reserves as % of GDP Age dependency ratio, old (% of working-age population) Projected old-age dependency ratio by 2030 of pre-retirement earnings, 2016 Net equity of households in pension funds reserves as % of GDP Net equity of households in life insurance reserves as % of GDP	87% 24% 32.0% 38.7% 54.9% 151% 32%
Sweden Net equity of households in pension funds reserves (in € bn) Net equity of households in life insurance reserves (in € bn) Working population Population ageing trend Net pension replacement rate United Kingdom Net equity of households in pension funds reserves (in € bn) Net equity of households in pension funds reserves (in € bn) Net equity of households in life insurance reserves (in € bn) Working population	405 112 5.3 m 7.3% 3,471 3,471 743 33.9 m	Net equity of households in pension funds reserves as % of GDP Net equity of households in life insurance reserves as % of GDP Age dependency ratio, old (% of working-age population) Projected old-age dependency ratio by 2030 of pre-retirement earnings, 2016 Net equity of households in pension funds reserves as % of GDP Net equity of households in life insurance reserves as % of GDP Age dependency ratio, old (% of working-age population)	87% 24% 32.0% 38.7% 54.9% 151% 32% 29.0%
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Source: OECD, Eurostat, World Bank, EC Ageing Report 2018

Out of the different factors that characterise a pension system, this report will focus on the *old-age dependency ratio*, the *net replacement ratio* of pre-retirement income, the



population ageing trend, the public pension part of the final retirement income (net pension replacement ratio) and the net equity of households for life insurance and pension fund entitlements. The aim of this short analysis is ultimately to highlight the importance of the market for private pension products and the need for better returns, as the former are designed to fulfil the social purpose of Pillar II and Pillar III schemes, i.e. covering the risk of poverty in old-age. The rationale is quite simple: if the public pension system is strong in the short-term, providing a large portion of pensions at sufficient levels to ensure pension adequacy, and it is sustainable in the long-term, the need and incentive to save more in private pension products will be lower. At the same time, the level of actuarial provisions of pension funds and life insurances for future pension entitlements is very indicative of the reliance of the population on the public pension system.

Old-age dependency ratio

A useful indicator of the pressure on pension systems is the old-age-dependency ratio, defined as the ratio between the total number of elderly persons when they are generally economically inactive (aged 65 and above) and the number of persons of working age.³⁵ When the ratio is low (like in Slovakia with 22% or Poland with 24%, corresponding to less than 1 pensioner to 4 workers), it means that the pressure on the state pension is low. When the old-age dependency ratio is high, it means that the burden on PAYG schemes is significant: in the short term, because they need to collect more in order to pay for current pension obligations; in the long term, because pension rights generally will increase proportionally with the amount of paid contributions during employment. The highest level among the countries in this report is found in Italy (36%), meaning that there is a lot of pressure on the Italian Pillar I. Bulgaria, Denmark, Estonia, France, Germany, Latvia and Sweden all maintain ratios of 30% or above.³⁶

Population ageing trend

Indicated as early as 2011, "although each pension system differs from Member State to Member State, all of them face similar challenges in particular with regard to the phenomenon of an ageing population".³⁷ An ageing population means that the number of retirees increases relative to the number of workers. The effect is that the same pension

³⁵ Eurostat definition: <u>http://ec.europa.eu/eurostat/web/products-</u> <u>datasets/product?code=tsdde511</u>

³⁶ All data are take from the World Bank statistics – The World Bank, Age dependency ratio, old (% of working-age population) <u>https://data.worldbank.org/indicator/SP.POP.DPND.OL</u>.

³⁷ Werner Eichhorst, Maarten Gerard, Michael J. Kendzia, Christine Mayrhuber, Connie Nielsen, Gerhard Runstler, Thomas Url, 'Pension Systems in the EU – Contingent Liabilities and Assets in the Public and Private Sector' European Parliament Directorate General for Internal Policies (October 2011) P/A/ECON/ST/2010-26.



contributions need to pay for a higher number of pensioners, which can make it difficult for the state pension to ensure an adequate level of retirement income stream. The European Commission's 2018 Ageing Report shows that in all countries in this Report the retired population (+65 years) will have increased by 2030 with respect to 2016. The countries where the forecasted situation is better are Estonia (+5%) and Sweden (+7.3%), whereas in Member States such as Poland, Lithuania or Slovakia there will be nearly 50% more retirees in 2030 compared to 2016. This also determined the *projected old-age dependency ratio*.

Projected old-age dependency ratio

As indicated above, the old-age dependency ratio determines how many workers contribute to the state pension of one current retiree. While at the time of writing, public pensions in the countries covered, on average, rely on three working-age individuals to provide for the pension entitlements of one pensioner, by 2030 this level will, for most countries in this Report, be close to 50%, or every state pension will depend on the level of contributions of almost two working-age individuals. These assumptions will be translated, as for the *old-age dependency ratio*, into a higher pressure on public pensions (Pillar I).

Net equity of households in pension fund reserves

The net equity of households in pension funds and reserves of life insurances are a classification of financial accounts that represent the value of technical (mathematical) reserves of insurance and pension fund providers hold to pay future pension liabilities (entitlements), based on actuarial estimations.³⁸ They reflect the savings that contributors to pension funds and life insurances have accumulated for their retirement income. These indicators are expressed in the table above (Table GR1) both in their nominal value (*in* \notin *billion*) and as a percentage of the GDP for 2017.

The net equity of households in pension fund reserves ranges from a minimum of 4.8% of GDP in Romania to a maximum of 195% in the Netherlands. With the exception of the Netherlands, United Kingdom (151%), Sweden (87%) and Denmark (65%), this ratio is inferior to 30% in all countries. This reflects the fact that only those four countries have been building pre-funded pension schemes for a long time, whereas other countries have widely relied on a publicly-managed PAYG scheme.

³⁸ See OECD, 'Net Equity of Households in Life Insurance Reserves and in Pension Funds' OECD Glossary of Statistical Terms – <u>https://stats.oecd.org/glossary/detail.asp?ID=1754</u>; see also Francois Lequiller, 'International Differences in the Recording of General Government Pension Schemes in the National Accounts' Contribution to the IMF EDG on the Treatment of Pension Schemes in Macroeconomic Statistics, 3 - <u>https://www.imf.org/external/np/sta/ueps/2003/030303.pdf</u>; International Monetary Fund, 'Monetary and Financial Statistics Manual' (2000) IMF, 34.



Net equity of households in life insurance reserves

However, one should also take into account a second indicator to form a correct perception of savings accumulated for retirement: the ratio of the net equity of households in life insurance reserves and annuities as a percentage of GDP. Indeed, many pension arrangements are organised within the legal framework of life insurance contracts, both in Pillar II (occupational and company schemes) and Pillar III (individual private contracts) of the pension systems. For instance, the net equity of households in life insurance reserves grew to 90% of GDP in Denmark (from 87% in 2016) but decreased to 75% in France (from 77% in 2016). Moreover, in countries like France, life insurance is widely used by households in order to obtain additional resources at retirement age, even though most products offered by insurance companies are not specifically designed for retirement, i.e. subscribers can withdraw their savings at any moment even when they are not retired. It is not possible to know ex-ante which percentage of life insurance contracts will actually be used during the retirement period, but many polls confirm that this objective is a major motivation for subscribing to a life insurance contract. Less widespread in Eastern European countries, the weight of life insurance is equal or inferior to 5% of GDP in Bulgaria (1.30%), Poland (4%), Romania (the lowest at 0.9%), the Baltic States (between 1.50% and 2.10%).

Net replacement ratio

The purpose of multi-pillar pension systems is to provide a net pre-retirement replacement ratio that ensures pension adequacy. Pension schemes, life insurance contracts and PAYG systems are combined differently in each country to build the overall financial income of retirees.³⁹ The public (mandatory) basis is illustrated in the net pension replacement rate from public pension systems. These replacement rates are highest in the Netherlands (above 100%), closely followed by Italy (93%) and still solid in Slovakia (84%) and Bulgaria (89%). OECD reports the lower pre-retirement income replacement ratios for Romania (52%), Germany (50%) and Poland (39%).⁴⁰ Where this indicator is high, the incentive for the working population to save in supplementary pension products will be lower, but the pressure on the state system may become higher as public expenditure for Pillar I pensions will increase, based on the projected demographic figures.

Overall, the countries under review can be divided into three categories:

• In the first group of countries comprising Denmark, Sweden, the Netherlands, and the United Kingdom, the sum of pension and life insurance assets (and liabilities)

³⁹ Looking only at financial sources of pension income; property-related income is not in the scope of this study.

⁴⁰ OECD Data, Net pension replacement rates - <u>https://data.oecd.org/pension/net-pension-replacement-rates.htm</u>.



represents amounts superior to the annual GDP. In these countries, the issue of the real returns of private pensions is a crucial one for future retirees, especially for those who are members of defined contribution schemes.

- The situation is reversed in this group of countries where citizens have little prefunded assets available for retirement. The sum of life insurance contracts and pension funds' assets represented about, or less than, 15% of GDP in Bulgaria, Estonia, Latvia, Poland, Romania and Slovakia. In these countries, citizens will predominantly depend on the quality and sustainability of arrangements within the framework of PAYG systems.
- The third group of countries is in an intermediate position. Pension funds and life insurance contracts represent 86% of GDP in France, 70% in Belgium, 57% in Germany, 55% in Italy and 30% in Spain. In these countries, citizens depend both on the sustainability of the PAYG systems and on the returns of private pension savings. Governments focus on strengthening the public pension system (in Italy for instance) and/or on raising savings levels in private pension products (as is the case for Germany). However, when private pension products deliver poor benefits, the legitimacy of such efforts is questioned in the public debate.

A limitation of the present report is that it does not take into account real estate as an asset for retirement. The proportion of households owning their residences varies greatly from one country to another. For example, it is especially low in Germany, where a majority of households rent their residences and where home loan and savings contracts have consequently been introduced as the most recent state-subsidised pension savings scheme. For the time being, returns on pension savings are all the more important since a majority of retirees cannot rely on their residential property to ensure a decent minimum standard of life.

However, residential property is not necessarily the best asset for retirement: indeed, it is an illiquid asset and it often does not fit the needs of the elderly in the absence of a broad use of reverse mortgages. The house might become too large or unsuitable in case of dependency. In that case, financial assets might be preferable, on the condition that they provide a good performance.

Return attribution

Inflation

For several of the countries analysed in this research report, inflation rates were significant and consequently had a severe impact on returns in real terms over the periods in review. One has to keep in mind that even for those countries with moderate inflation, the



compound effect over long periods, as applicable for the case of retirement savings, can lead to considerable losses in purchasing power.

		Table	GR2(A)	. Inflatior	n in Euro	zone Me	mber State	es (in %)		
Year	BELGIUM	ESTONIA	FRANCE	GERMANY	ІТАԼҮ	ΙΑΤΛΙΑ	LITHUANIA	NETHERLANDS	SLOVAKIA	SPAIN
2000	2.7%	3.9%	1.8%	1.4%	2.6%	2.6%	1.1%	2.3%	12.2%	3.5%
2001	2.4%	5.6%	1.8%	1.9%	2.3%	2.5%	1.5%	5.1%	7.2%	2.8%
2002	1.5%	3.6%	1.9%	1.4%	2.6%	2.0%	0.3%	3.9%	3.5%	3.6%
2003	1.5%	1.4%	2.2%	1.0%	2.8%	2.9%	-1.1%	2.2%	8.4%	3.1%
2004	1.9%	3.0%	2.3%	1.8%	2.2%	6.2%	1.2%	1.4%	7.5%	3.1%
2005	2.5%	4.1%	1.9%	1.9%	2.2%	6.9%	2.7%	1.5%	2.8%	3.4%
2006	2.3%	4.4%	1.9%	1.9%	2.3%	6.6%	3.8%	1.7%	4.3%	3.6%
2007	1.8%	6.7%	1.6%	2.3%	2.0%	10.1%	5.8%	1.6%	1.9%	2.9%
2008	4.5%	10.6%	3.2%	2.7%	3.6%	15.3%	11.1%	2.2%	3.9%	4.1%
2009	0.0%	0.2%	0.1%	0.2%	0.8%	3.3%	4.2%	1.0%	0.9%	-0.2%
2010	2.3%	2.7%	1.7%	1.2%	1.6%	-1.2%	1.2%	0.9%	0.7%	2.1%
2011	3.4%	5.1%	2.3%	2.5%	2.9%	4.2%	4.1%	2.5%	4.1%	3.0%
2012	2.6%	4.2%	2.2%	2.1%	3.3%	2.3%	3.2%	2.8%	3.7%	2.4%
2013	1.2%	3.2%	1.0%	1.6%	1.3%	0.0%	1.2%	2.6%	1.5%	1.5%
2014	0.5%	0.5%	0.6%	0.8%	0.2%	0.7%	0.2%	0.3%	-0.1%	-0.2%
2015	0.6%	0.1%	0.1%	0.1%	0.1%	0.2%	-0.7%	0.2%	-0.3%	-0.6%
2016	1.8%	0.8%	0.3%	0.4%	-0.1%	0.1%	0.7%	0.1%	-0.5%	-0.3%
2017	2.2%	3.7%	1.2%	1.7%	1.4%	2.9%	3.7%	1.3%	1.4%	2.0%
AAVG	2.0%	3.5%	1.6%	1.5%	1.9%	3.7%	2.4%	1.9%	3.4%	2.2%



Table GR2(B). Inflation in non-Eurozone Member States (in %)						
Year	BULGARIA	DENMARK	POLAND	ROMANIA	SWEDEN	NN
2000	10.3%	2.8%	10.1%	45.7%	1.3%	0.8%
2001	7.4%	2.3%	5.4%	34.5%	2.7%	1.2%
2002	5.8%	2.4%	1.9%	22.5%	1.9%	1.2%
2003	2.3%	1.8%	0.7%	15.3%	2.3%	1.3%
2004	6.2%	1.0%	3.7%	11.9%	1.0%	1.3%
2005	6.0%	1.8%	2.2%	9.1%	0.8%	2.1%
2006	7.4%	1.8%	1.2%	6.6%	1.5%	2.3%
2007	7.6%	1.7%	2.6%	4.9%	1.7%	2.4%
2008	11.9%	3.6%	4.2%	7.9%	3.4%	3.5%
2009	2.5%	1.0%	4.0%	5.6%	1.9%	2.2%
2010	3.0%	2.2%	2.7%	6.1%	1.9%	3.2%
2011	3.4%	2.7%	3.9%	5.8%	1.4%	4.5%
2012	2.4%	2.4%	3.6%	3.4%	0.9%	2.9%
2013	0.4%	0.5%	0.8%	3.2%	0.4%	2.5%
2014	-1.6%	0.4%	0.1%	1.4%	0.2%	1.5%
2015	-1.1%	0.2%	-0.7%	-0.4%	0.7%	0.0%
2016	-1.3%	0.0%	-0.2%	-1.1%	1.1%	0.7%
2017	1.2%	1.1%	1.6%	1.1%	1.9%	2.7%
AAVG	4.0%	1.6%	2.6%	9.6%	1.5%	2.0%

Table	e GR2(C). EU Infla	ation
2000	2001	2002
1.9%	2.2%	2.1%
2003	2004	2005
2.0%	2.0%	2.2%
2006	2007	2008
2.2%	2.3%	3.7%
2009	2010	2011
1.0%	2.1%	3.1%
2012	2013	2014
2.6%	1.5%	0.5%
2015	2016	2017
0.0%	0.2%	1.7%
	Annual Average	
	1.8%	

<u>Source</u>: Eurostat HICP monthly index (2015=100, prc_hicp_aind), annual averages (AAVG) are calculated by BETTER FINANCE.



Over the last 18 years, from 2000 to 2017, the highest annual average inflation rates could be observed in Eastern European countries. By far the most important loss of purchasing power was recorded in Romania with an annualised average of 9.6%. Especially in the early 2000s, Romania suffered from high double-digit inflation rates of 45% in 2000 and 35% in 2001, and it took until 2005 to see it drop under 10%. The other countries that witnessed double-digit inflation rates were Bulgaria (2000, 2008), Poland and Slovakia (2000) and Latvia (2007, 2008), as well as Lithuania (2008) although it remained below 15%. The annual average rates for other Eastern European countries ranged in between 4.0% (Bulgaria) and 2.6% (Poland), with the latter being the country coming closest to the highest rate recorded in a Western European country: Spain, at 2.2%, which was also the European Union average. The countries with the lowest average inflation rate were Sweden and Germany at 1.5%, closely followed by France and Denmark (at 1.6% each).

While in the first nine years of the millennium no deflationary trends occurred, the year of 2009 saw the first negative inflation rates in the Baltic states: Estonia (-1.9%) and Latvia (-1.4%). The more recent years of 2014 and 2015 brought deflation to a large number of countries (7 countries in 2014 and 6 in 2015). Aiming to maintain inflation rates below but close to 2%, the European Central Bank undertook considerable monetary policy efforts to bring the rates back to the desired levels. In 2017, inflation rates rose again for all countries except Germany and Spain (where deflation was reported) and Sweden, where inflation was constant at 1.7%, and with Belgium, Germany, Sweden and the United Kingdom measuring rates around 2%, and deflationary worries faded.

The low inflation rates of the recent years go hand in hand with a reduction in public sector deficits. See recent numbers in the following table:

Table GR3. Public sector deficit and debt (in %)							
	Public Sec	tor Deficit a	is a % of GDP	Public	Debt as a %	of GDP	
	2015	2016	2017	2015	2016	2017	
Belgium	-2.5	-2.6	-1.0	106.0	105.9	103.1	
Bulgaria	-1.6	0.0	0.9	26.0	29.5	25.4	
Denmark	-1.3	-0.9	1.0	39.5	37.8	36.4	
Estonia	0.1	0.3	-0.3	10.1	9.5	9.0	
France	-3.6	-3.4	-2.6	95.6	96.3	97.0	
Germany	0.7	0.8	1.3	71.2	68.3	64.1	
Italy	-2.7	-2.4	-2.3	132.1	132.6	131.8	
Latvia	-1.3	0.0	-0.5	36.5	40.5	40.1	
Lithuania	-0.2	0.3	0.5	42.6	40.1	39.7	
Netherlands	-2.1	0.4	1.1	64.5	61.8	56.7	
Poland	-2.6	-2.4	-1.7	50.2	53.8	50.6	
Romania	-0.8	-3.0	-2.9	37.3	37.2	35.0	
Slovakia	-2.7	-1.7	-1.0	52.5	51.9	50.9	
Spain	-5.1	-4.5	-3.1	99.8	99.4	98.3	
Sweden	0.3	0.9	1.3	44.7	41.2	40.6	
UK	-4.3	-3.0	-1.9	88.0	85.4	87.7	

Source: Eurostat: (1) Public Sector Deficit as a % of GDP -

<u>http://appsso.eurostat.ec.europa.eu/nui/show.do;</u> (2) Public Debt as a % GDP – <u>http://ec.europa.eu/eurostat/tgm/table.do?tab=table&plugin=1&language=en&pcode=sdg_17_40.</u>

In 2017, a surplus was observable in Bulgaria, Denmark, Germany, Lithuania, Netherlands and Sweden. Germany, in particular, recorded its fourth consecutive year with a surplus (+1.3%), while Estonia recorded a deficit (-0.3%) after recording a surplus for two years in a row. Spain remains the country with the highest public deficit at -3.1% of GDP, a breach of the Maastricht Treaty requirement⁴¹ ("-3% ratio of the planned or actual government deficit to gross domestic product at market prices") for the third year in a row.

When it comes to the second criterion of the Maastricht Treaty concerning the theoretical ceiling of *"60% for the ratio of government debt to gross domestic product at market prices"*⁴², eleven countries had an outstanding level of debt below this threshold while seven countries, all of them from Western Europe, surpassed it.

Asset Mix

In the 2018 version, BETTER FINANCE attempted to present the asset allocation in pension funds in all countries in scope of the analysis using the data from the analysis of individual country cases. However, this was not possible since sufficient data is not publicly available

42 Ibid.

47 | Page

⁴¹ Article 1 of the Protocol No. 12 on the excessive deficit procedure of the Treaty on European Union, OJ C 115, 9.5.2008, p. 279–280.



from national regulators or representative/professional associations. Therefore, countries in the table below (GR4) indicated with an asterisk continue to report OECD Data, while the other countries are based on data from this report itself.

There are striking differences between pension funds' asset allocations across European countries as shown by the following table:⁴³

Table GR4. Pension funds' asset allocation, [in % of total assets]						
Country	Year	Cash and deposits	Bills and bonds	Equities	Other	Data source
	2005	10%	25%	36%	29%	
	2010	7%	43%	38%	13%	
Belgium*	2015	4%	44%	42%	10%	*OECD Data
	2016	N/A	N/A	N/A	N/A	
	2017	5%	45%	43%	7%	
	2005	1%	57%	29%	14%	
	2010	0%	70%	16%	14%	
Denmark*	2015	0%	63%	18%	19%	*OECD Data
	2016	0%	62%	17%	20%	
	2017	1%	59%	19%	20%	
	2005	7%	44%	48%	2%	
	2010	9%	17%	70%	4%	RETTER
Estonia	2015	20%	22%	58%	0%	
	2016	23%	18%	59%	0%	TINANCE Data
	2017	4%	46%	49%	0%	
	2005	4%	46%	12%	38%	
Germany	2010	2%	46%	5%	46%	
sermany *	2015	4%	54%	5%	38%	*OECD Data
	2016	4%	51%	6%	39%	
	2017	4%	50%	6%	40%	
	2005[2]	7%	42%	13%	38%	
	2010	6%	58%	12%	24%	
Italy	2015	5%	63%	17%	16%	
	2016	7%	58%	18%	17%	
	2017*	6%	45%	21%	28%	*OECD Data
	2015	19.3%	45.7%	34.6%	0.5%	RETTER
Latvia	2016	12.7%	47.2%	39.4%	0.7%	
	2017	7.1%	43.0%	49.0%	0.8%	FINANCE Data
	2005	2%	41%	46%	11%	
	2010	2%	42%	35%	20%	
NL*	2015	3%	46%	38%	13%	*OECD Data
	2016	2%	45%	39%	14%	
	2017	3%	48%	46%	2%	

⁴³ We could not find any available data for France.



	2005	4%	63%	32%	0%	
	2010	3%	59%	36%	1%	
Poland*	2015	7%	10%	82%	0%	*OECD Data
	2016	7%	9%	83%	1%	
	2017	6%	9%	85%	0%	
	2005[1]	51%	11%	5%	0%	67%[1]
	2010	46%	50%	4%	0%	
Slovakia	2015	16%	73%	11%	0%	BETTER
	2016	11%	75%	15%	0%	FINANCE Data
	2017	13%	68%	19%	0%	
	2005	5%	64%	21%	10%	
	2010	19%	58%	12%	11%	
Spain*	2015	17%	62%	11%	9%	*OECD Data
	2016	15%	64%	14%	8%	
	2017	11%	47%	13%	28%	
	2005	1%	58%	34%	7%	
	2010	3%	72%	18%	7%	
Sweden*	2015	2%	67%	18%	13%	*OECD Data
	2016	N/A	N/A	N/A	N/A	
	2017	N/A	N/A	N/A	N/A	
	2005	3%	23%	48%	27%	
	2010	4%	29%	31%	37%	
UK*	2015	2%	34%	20%	43%	*OECD Data
	2016	4%	43%	22%	31%	
	2017	2%	28%	13%	57%	
	2015	12%	56%	28%	3%	BETTER
Bulgaria	2016	15%	55%	26%	3%	
	2017	7%	61%	29%	3%	THRANCE Data
	2015	12%	40%	47%	1%	RETTER
Lithuania	2016	9%	46%	45%	1%	FINANCE Data
	2017	6%	46%	46%	2%	THRAICE Data
	2010	7%	80%	12%	1%	
Pomania	2015	5%	72%	19%	4%	BETTER
Nomania	2016	7%	70%	19%	4%	FINANCE Data
	2017	9%	68%	20%	4%	

<u>Sources</u>: OECD Pension Funds in Figures - 2016 and 2017 statistical tables on asset allocation (<u>http://www.oecd.org/pensions/private-pensions/pensionmarketsinfocus.htm</u>); BETTER FINANCE Pensions Report (2018);

[1] Data for a part of the asset allocation in 2015 is missing.

[2] 7.2% of the total were estimated with an equal weighting in asset classes

Asset allocation data in this table include both direct investments in cash and deposits, bills and bonds (both sovereign and corporate), equities and indirect investments through



collective investment schemes (investment funds such as UCITS⁴⁴ or AIF⁴⁵). The "other" category comprises assets, such as loans, land and buildings, real estate investment trusts (REITS), hedge funds, derivatives, commodities and precious metals, insurance contracts, money market instruments, private equity funds and other structured (unallocated) products.

In Belgium, bills and bonds represented the main component of investments in 2017 (45%). This percentage has considerably evolved in just over a decade and more than doubled since 2005 (25%). All other asset categories, in return, saw their portion reduced with cash and deposits and other assets more than halved.

The specificity of Denmark is the predominance of corporate securities, both equity and bonds. Public bonds play a minor role because public deficits are small, as explained in the initial study. As of 2015, about 80% of Danish pension funds' assets are allocated to bonds and equity whereas cash and deposits represent 1%. The overall asset allocation in 2017, and in particular the portion of bills and bonds and equity, resembled the one of the other Scandinavian country covered by this report: Sweden (about 65% in bills and bonds, about 18% in equities).

Estonian, Latvian, Slovakian and Spanish pension funds held relatively large portions of cash and deposits (around 20%) in the year of 2015. The situation has changed and the asset allocation in these countries dropped to around half of that in 2017. While the two Baltic states' pension funds did also hold considerable parts in equities (Estonia: 31%, Latvia: 21%), Spanish pensions funds held less (10%) and Slovakian's almost none in 2015 but evolved to a higher concentration in other securities.

In Germany, collective investment schemes play a predominant role in pension funds' assets. An additional feature of German pension funds is the importance of loans in their assets with most of these loans attributed to employees in companies. The portion directed to equities continues to be the second lowest (6%) for the countries under review. One has to keep in mind that the OECD data aggregates Pensionskassen and the riskier but less distributed pension funds.

For Italy, the previous reports published data aggregated by OECD. However, this year's edition uses the data published by the Supervisory Authority (Commissione di vigilanza sui fondi pensione – COVIP). According to the latter, in Italy, public bonds and bills represent almost half of the pension funds' assets in 2015 and have had, at least since 2005, by far the highest weighting of the total. Households have traditionally been strong investors in Italian

 ⁴⁴ "UCITS" stands for Undertakings for Collective Investment in Transferable Securities, which is the most common legal form mutual funds in the EU take, in particular because of the *passporting rights*.
 ⁴⁵ "AIFs" stand for Alternative Investment Funds, which are all the non-UCITS funds.



government bonds, but they have progressively diminished their exposure to these types of products and institutional investors, pension funds among others, have been compensating for their withdrawals.⁴⁶

In the Netherlands, assets are nearly equally divided between bonds and bills on the one hand and equities on the other. In 2017, slightly more bills and bonds are held (48%) while ten years ago equities were still a little below (46%).

In Poland, equity accounted for 82% of the PFE assets in 2015 with a huge increase in this asset class in recent years (from 32% in 2005 to 85% in 2017). Bills and bonds played the smallest role among the countries under review, and their decline ran counter to a trend that saw a rise in equities with cash and deposits and other assets being stable over time.

The United Kingdom has traditionally been the country where equities form a major part of the asset allocation of pension funds. Their share decreased from 47% to 20% between 2005 and 2015 and continued to fall to 13% in 2017, while other types of securities are massively included in pension savings products' portfolios (57%) which might partly still include equities, as well as a growing portion of bonds and bills.

For most countries, the period 2005-2017 shows a decrease in equities and an increase of investments in public debt in the asset allocation of pension funds, partially due to unrealised capital gains generated by the historical decrease of interest rates.⁴⁷

Asset performance

Equity markets

Equity returns are of a volatile nature in the short-term and hence need to be observed with a long-term perspective in mind. The real return calculations in this report date back to 31/12/1999 at the earliest, so we take a look at how equity markets performed over that same period. Overall, the 21st century began with one of the most severe bear markets in history and faced, in conjunction with the downward cycle of 2007-2008, two longer-lasting upward cycles from 2003-2006 and 2009-2017. Data in the table below is calculated based on gross performances (*nominal return*), then adjusted for inflation (*return net of inflation*).

⁴⁷ A decrease in market interest rates translates into an increase in the mark-to-market value of fixed interest debt products held by investors.



⁴⁶ Zicchino, Lea; Alemanno, Andrea; "Italians are no Longer Bond People"; OEE Insights; No. 5; July 2017.



Table GR5. Historical Returns on Equity Markets, yearly average						
Country	Period	Nominal Return	Nominal return net of inflation [1]			
Belgium	(2000-2017)	3.5%	1.46%			
Bulgaria	(2005-2017)	-7.98%	-10.79%			
Denmark	(2000-2017)	9.95%	8.18%			
Estonia	(2002-2017)	9.57%	6.28%			
Europe	(2001-2017)	3.46%	1.46%			
France	(2000-2017)	3.13%	1.55%			
Germany	(2000-2017)	3.59%	2.07%			
Italy	(2000-2017)	0.21%	-1.65%			
Latvia	(2001-2017)	11.53%	6.38%			
Lithuania	(2008-2017)	6.72%	3.77%			
Netherlands	(2000-2017)	3.95%	2.05%			
Poland	(2000-2017)	4.62%	1.95%			
Romania	(2005-2017)	3.39%	-0.65%			
Slovakia	(2000-2017)	7.82%	4.23%			
Spain	(2000-2017)	3.56%	1.34%			
Sweden	(2000-2017)	4.21%	2.67%			
UK	(2000-2017)	2.33%	0.29%			

<u>Sources</u>: MSCI Indices (Gross Returns) - <u>https://www.msci.com/end-of-day-data-search</u> (returns in €);

Eurostat HICP (prc_hicp_aind);

• Bratislava Stock Exchange - <u>http://www.bsse.sk/bcpben/Trading/Indices/SAXIndex.aspx;</u>

• NASDAQ Nordic OMX Villnius, Talinn, Riga –

 http://www.nasdaqbaltic.com/market/?pg=charts&lang=en&idx_main%5B%5D= OMXV&add_index=OMXBBPI&add_equity=LT0000128696&period=other&start= 18.12.2000&end=09.07.2018

[1] Annual average rate of change

Since not all equity indexes (MSCI) have data available for the entire 18-year period, it is difficult to perfectly compare the performances of the same stock market indicators between all the countries in the same time-frame.

However, most equity markets have regained their nominal levels from the beginning of the millennium and even recorded distinct positive returns. The only countries with a negative average nominal return over the full period was Italy, at -1.63% and Bulgaria, with a considerably low net annualized rate of return (-10.72%) In real terms, the best performing equity index is still the Danish market, with a +8.18% annual growth rate, followed by Latvia (+6.38%), Slovakia (+4.23%), and Estonia (+6.28%), but on 16 years. However, due to the strong inflation recorded at the beginning of the 21st century, Romania reports negative returns (-0.65% on average).



The other countries with positive nominal returns lagged behind by a large margin, and their averages ranged between 2.67% (for Sweden) and 0.29% (for the UK).

However, the equity indices used in Table GR5 are narrow, large cap only indices, usually including only a few tens of stocks each, and excluding all mid and small cap equities. Broader indices are required to better reflect the returns of the whole of equity markets in Europe. Those include mid and small capitalisations, which have massively outperformed the "blue chips" over the last 18 years. As a result, the broader country equity market returns were much higher (for example the real return of the French broader equity market shown in Graph FR I has been very positive). But these broader country equity indices are unfortunately less known and often available only for recent years in Europe.

Only looking at the most recent year of 2017, European equity markets continued to progress taken as a whole. However, contrary to the long trend, Danish equities clearly slipped (-13.8%) in 2016 in real terms after a very strong year of 2015 (37.4%) but gained back and exceeded the cumulative level of 2015 (552% nominal and 418% real returns over 18 years).⁴⁸ In 2017 MSCI indices reported positive returns for all the countries in review. The strongest real performance was recorded for Danish equities in 2017, followed by Slovakian equities (+4.23%). The worst performing markets in real terms were still Romania, Bulgaria and Italy with negative returns ranging between -10.79% to -0.65%.

BETTER FINANCE tried to provide a harmonised base of comparison for all equity markets in focus over the same 18-year period (replacing missing MSCI data with the local indexes), but this was not possible.

When looking at the cumulated results at European level, as well as in the individual countries where we developed this analysis (see French, German, Spanish and UK country cases), broad stock market indices performed much better than the better known and much narrower large cap or "blue chip" indices (Stoxx Europe 50, FTSE 100, DAX 30, IBEX 35, CAC 40).

The following graph shows a comparison of the broad STOXX All Europe Total Market index which includes 1,466 European stocks (as of 23 June 2017)⁴⁹ and the much narrower Stoxx Europe 50.

⁴⁸ This means that the starting date of these calculations, 31/12/1999, represents the base value of 100%. Therefore, the profit in nominal terms would be 452% and in real terms only 318%.

⁴⁹ <u>https://www.stoxx.com/index-details?symbol=TE1P</u>. There was no data available for year of 2000. The performance of the narrower MSCI Europe TR (Net) index (446 components as of 31 May 2017) for that year was taken as a proxy instead.

^{53 |} Page





Graph GR1. Cumulative performance of wide European equity index (STOXX AETM) vs narrow index (STOXX 50)

Sources: BETTER FINANCE, Eurostat, STOXX

At European level, the difference at the end of our 18-year period is an astonishing 58% in favour of the broader stock market index in nominal terms. And whereas the performance of the narrow index (29% nominal) was heavily outmatched by inflation (39%) over the last 18 years, the broader European stock market recorded a positive real performance with a cumulated gain of 34%.

Government bond markets

As already mentioned above, it is important to note that a decrease in interest rates translates into an increase in the mark-to-market value of bonds which had a positive impact on outstanding debt assets of pension funds. On the other hand, the capacity to provide good remuneration through new bond issuances is hereby reduced.



The following table indicates the returns of thirteen major European bond markets for the period 2000-2017:

Table GR6. Historical Returns on Bond Markets, yearly average							
Country	Year	Nominal Return	Real Return				
Belgium	(2008-2017)	1.61%	-0.21%				
Denmark	(2008-2017)	2.01%	0.74%				
Germany	(2008-2017)	3.27%	1.96%				
Spain	(2008-2017)	5.36%	4.10%				
France	(2008-2017)	5.01%	3.81%				
Italy	(2008-2017)	5.01%	3.56%				
Lithuania	(2008-2017)	5.55%	2.94%				
Netherlands	(2008-2017)	4.67%	3.25%				
Romania	(2008-2017)	6.36%	3.21%				
Sweden	(2008-2017)	3.90%	2.55%				
United Kingdom	(2008-2017)	4.16%	1.76%				
EMU	(2008-2017)	4.83%	3.21%				

<u>Sources</u>: Morningstar, Eurostat HICP annual average

The European government bond markets all showed steady nominal average returns over the past 10 years, ranging between 6.36% (Romania) and 1.61% (Belgium). Real average returns ranged even closer together, with the highest in Spain at 4.10% and Belgium and Denmark at the bottom with -0.21% and 0.74% annually respectively. While equity markets usually perform better in the long run, the aggregate general bond market outperformed the corresponding equity markets from Table GR 5 in the period from 2000 to 2017.

The following graph shows the long-term cumulated returns of European bonds as a whole - that is both government and corporate bonds - as measured by the Barclays Pan-European TR index:





Graph GR2. Cumulated Performance of European Bond

Sources: Eurostat HICP (prc HICP aind), Bloomberg Barclays pan-European aggregate bond index

Over the last 18 years, European bonds as a whole enjoyed a very positive nominal return which was significantly higher than the return of European equities, and due to the continuous fall of bond interest rates over the period under review. It is difficult to foresee a continuation of this past trend given the very low level of interest rates reached today. However, in 2016-2017 this index almost stagnated, growing from 129.1% to 129.55% in nominal terms. Overall, the real cumulative growth of the broad bond index was of 65%.

Graph GR2 shows that this period has indeed been particularly favourable to bonds as an asset class as illustrated by the considerable outperformance versus European inflation over time.

Portfolio Manager / Advisor Competence

The initial BETTER FINANCE study highlighted that in almost all categories of investment funds, a majority of funds under-performed their benchmarks. Investment funds play an important role in today's asset allocation of pension vehicles, thus it is interesting to compare investment fund performances to benchmarks.

The Standard & Poor's annual "SPIVA" report measures the proportion of active funds that have beaten their benchmark. The results from the latest SPIVA Europe Scorecard for yearend 2016 are shown in the following table:

Table GR7.	Percentage of Euro	opean Equ	iity Funds l	Beating th	eir Benchm	arks
Fund Category	Comparison Index	1-year (2017)	3-year (2015- 2017)	5-year (2013- 2017)	10-year (2008- 2017)	10y AVG
	Percent	ages calcu	ulated in E	uro		
Europe Equity	S&P Europe 350	53	41	27	15	
Eurozone Equity	S&P Eurozone BMI	26	23	12	12	
France Equity	S&P France BMI	47	41	30	18	
Germany Equity	S&P Germany BMI	61	39	28	25	18
Italy Equity	S&P Italy BMI	72	60	58	29	
Spain Equity	S&P Spain BMI	32	46	28	21	
Netherlands Equity	S&P Netherlands BMI	25	22	7	6	
	Percentages	calculated	່ in local cເ	urrencies		
U.K. Equity	S&P United Kingdom BMI	0	76	71	17	
Denmark Equity	S&P Denmark BMI	7	23	35	6	19
Poland Equity	S&P Poland BMI	62	66	47	27	
Sweden Equity	S&P Sweden BMI	51	54	46	24	

<u>Sources</u>: S&P Dow Jones Indices LLC, Morningstar; BETTER FINANCE own Computations - SPIVA Europe Scoreboard, Year-End 2017, Report 1, p.4

The latest findings for 2017 once again reveal that a large majority of funds do not outperform their respective benchmark, with Italy being the only exception. For funds investing in European equities, only 15% were able to outperform their benchmark, the S&P Europe 350. The worst results on a country basis were recorded in the Netherlands and in Denmark, where only 6% (for both) of the equity funds delivered a cumulative profit over 10 years above that of their benchmark. Germany and the UK, where only 25% and 17% respectively outperformed the respective country index. Funds investing in the Nordic countries compared better. While 51% of funds investing in Swedish equity in 2017 beat their benchmark, almost no funds investing in Danish equities outperformed their respective country index equities outperformed their benchmark.



The best performing equity funds market over the longer-term was in Italy, where almost a third of the equity funds have outperformed their benchmark.

For retirement savings products, consistent positive long-term returns are of particular importance. The SPIVA Europe Scorecard discloses outperformance over a ten-year period as the longest time horizon. The performance of funds in comparison to their benchmarks tends to worsen over the long run. Over 10 years, only 15% of the funds investing in equities in Europe outperform their benchmark and almost none of those investing in Dutch equities (3%). The SPIVA Scorecard furthermore reveals that active portfolio management did also largely underperform in less efficient markets⁵⁰. However definitive conclusions cannot be drawn from these calculations because they relate to a period that is too short, including no more than two cyclical periods: equity markets fell sharply in 2008 and 2009, then they recovered progressively until June 2017, with short sub-periods of decline in most countries. Prior research found that investment funds tend to outperform their benchmarks in a bearish market while they underperform in a bullish market.⁵¹

For a longer time horizon and especially in the case of retirement savings, a recent study⁵² provides relevant results for UK personal pension funds operated by 35 providers over a 30year period (1980-2009). Big providers performed better than their prospectus benchmarks, but they underperformed treasury bills over the period of a fund's lifespan. Similarly, specialisation of portfolio managers in the investment universe is shown to deliver superior average annual returns but does not show superior long-term performances. More generally, they found that short-term performances based on arithmetic annual averages are not relevant indicators of the long-term performance calculated as geometric compounded returns similar to the methodology used in the present study. The authors also showed that younger funds perform better than older ones, which are under lower competitive pressure given the cost of leaving a fund to join a better performing one.

Investment charges

Findings of the initial study by BETTER FINANCE on the opacity and weight of charges did not change dramatically over the successive research reports. Charges are often very complex and far from being harmonised for different pension providers. Consequently, this makes it difficult for consumers to understand and entirely capture the magnitude of

⁵⁰ S&P Dow Jones Indices (2017): SPIVA® Europe Scorecard, Year-End 2016, April 2017.

⁵¹ IODS (2014) : Study on the Performance and Efficiency of the EU Asset Management Industry, a study for the European Commission (Internal Market and Services DG) and the Financial Services User Group (FSUG), August 2014

⁵² Anastasia Petraki and Anna Zalewska (April 2014), "With whom and in what is it better to save? Personal pensions in the UK", working paper of the Centre for Market and Public Organisation, University of Bristol.



charges on their pension product. Generally speaking, charges are heavier on personal pension products than on occupational pension funds, as employers are in better position to negotiate with competing providers than individuals are.

To tackle this complexity, some pension providers - for example, some auto-enrolment schemes in the United Kingdom – set up fixed costs per member, but this penalises low paid workers. A report of the Office of Fair Trading (2013) highlighted the lack of transparency and comparability in terms of fees charged to members of UK pension funds: various fees are added to the Annual Management Charges (AMC) on the basis of which pension fund providers usually promote their services. The dispersion of charges has also been found to be very significant, depending, amongst others, on the type (personal plans are more heavily charged than occupational ones) and the size of the funds.

Following the OFT study, the Department for Work and Pensions issued a regulation which took effect on 6 April 2015⁵³. The default schemes used by employers to meet their automatic enrolment duties are subject to a 0.75% cap on AMCs. The cap applies to most charges, excluding transaction costs. Moreover, an audit was conducted on schemes being "at risk of being poor value for money". It found that about one third of surveyed schemes had AMCs superior to 1% and that a significant number of savers would have to pay exit fees superior to 10% in case they wanted to switch to a better performing fund. Moreover, starting from October 2017, existing early exit charges in occupational pension schemes cannot exceed 1% of the member's benefits and no new early exit charges can be imposed on members who joined that scheme after 10 October 2017.

While not necessarily as advanced as in the United Kingdom, the introduction of transparent, limited and comparable charges is the subject of debates in several of the investigated countries.

Taxation

The general model applied to pension products is usually deferred taxation: contributions are deducted from the taxable income and pensions (payouts) are taxed within the framework of income tax or, usually, at a more favourable rate. Some countries are currently in the middle of a transitional phase comprising proportionate deferred taxation which will lead to entire deferred taxation in the future.

The so-called EET regime, "a form of taxation of pension plans, whereby contributions are exempt, investment income and capital gains of the pension fund are also exempt, and

⁵³ https://www.legislation.gov.uk/ukpga/2015/8/contents/enacted



benefits are taxed from personal income taxation"⁵⁴, is predominant in the countries covered by this research report. There are only a few exceptions, like in Poland, where the reverse rule is applied: contributions are paid from the taxable income while pensions are tax-free (the only exception from the TEE regime are IKZEs – individual pension savings accounts). Pensions in Sweden are taxed at all three stages with contributions to occupational pensions being partially deductible as the only exception. Furthermore, in Bulgaria and for the funded pensions in Slovakia, one can even observe EEE regimes with no pension taxation at all within defined tax exemption limits.

Usually, the accumulated capital can be withdrawn by the saver as a lump sum at retirement age, at least partially. Our calculations of returns net of taxation are based on the most favourable taxation case and assume that the saver withdraws the maximum lump sum possible.

Savings products used as retirement preparation, but which are not strictly pension products, might benefit from a favourable tax treatment. This is the case of life insurance in France but successive increases of the rate of "social contributions" on the nominal income tend to diminish the returns of the investment.

An overview of the main taxation rules applied on a country basis can be found in the following table:

Table GR8. Overview of Main Taxation Rules Applied in the Country Reports		
Belgium	 EET regime - only withdrawals are taxed; Contributions are tax deductible up to prescribed limits; Employees pay generally 2% solidarity tax and 3.55% INAMI tax on benefits; Pillar II: Taxation in pay-out phase depending on origin of contribution, local taxes to be added; Pillar III: Taxation in pay-out phase at the age of 60, local taxes to be added. 	
Bulgaria	 EEE regime; Annual contributions of up to 10% of annual taxable income is tax free; 	
Denmark	 TTT regime (combination of ETT and TTE); Annuities, periodic instalments, and lump-sum pensions under the form of kapitalpension are income tax deferred and follow an ETT regime; Lump-sum pensions under the form of alderopsparing are taxed TTE; 	
Estonia	• EET regime for taxation:	

⁵⁴ OECD definition: https://stats.oecd.org/glossary/detail.asp?ID=5225



	 Contributions paid towards the pension schemes are tax-exempt. Returns achieved by respective pension funds are tax-exempt. Benefits paid out during the retirement are subject to the income tax taxation.
	• EET regime;
France	 PERP, Prefon, Corem, CRH contributions are income tax deductible; Contributions to some DC pension plans (PERCO and PERP) are income tax deductible but no deductibility from social levies. No tax deductibility for life insurance contracts; social levies of employers' contributions to corporate savings plans (PEE and PERCO) and defined contribution plans ("Article 83") increased from 8% to 20%. the minimum tax rate on life insurance income is now 23% pay-outs are taxed in the retirement phase (sometimes with tax reductions).
Germany	 EET regime, taxation divides retirement savings into three groups: Statutory pension insurance and the Rürup pension: deferred taxation; contributions up to a deduction cap are exempted from taxation and generally subject to tax in its entirety during the payout phase. Standard pension insurance or life insurance products: contributions to the products come from taxed income; benefits are taxed at the personal income tax rate on the corresponding earnings in the retirement phase Occupational pensions and the Riester pension: deferred taxation; contributions up to a deduction cap are exempted from taxation and generally subject to tax in its entirety during the pay-out phase.
Italy	 ETT regime, contributions are tax deductible up to prescribed limits; Accruals are taxed at 20% (12.5% on income derived from public bonds) in the capital accumulation phase; Taxation in the pay-out phase varies from 9-15%.
Latvia	 EET regime; Pillar II – Contributions are personal income tax deductible item and therefore the contributions are not subject to additional personal taxation; Income or profits of the fund are not subject to Latvian corporate income tax at the fund level; a general principle for all investment and savings-based schemes to levy the income taxation on the final beneficiary. Pillar III – Voluntary private pensions are generally taxed as Pillar II, however there are deduction limits in the contribution phase: payments (contributions) made to funds shall be deducted from the sum amount of annual taxable income, provided that such



payments do not exceed 10 % of the person's annual taxable income.

Lithuania	 <u>EEE regime</u>; Employee contributions are tax-deductible even if they are higher than required; for pillar III, there is a tax-refund policy during the contribution phase, which means that the contributions of up to 25% of gross earnings, the income tax (15%) is returned;
Poland	• TEE regime for Employees Pension Programs (PPE) and Individual Retirement Accounts (IKE); EET for Individual Retirement Savings Accounts (IKZE);
Romania	 benefits are taxed with a reduced flat-rate income tax (10%) EET regime applies for both mandatory and voluntary pensions; for funded pensions (Pillar II), pension benefits paid out during retirement will be subject to a personal income tax (10% tax rate) above a certain level (€460 in 2018); the social security contributions have been removed as of 2018 and are supported completely from the consolidated state budget. for voluntary private pensions (Pillar III), contributions are tax deductible up to a deduction limit, investment income is tax exempted and benefits are subject to the personal income tax.
Slovakia	 EEE regime, funded pensions are usually not taxed; Supplementary pensions follow the EET regime with several exceptions and specifications.
Spain	 EET regime, contributions are tax deductible up to prescribed limits; No taxation in the capital accumulation phase; Pay-outs are taxed differently depending whether they take the form of an annuity or the form of a lump sum payment.
Sweden	 EET regime for public pensions; ETT regime for private pensions; Employers can partially deduct contributions to the second pillar; returns are subject to an annual standard rate tax based on the value of the account and the government-borrowing rate Investment return is subject to tax rate on standard earnings at 15%; in Pillar III, until 2016 there was a tax deduction of SEK 1,800 per year available; returns are subject to an annual standard rate tax based on the value of the account and the government-borrowing rate
The Netherlands	 EET regime; Contributions paid into pension funds are tax deductible; Taxation is applied in the pay-out phase at the personal income tax rate.



	• EET regime;
UK	 Allowances and tax relief on contributions with test against lifetime allowance
	 Pay-outs are taxed as income, there are three marginal rates in the UK at the moment.

Source: BETTER FINANCE own composition

Conclusion

The objective of this research report is an evaluation of the real return of private pensions in the 16 EU countries under review. The net returns after fees, commissions, inflation and taxes are critical to protect the purchasing power of the income of pension savers when they retire. Unfortunately, information on these real returns is scarce, hence this research report provides a global and coherent approach, making use of all individual and historical data available in order to augment transparency and deliver simulations on real performances for EU pension savers. One has to keep in mind that the diversity of the European pension landscape and the lack of available data complicate the drawing of straightforward conclusions. For instance, most pension funds for the countries under review are offered as defined-contribution plans while those in Germany, as of now, and the majority of those in Belgium are offered as defined-benefit plans. Although the aim of comparability would be to present all results in a harmonised manner (either Pillar II vs Pillar III or on product categories - investment funds vs insurance products), complete data for all is not reported, neither for the full reporting period, nor are the concepts (Pillars, occupational vs supplementary plans) so common in all E.U. Member States. Therefore, for ease of reference, the names of the pension vehicles have been used as presented in each individual country case.

Tab	le GR9. Yearly Real Returns of Private Pension Products
	Occupational Pension Plans (IORP [1]), 2000-2017: +1.90%
	"Assurance Groupe" (Branch 21), 2002-2014: + 2.50%
Belgium	Pension Savings Funds, 2000-2017: +1.90%
	Life Insurance (Branch 21), 2002-2014: +1.90%
	Life Insurance (Branch 23), 2005-2014: +1.60%
	Universal Pension Funds*, 2002-2017: +1.67%
Bulgaria	Professional pension funds*, 2001-2017: +1.70%
	Voluntary Pension Funds*, 2004-2017: +0.50%
Denmark	N/A [1]
Esta via	Mandatory Pension Funds, 2003-2017: +0.33%
Estonia	Supplementary Pension Funds, 2003-2017: +1.21%
F	Life Insurance, Capital guaranteed, 2000-2017: +1.90%
France	Life Insurance, Unit-linked, 2000-2017: -0.82%



	Corporate savings plans, 2000-2017: +0.81% Public Employee Pension, 2002-2017: -1.36%
Germany	Pensionskassen and Pension Funds, 2002-2015: +2.19% Riester Pension Insurance, 2005-2017: +1.54% Rürup Pension Insurance, 2005-2017: +1.63%
Italy	Closed Pension Funds, 2000-2017: +1.41% Open Pension Funds, 2000-2017: 0.10% PIP with Profits, 2008-2017: +1.30% PIP Unit-Linked, 2008-2017: +0.70%
Latvia	State Funded Pension Funds, 2003-2017: -0.38% Voluntary Private Pension, 2011-2017: +1.87%
Lithuania	Occupational pensions (2004-2017): +1.16% Supplementary pensions (2004-2017): +0.83%
Poland	Employee Pension Funds, 2002-2017: +4.27% Voluntary Penion Funds, 2013-2017: +9.02%
Romania	Pillar II Funded Pensions, 2008-2017: +4.96% Voluntary Pension Funds, 2007-2017: +2.76%
Slovakia	Pillar II Pension Funds, 2005-2017: +0.62% Supplementary Pension Funds, 2009-2017: +0.79%
Spain	Pension funds (weighted average), 2000-2017: +0.05%
Sweden	AP7 Occupational pension fund, default option 2000-2017: +9.00% Occupational pension funds, own choice: 2000-2017: +5.70%
The Netherlands	Pension Funds, 2000 - 2017: +2.85% Life Insurance**, 2000 - 2017: -0.11%
United Kingdom	Pension Funds, 2000-2016: +3.10%

*Gross of fees; ** Net of inflation, charges and tax

Source: Own Research, BETTER FINANCE Research

Occupational pension funds as per the definition and scope of the EU "Institutions for Occupational Retirement Provision Directive" (IORP).

[1] The returns on private pension products in Denmark cannot be calculated on average since the Danish Supervisory Authority started to report the returns for two categories: *hybrid defined-contribution* (DC) with guarantee and *defined-contribution* (DC) with no guarantee. Therefore, averages as of 2016 cannot be calculated.

This update of the annual research by BETTER FINANCE highlights an improvement of the real returns of pension savings over the period 2000-2017 as compared to 2002-2011, in the context of upwards equity markets and declining inflation rates. We also tried to extend calculations to the longer period of time that we are considering, from 2000 to 2017, where data were available. Over the long run, real returns were on average quite low and below those of capital markets (equities and bonds).

In France, retirement provision through the widely used life-insurance showed positive returns for guaranteed contracts and negative returns for unit-linked ones. The corporate (occupational) pension plans were the best performing of all voluntary pension schemes in France, returning an average annual real growth rate of 0.81% over the long-term. Other

64 | Page



types of occupational or personal pension products (for self-employed, agricultural sector), also had a modest profit, but on a very short period according to latest data (2011-2017).

Italy and the United Kingdom are two opposite examples of policy options chosen by governments to tackle the imbalances of pension systems. In Italy, an ambitious reform was implemented (as of 2011) by Minister Elsa Fornero under the Monti government in order to secure the public PAYG system, despite very unfavourable demographic trends. As such, the poor returns of the personal pension plans will have a limited impact on the replacement rates of retirees' income, the downside being the heavier reliance on the public pension scheme. However, the newly formed coalition (2018) put forward plans to undo the reform, reduce the standard retirement age and eliminate several conditions for full pension entitlement. Under the current law, the State's expenditure on pensions will rise to 16.2% of GDP by 2040.

By contrast, pensions in the UK are more heavily dependent on pre-funded schemes. As such, the total value of pension assets as % of the 2017 GDP reached 106%, which is modest compared to the Netherlands or Denmark, but more than twice higher than the average in the 16 countries in scope of this Report. The Government has implemented "autoenrolment" to extend the benefits of pension funds to most employees. There, the excessive charges borne by pension fund members have led public authorities to take measures to improve transparency and to limit the fees charged by pension providers.

Like in Italy, demographic trends in Germany (by 2030 the retired population – aged 65 or above – will be 23% higher compared to the total population) are very unfavourable and the Government ran several reforms to promote private pension savings, with the latest reforms aimed mainly at occupational provision but also impacting the continuously criticised Riester regime through higher allowances.

In Spain, the promotion of occupational and personal pension schemes has only recently been established. Personal pension provisions and pension funds are taxed according to the beneficial EET formula; however, pension disclosures to individuals are broadly inadequate. The 18-year period provides around zero returns in real terms for pension funds.

Only a small minority of Poles participate in employee pension schemes and personal pension products because they have only recently been set up. Those who participated in employees' pension funds benefitted from a very substantial annual real rate of return of 4.27%. However, the disclosure policy of pension providers is far from being satisfactory, especially as there is no guarantee: a market downturn would severely impact the wealth of pension fund participants, a risk that few of them may be aware of.



Pension funds in the Netherlands were among the better performers at 2.89% over the long 18-year period, while insurance companies lost -0.07% in real terms over the same period, having picked up since the last reporting period and trending to positive real returns.

The best results for funded (occupational) pension schemes were recorded in Romania with a strong real return of 5.1% before taxation, but over a 10-year period only. Albeit performing only half as strong as the funded ones, voluntary pensions did also clearly perform positively (2.8%) over 10 years.

Funded pensions in Slovakia lost in real terms (-0.2%) up to 2016 but grew in NAV to reach positive figures by 2017 with 0.62% on an annual basis over a 13-year period, while supplementary pensions performed somewhat more positive and continued to grow at 0.79% over 9 years.

In Bulgaria, universal, occupational and professional pension funds all could record positive real returns between 0.5% and 1.7% supported by the very favourable EEE formula.

In the Baltic States, supplementary pensions could register positive returns (Estonia 1.21%, Lithuania 0.83% and Latvia 1.87%) before taxation, while funded pensions were close to zero in Estonia, performed slightly better in Lithuania and were negative in real terms in Latvia.



Recommendations

Unfortunately, most of the BETTER FINANCE's 2017 recommendations remain valid in 2018.

- 1. Restore and standardize relative past performance disclosure for all long-term and retirement savings products:
 - Re-instate standardised disclosure of past performance of "retail" investment products compared to objective market benchmarks (as required up to 2017 for all UCITS investment funds in the UCITS IV Directive and in the KIID Regulation of 2010⁵⁵): long term historical returns after inflation; after all charges to the investor; and after tax when possible
 - Make the period of the past performance disclosure consistent with the time horizon of the investment product: it is currently 10 years minimum for UCITs funds and it should be longer for pension products.
 - Extend the exemption of UCITS funds⁵⁶ from the PRIIPs Regulation by a minimum of three years as the elimination of the requirement for the disclosure of past performance of the PRIIPs and their chosen benchmarks in favour of 'four future performance scenarios' without any benchmarks, and with non-standardized durations (10 year minimum in the UCITS KIID Regulation) leaves retail investors confused and in the dark as they will not know whether these products met their investment objectives or made any money in the past or not. They will also de facto no longer be able to compare the performances and fees of similar products.
 - Disclose total fees and commissions charged to the end investor, both direct and indirect
 - Disclose the funding status when relevant
 - Disclose transfer/exit possibilities and conditions and provide this information in plain language.
 - Extend the PRIIPs⁵⁷ ' KID⁵⁸ principle (meaning a standardized plain language and short information document) to all long-term and pension savings products, including pension products, shares and bonds.
 - Initiate a targeted review of the PRIIPs Regulation no later than this year.

⁵⁵ But abrogated on 8 March 2017 by the Commission delegated regulation (EU) 2017/653, supplementing Regulation (EU) No 1286/2014 on key information documents for PRIIPs

⁵⁶ Also, in view of the 2017 request to ESAs to issue reports on the cost and past performance of the main categories of retail investment, insurance and pension products where the EC itself called for the UCITS KIID to serve as a key source for the performance data.

⁵⁷ PRIIPs: Packaged Retail and Insurance-based Investment Products

⁵⁸ KID: Key Information Document (the existing summary document for UCITS funds is the "KIID": Key Investor Information Document).



- Eliminate future performance scenarios or at the very least make the PRIIPs KID compliant with MIFID II rules on performance disclosure, in particular by adding to the future performance "information" a prominent warning stating that such forecasts are not reliable indicators of future performance.
- 2. Address important omissions in the scope of the EC's 2017 request for "the European Supervisory Authorities (ESAs) to issue recurrent reports on the cost and past performance of the main categories of retail investment, insurance and pension products"⁵⁹. It seems that insurance-based occupational pension products are not included. It would be also important that Defined Contribution (DC) non-insurance-based Occupational Pension Schemes ("IORPs") be included in the scope from the start. As it stands, the Commission's request seems to exclude all occupational pension products, leaving plenty if not most long-term savers in the dark.
- 3. After the vote of the ECON Committee report⁶⁰ on the Pan-European Personal Pension Plan (PEPP) proposal, the co-legislators entering now (September 2018) the crucial trialogue phase of the negotiations should make sure to, at least, protect the long-term purchasing power of the life-time savings of EU citizens in the default investment option:
 - With a default option that is really simple (enough to be subscribed without advice and related fees), low cost and really safe;
 - With a "capital protection" that really protects EU savers' money. Therefore, the notion of "capital" must be calculated on the basis of the amounts saved before the deduction of all accumulated fees, charges and expenses directly or indirectly borne by investors and if possible in real terms, otherwise the long-term, accumulated fees and inflation will destroy both the nominal and real value of this "protection". If not, there should be at least a mandatory and prominent warning in the PEPP KID pointing to the very negative impact that inflation and fees will have on the real net value of the "protected" capital over time. If adopted without these conditions, the

⁶⁰ Please see the Recital 39 and Article 2.21 in the ECON Committee report <u>http://www.europarl.europa.eu/sides/getDoc.do?type=REPORT&mode=XML&reference=A8-2018-0278&language=EN</u> as well as BETTER FINANCE's press release <u>http://betterfinance.eu/media/press-releases/press-release-details/article/econ-meps-adopt-a-final-report-on-a-basic-pepp-that-will-hurt-pension-savers/</u>

⁵⁹ Since early 2015, BETTER FINANCE has been calling on the European Commission (EC) to address the lack of information on the past performance and costs of the financial products (please see our recommendation no. 2 on page 27 of our 2015 briefing paper: "An EU Capital Market Union for Growth, Jobs and Citizens") and therefore we welcomed this Action being announced as part of the Capital Markets Union Action Plan as well as, 2 years later, in October 2017 the related EC's request to the ESAs.



so-called "capital protection will very seriously mislead consumers and make the PEPP's default option (called in the ECON report a "basic PEPP") not recommendable.

- With a clear, simple and standardised life-cycle "de-risking" approach supervised at EU level⁶¹
- With the disclosure of the provider's benchmark(s) and their past performance alongside the PEPP's past performance since the inception of the product.
- Benefiting from an equivalent tax regime, at least as attractive as for existing national personal pension products, in order to allow a real European coverage.

4. Simplify, standardise and streamline the range of product offerings:

- Seize the opportunity brought by ESAs Review for ESAs⁶² to strengthen their consumer protection, simplification and supervisory convergence mandates as well as to make full use of their new product intervention powers in order to ban any toxic investment product targeted at individual investors⁶³
- Restrict the use of non-UCITs funds (the 20 000 or so "AIFs") in all packaged longterm and pension products promoted to savers and individual investors, and in particular in the future PEPP.
- Reduce the excessive number of UCITs on offer in the EU.

⁶¹ Based on its research on the divergence of asset allocation paths in existing life cycle funds, BETTER FINANCE believes that the life cycle approach should be allowed if: i) the life-cycle "de-risking" design of the investment option will be simple, cost effective, standardised and supervised by EIOPA ii) Information disclosure will be improved with the publication of the asset allocation glidepath and corresponding target allocation table iii) diversification will be ensured iv) overall fees will be capped at 1%.

⁶² Please BETTER FINANCE's press release on the ECON report

http://betterfinance.eu/fileadmin/user_upload/documents/Joint_Open_Letters/en/ESAs_reform_E <u>CON_report_Joint_Statement.pdf</u> as well as ECON studies on mis-selling of financial products <u>http://www.europarl.europa.eu/RegData/etudes/ATAG/2018/626061/IPOL_ATA(2018)626061_EN.</u> pdf

⁶³ ESAs are already empowered by MiFIR (applicable since 3/01/2018) and PRIIPs (1/01/2018) to ban certain financial products/activities when, *inter alia*, those products/activities cause or may potentially cause a significant concern regarding the protection of consumers or other users of financial services (articles 40(2) and 41(2) MiFIR and article 16 (2) PRIIPs KID). This should ensure better prevention of consumer detriment caused by toxic, overly risky products and business models. However, this power should be straightforward, and not be conditional on a specific mandate granted by sectoral legislation MiFIR, MiFID, IDD etc. which may restrict the ESAs' leeway to take action where needed.



- ESAs to ensure EU individual investors have full access to low fee investment products such as shares, bonds and index ETFs (in line with the CMU initiative of the EU).
- 5. Better align the pricing of investment products with the interests of savers and end biased advice at the point of sale⁶⁴ and guarantee competent advice on long-term investments, including equities and bonds. Address the lack of consistency as regards terminology as it is contributing to the investors' confusion and work with stakeholders, like BETTER FINANCE, to agree on a standardised terminology, in particular on how to define concepts such as "investment advice", "personal recommendations", "product selling", "guidance", "planning", "fee-based" and "commission-based".
- 6. **Improve the governance of collective schemes**: at least half of the schemes' supervisory bodies should be designated directly by the pension schemes' participants;
- Establish EU-wide transparent, competitive and standardised retail annuities markets; and grant more freedom to pension savers to choose between annuities and withdrawals (but after enforcing a minimum threshold for a guaranteed life time retirement income);
- 8. Grant special treatment by prudential regulations to all long-term & pension liabilities allowing for an adequate asset allocation (in particular the solvency II⁶⁵ requirements should be recalibrated as to eliminate the penalisation of equity holdings by insurers when covering long term and pension liabilities).
- 9. Taxation to incentivise Pan-European long-term retirement savings and investments over consumption and short-term savings; Pan-European products such as ELTIFs and PEPPs will not emerge significantly unless they get the most favourable tax treatment already granted to numerous other nationally sponsored long-term investment products. The FTT (financial transactions tax) should be reviewed in order to actually meet its stated goal: tax the transactions of financial institutions (the largest ones by far being the Forex ones, and then derivatives) instead of those from the real economy (end-investors ones in equities and corporate bonds, individual ones in particular). To this end, a "FAT" (Financial Activities Tax) may be more fit for purpose;

⁶⁴ The 2018 EC Study on retail investment products confirmed BETTER FINANCE's findings, i.e. that investment products are not bought but sold, and that an average individual investor is not able to differentiate between the benefits and risks of different types of advice, often believing that advice provided by non-independent advisors via banks and insurers is "free" (unaware of incentive schemes and potential conflicts of interests).

⁶⁵ Solvency II Directive (Directive 2009/138/EC [recast])


- 10. For the EC to follow up on their "Consumer Financial Services Action Plan"⁶⁶ released in 2017 and go beyond the non-binding "Key Principles for Comparison Tools" in light of BETTER FINANCE's findings⁶⁷ as well as the Commission's study⁶⁸ it is clear that EU citizens are in dire need of comparable information on investment products, including past performances relative to the objectives of the providers (their "benchmarks"), and costs. It should be accessible via **independent web-based comparison tools for retail long term and pension savings products**. Moreover, data should be made accessible to independent non-profit online tools providers via modern standardized and documented API frameworks.
- 11. Improve financial literacy: Introduce financial mathematics' basics (compounding interest rates and returns, annuities) and capital markets' (shares and bonds) as part of school curricula; financial institutions to inform clients on shares, bonds and index ETFs (and not only on fee-laden more "packaged" products), and to allow at least a part of their financial education efforts to be guided by independent bodies.

⁶⁷ Please also see BETTER FINANCE's Robo-Advice Report <u>http://betterfinance.eu/fileadmin/user_upload/documents/Research_Reports/en/Robo_Advice_Report_2018_-_for_website.pdf</u>

⁶⁶ The EC's Financial Services Action Plan - <u>https://ec.europa.eu/info/publications/consumer-</u> <u>financial-services-action-plan_en</u>

⁶⁸ The 2018 EC Study on retail investment products



Imprint

Editor and Publisher

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