Will you afford to retire?

The Real Return of Long-term and Pension Savings

2023 Edition

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The European Federation of Investors and Financial Services Users
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Executive Summary

For long-term and pension savers, the year 2022 was undoubtedly a calamitous one. Poor capital market performance and sky-rocketing inflation across all European Union (EU) Member States resulted in disastrous returns, both in nominal and real terms, for virtually all of the product categories analysed in this report. This comes after a year 2021 that had seen strong equity returns, tempered by already rising inflation (BETTER FINANCE, 2022).

One or even two years of past performance, however, do not tell us much about the long-term performance of saving products. What matters for individuals who invest part of their income into those product is how much income they will be able draw from them in the distant future, in particular for retirement purposes. The objective of this report therefore is to provide readers with a long-term perspective on performance that aligns with the extended investment horizon. We analyse the costs and performance of a broad range of products across various holding periods, spanning up to 23 years.

Over this longer period good years supposedly make up for bad ones. Nevertheless, we observe that many of the product categories do not offer sufficient nominal returns in the long run to compensate for inflation, even with the moderate inflation rates of the 2010s. This weak performance then results in a loss of purchasing power for many European savers and investors.

The real net return of European long-term and pension savings

BETTER FINANCE's annual reports on the real return of long-term and pension savings have been met with criticisms—mainly from industry representatives—on account of our choice not to analyse risk-adjusted returns. However, the purpose of this report is to draw attention on what we—together with the European Insurance and Occupational Pensions Authority (EIOPA) consider to be "the main risk of a pension product [that] is the risk of not reaching the individual's retirement objective" (European Insurance and Occupational Pensions Authority [EIOPA], 2020, p. 3). Market risks may be part of this picture but, primarily,

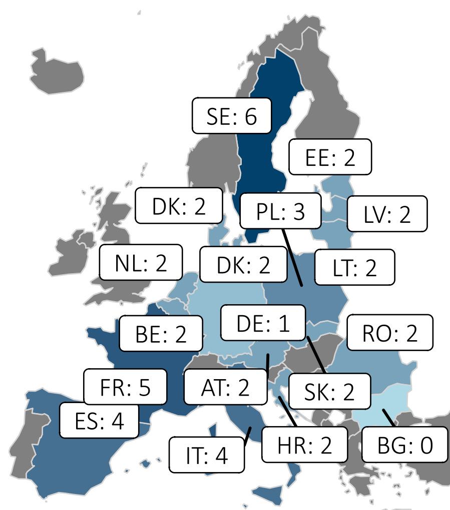
> the riskiness of a personal pension product is its potential inability to outperform inflation, and so to lose savings in real terms, or not being sufficiently "aggressive" to reach higher investment returns to compensate for potentially low contribution levels (EIOPA, 2020, p. 3).

Then, since reaching one's retirement income objective depends primarily on the real net rate of return, it is once more on this metric that BETTER FINANCE chose to focus this year's report.

This research report by BETTER FINANCE covers 17 of the 27 EU Member States. In each of these countries the team of contributors analyses the costs and performance of up to 6 product categories. Our goal is to calculate, based on publicly available data about these product

categories, the **real net return** that long-term and pension savers may expect to obtain from their investments. When we refer to real net return, we are indicating the rate of return on an investment after deducting all costs and charges levied by the product provider. This calculation also accounts for inflation, which reduces the purchasing power of both the invested capital and returns. Figure XS.1 shows the countries included in this study, and the number of product categories analysed in each country.

Figure XS.1 – Countries and number of product categories included in the report

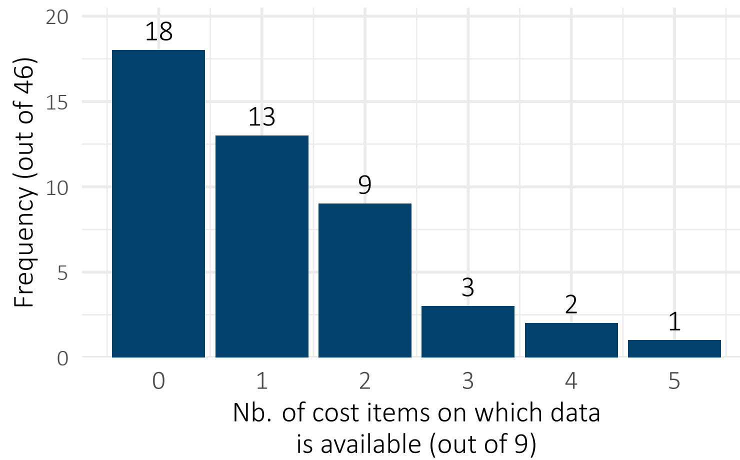


The reader may be surprised to see that we analyse 0 product categories in Bulgaria, and only 1 in Germany. In both cases, the reason is the unavailability of data on nominal returns, costs, and charges. In the case of Bulgaria, despite BETTER FINANCE's multiple calls on the relevant authorities, essential data that are necessary to calculate the real net returns of Bulgarian pension savings remain unavailable. For the second year in a row, we then had to renounce including any Bulgarian long-term or pension savings product category in our study. For Germany, our sample includes only life insurance on an aggregated basis. This does not do justice to the variety of long-term and pension saving products that exist in the country: the lack of data on returns and on costs and charges forced us to exclude important product categories, such as *Riester* or *Rürup* pensions, *Pensionkassen* or *Pensionfondsen*.

Even where we manage to calculate real net returns, it is increasingly difficult for the team of contributors to obtain data about costs and charges. In most cases, the available cost data are partial, covering only a subset of all cost items charged to investors. Information on costs is very often patchy and displayed in a way that makes it impossible for investors to compare cost levels across product providers, and for our contributors to aggregate this information at the level of product categories. The reader can appreciate this reality in Figure XS.2: for none of the 43 product categories included in our study could our contributors find data for more than 5 out of the 9 cost items defined in our methodology. Additionally, for more than a third of the product categories in our study, there is simply no cost information available.

For the 18 product categories for which no cost data is available, the lack of information on costs

Figure XS.2 – Availability of cost & charges data for 2022



and charges prevents us from evaluating the average effect of charges on investors' returns. Consequently, we are forced to start our analysis with disclosed nominal *net* returns, whereas providers' marketing communications usually communicate on the basis of nominal *gross* returns.

Given the challenges in obtaining fundamental data on the average costs and performance of long-term and pension savings products, which capture a large share of the wealth of European households, we advocate for EU and national authorities to urgently enact and implement the proposed rules on product oversight, governance, and information to investors, as outlined in the recent Retail Investment Strategy (RIS) proposals made by the European Commission (see our policy recommendations in the next section).

While opacity on cost and charges is pervasive across the countries we study, it is only fair to acknowledge the few cases in which industry and supervisors made significant efforts to define and implement coherent reporting frameworks.

2022: Annus horribilis for long-term and pension savings

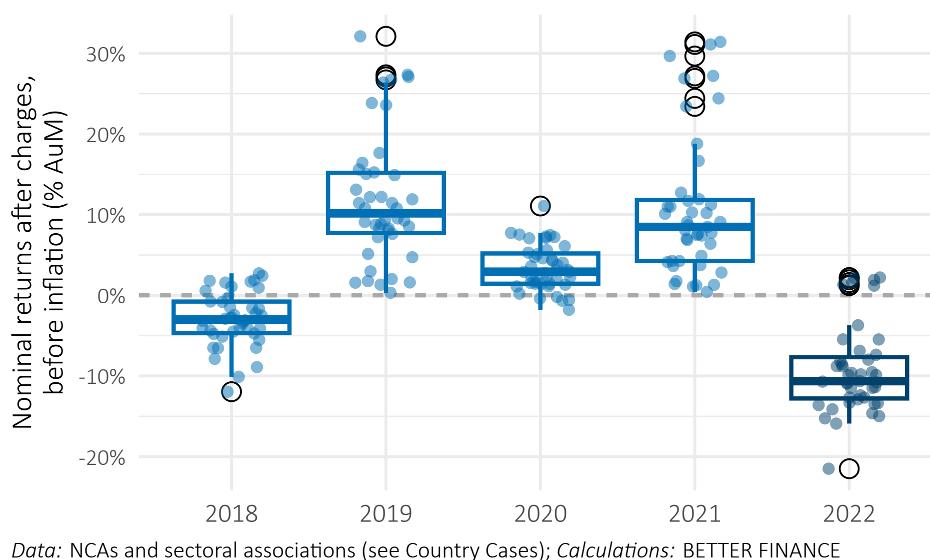
The long-term and savings products included in our study have performed particularly poorly this year, with nominal net returns (that is, after charges but before inflation) turning negative for 35 out of 41 product categories. As shown in Figure XS.3, 2022 presents a sharp contrast with 2021, which had seen strong equity markets boost performance.[1]

These poor results across the board stem from a combination of capital markets taking a plunge and inflation skyrocketing, triggered, inter alia, by Russia's attack on Ukraine and other perceived geopolitical risks.

Figure XS.4 shows the performance of European capital markets, using two pan-European market indices as proxies—one for equities and one for bonds. Based on these, we calculate the

[1] In box plots such as Figure XS.3, the central box represents the interquartile range (i.e., 50% of the data), the thick central line is the median, the whiskers (vertical lines) indicate where roughly 99% of the data points are located, and the black circles at each end of the whiskers represent outliers.

Figure XS.3 – Average 1-year return rates of analysed product categories (2018–2022)



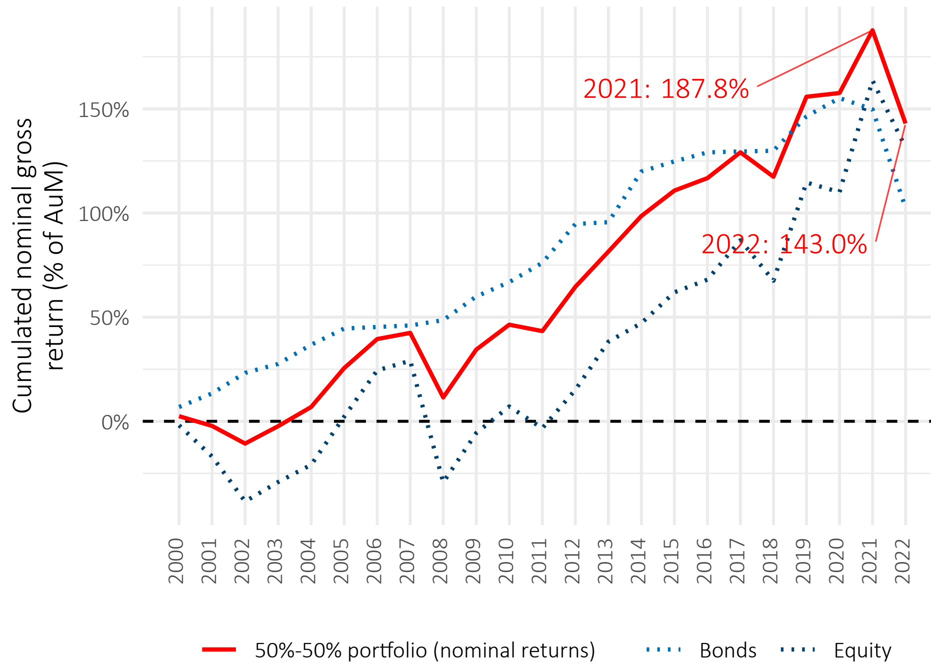
Data: NCAs and sectoral associations (see Country Cases); *Calculations:* BETTER FINANCE

cumulative return of a hypothetical portfolio composed of European equity and bonds in equal proportion, with annual rebalancing. The cumulated return of this portfolio, which we use as a benchmark throughout our report to assess the performance of long-term and pension products, dropped by 44.8 percentage points between end-2021 and end-2022 (before inflation).

Meanwhile, inflation, which had already begun to rise in 2021, reached levels unseen in decades by 2022. This can be observed in Figure XS.5, where the inflation rate for 2022 is juxtaposed with the annual average inflation over the period 2000-2022 for each country in our study, as well as the EU and Euro Area averages.

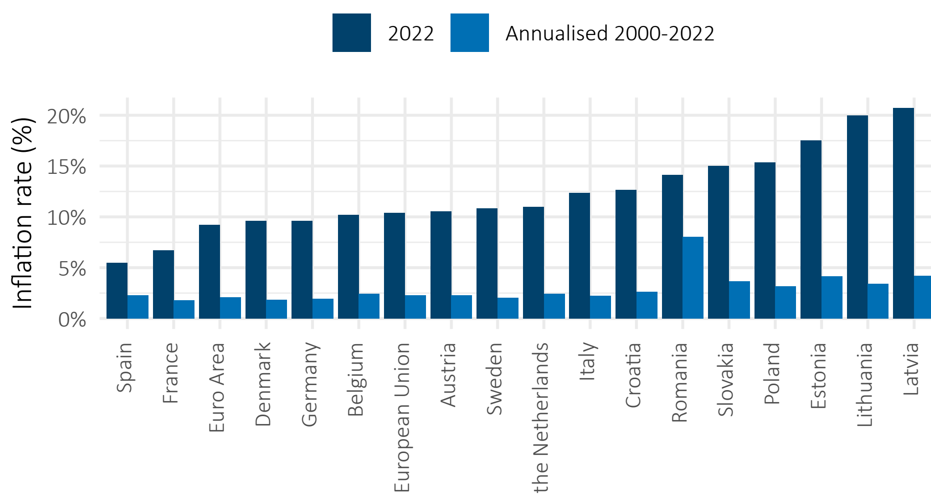
Both phenomena combined to create a "perfect storm", resulting in dramatic losses, in real terms, for long-term and pension savers. Figure XS.6 illustrates the average performance of analysed long-term and pension-saving products in nominal terms (left-hand box) vs. real terms (right-hand box). The already strikingly poor nominal returns of most products are pushed significantly further into negative territory when taking into account inflation. All of the positive nominal net returns turn negative after inflation.

Figure XS.4 – Cumulated performance of European capital markets (2000-2022)



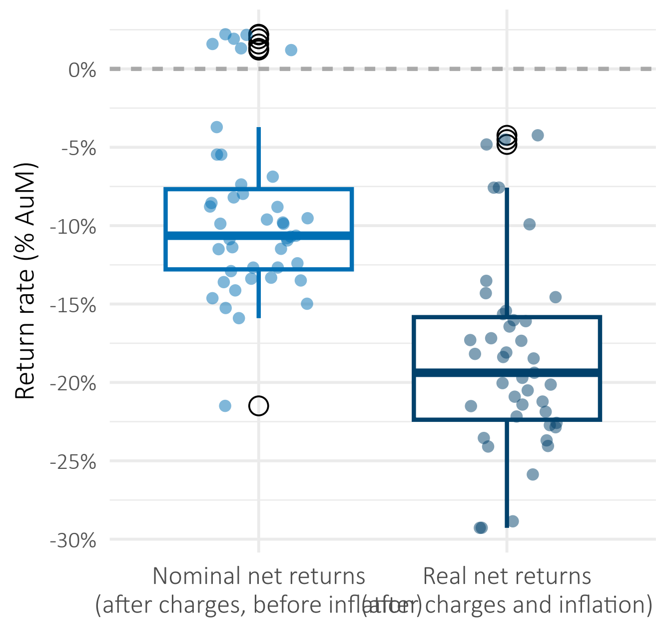
Equity index: STOXX All Europe Total Market (gross return); Bonds index: Barclays Pan-European Aggregate Index (gross return); The 50%-50% portfolio is rebalanced annually.

Figure XS.5 – Inflation 2022 vs. 23 year annual average



Data: Eurostat (HICP monthly index); *Calculations:* BETTER FINANCE.

Figure XS.6 – Average 2022 1-year net returns: nominal vs. real

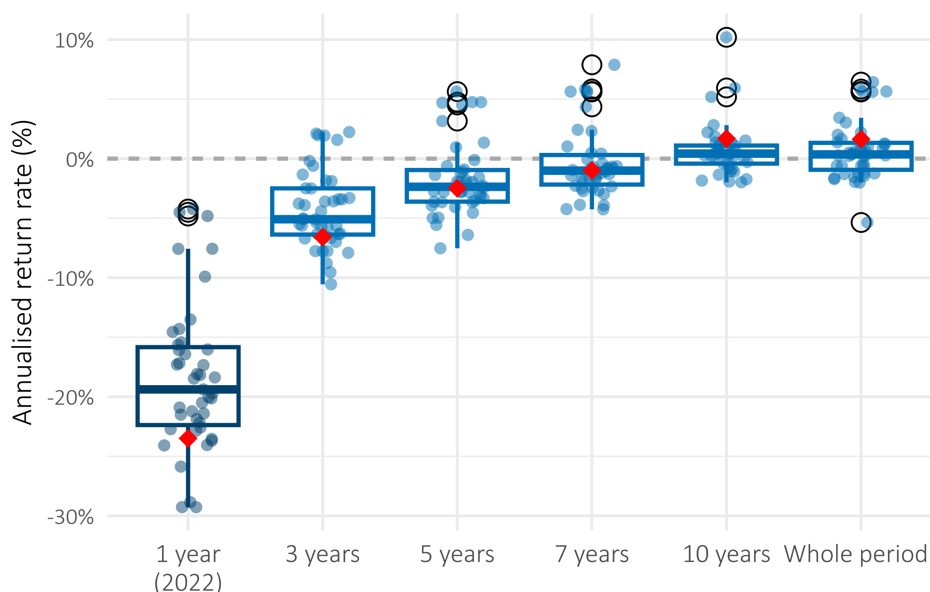


Calculations: BETTER FINANCE

The long-term view on long-term savings

Naturally, one should not assess the performance of long-term and pension savings products based on the results obtained in one bad year but rather take a long-term view. That is why our ambition in this report is to gather data about costs and performance for a period of up to 23 years (2000–2022), calculating annualised and cumulated returns over more than two decades.

Figure XS.7 – Average annualised real net returns over varying holding periods



Calculations: BETTER FINANCE; * The reporting period varies across products (earliest year: 2000)

Figure XS.7 displays the average performance after charges and inflation of the long-term and pension saving products analysed in our report over varying holding periods, from 1 year (2002) to the whole period for which data could be found ("whole period", up to 23 years). The first observation is that the longer products are held, the better performances can be expected to be. The effect of the heavily negative results in 2022 is indeed felt over short holding periods, which at least partly explains the negative performance of many products over 3, 5 or even 7 years.

When looking at results over 10 years and entire reporting periods, we generally see better results than for shorter timeframes, as capital market volatility tends to smooth out over time. Nevertheless, it is striking that even over the long-term, many of the analysed product categories show disappointing results.

12 out of the 37 product categories have negative real net performance, and of the 25 that show positive performances, only 6 manage to beat the 10-year performance of our benchmark portfolio (1.68%, shown by the red diamonds in Figure XS.7).

The median real net performance is only 0.4%.The average 10-year performance from 2013–2022, though influenced by the robust performance of Sweden' Premium pensions (AP7 Såfa +10.2%, other funds +5.9%), only reaches 0.7% (see Table XS.1).

Observing the distribution of performance levels across pension system pillars, we also note that

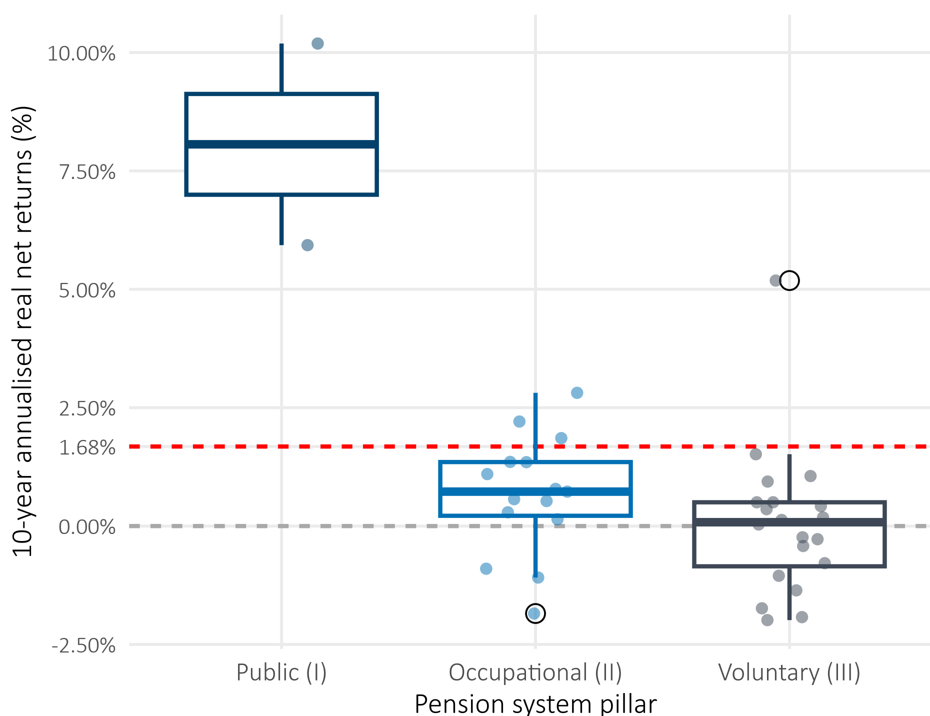
Table XS.1 – Summary statistics of performance over varying holding periods

Holding period	Nb. of product cat.	Median	Mean	Standard Deviation	Best performance	Worst performance
1 year	43	-19.4%	-18.4%	6.2pp.	-4.2%	-29.3%
3 years	43	-5.1%	-4.3%	3.2pp.	2.2%	-10.6%
5 years	42	-2.4%	-1.7%	3.1pp.	5.6%	-7.5%
7 years	42	-1.0%	-0.3%	3.0pp.	7.9%	-4.3%
10 years	37	0.4%	0.7%	2.3pp.	10.2%	-2.0%
Whole period*	43	0.4%	0.7%	2.4pp.	6.4%	-5.4%

Calculations: BETTER FINANCE
* "Whole period" varies across products (up to 23 years)

occupational pension schemes in Pillar II generally outperform voluntary products within Pillar III. Figure XS.8 illustrates the distribution of 10-year performance per pillar.

Figure XS.8 – Average 10-year annualised real net returns per Pillar



Calculations: BETTER FINANCE, returns are shown after charges and inflation.

Swedish Premium pensions, which show very strong performance compared to the rest of the analysed product categories, are classified as Pillar I products but bear strong resemblance to occupational pension schemes (Pillar II). Leaving these extreme positive outliers aside, we observe that median 10-year performance of Pillar II products (central line of the middle box) is above the upper limit of the interquartile range of Pillar III performances (upper bound of the right-hand box), meaning that 75% of Pillar III products have a performance below the median performance of Pillar II products. Spanish Equity Pension Plans constitute a notable exception,

with 10-year real net returns above 5%, the only product in Pillar III to beat our 50% equity-50% bond benchmark portfolio (the dotted red line in Figure XS.8)

It is beyond the scope of this report to explore the significance of the trend, although future research should investigate the factors that may explain it, including differences in asset allocation, management costs, distribution costs, and the potential effect of auto-enrolment schemes. Additional cost data would be particularly valuable to consistently analyse whether the observed divergence in performance might arise from higher costs associated with Pillar III products. We hope that such data becomes available if the EU legislator follows the much-welcomed proposals regarding cost disclosures under the Markets in Financial Instruments Directive (MiFID) and Insurance Distribution Directive (IDD), crucial elements of the European Commission's proposals for the Retail Investment Strategy (RIS).

Policy recommendations

Policy recommendation 1 — Supervisory reporting and statistics

Urgently improve reporting to supervisory authorities and publication of sectoral data, including the ESAs's report on the cost and performance of retail investment products.

The report once more highlights the difficulty to obtain data about long-term and pension saving products. Gathering comprehensive data about costs and charges is often an impossible task. Even obtaining data about net returns is becoming increasingly difficult.

Nevertheless, counter-examples exist, where detailed figures are reported in a harmonised way by market participants to a supervisory authority or sectoral organisation, which aggregates and makes them available to the public. The EU legislator should draw inspiration from these examples and incorporate into EU law - specifically, theMiFID and IDD legislation for Pillar III products, currently under review as part of the Retail Investment Strategy (RIS), or the next revision of the IORP II directive on occupational pensions - requirements for national competent authorities (NCAs) to adequately report figures on a quarterly or monthly basis. This should include the constant updating and public reporting of assets under management (AuM) and net AuM, unit value, asset allocation, as well as the number of participants for all supervised vehicles in the area of long-term and pension savings.

As part of these efforts to better report on the costs and performance of retail investment products, BETTER FINANCE calls on the European supervisory agencies (ESAs) to keep improving their annual costs and performance reports. Currently, the data and coverage of these reports are incomplete and based on commercial databases or surveys. The European Securities Markets Authority (ESMA), the EIOPA and—in the future—the European Banking Authority (EBA) should be able to rely on regular reporting of supervisory data from NCAs, which themselves should have the necessary powers to require regular reporting of data on the costs and performance of saving and investment products in their respective areas of competence.

Policy recommendation 2 – Conflicts of interest in scheme management and product distribution

Harmonise and reinforce rules to curb the conflicts of interests in the distribution of long-term and pension saving products, and improve the governance of collective long-term pension schemes.

Conflicts of interest plague the management and distribution of long-term and pension saving products in Europe. The sales commissions-based distribution system of voluntary long-term and pension saving products (Pillar III) directs retail investors towards fee-laden and often underperforming products. Our report showcases various product categories with high average fees and poor long-term returns that so-called "advisors" are paid to recommend to consumers, against the best interest of the latter.

BETTER FINANCE has consistently opposed this system, and strongly supports the European Commission's proposal to partially ban so-called "inducements" as part of the RIS. We believe that the inducements-based distribution system hurts retail investors through higher charges, the illusion of "free" investment advice and a selection bias in distributors' recommendations, all of which result in lower returns and inadequate retirement income for European citizens.

For more details on BETTER FINANCE's position regarding conflicts of interests in the distribution of retail investment products, see (BETTER FINANCE, 2023a, pp. 4–13)

In occupational pension schemes (Pillar II), the issue of conflicts of interest takes on a different form. In those schemes, it is crucial that the board, which takes decisions on behalf of the scheme's members, includes independent members representing the interests of beneficial owners.

Policy recommendation 3 – Information to (prospective) investors

Provide simple, intelligible, and comparable information on cost and performance of long-term and pension saving products.

Obtaining information on long-term and pension vehicles, as well as monitoring them, should not be difficult for non-professional savers. This implies also reinstating standardised actual cost and past performance disclosure, and in real terms alongside the less relevant nominal ones.

The proposed revisions to the EU's MiFID and IDD legislation, along with the amendments to the PRIIPs regulation, offer the opportunity to finally provide investors with the information they actually need to compare the costs of products. BETTER FINANCE strongly supports, in particular, the provision of annual statements to holders of investment funds' shares distributed under MiFID and to life insurance policyholders distributed under IDD, including the provision of information on the cost of distribution and the possibility to obtain a detailed breakdown of all charges

Although we welcome the innovations introduced to the format of Key Information Documents (KIDs) by the proposed amendments to the PRIIPs regulation, we still call for a thorough review of this legislation to drastically improve the understandability and comparability of the information provided in the KID. We strongly believe that providers of packaged retail and insurance-based

investment products (PRIIPs) should include the actual most recent costs of their products in the KID.

PRIIPs providers should also be required to provide 10 years of past performance data together with the benchmark that is used as investment objective by the product provider. While past performance is not indicative of future performance, it is a good indicator of whether a PRIIP has ever made money or not for the investor, and of an asset manager or insurance company's ability to meet its investment objectives, and to generate returns for the client. Furthermore, it is comparable across product providers and timelines, as it does not rely on assumptions and hypothetical scenarios. The past performance of various products shows how their respective providers navigated through a similar set of real-world circumstances. Finally, displaying past performance in comparison with the product's stated benchmark enables the prospective investor to clearly see whether the provider has been able to make good on their commitment to meet its target.

For more information about our recommendations regarding information to investors and prospective investors, see BETTER FINANCE (2023a, pp. 17–22).

Readers may also refer to BETTER FINANCE's response to the consultation conducted by EIOPA on the review of the Directive on institutions for occupational retirement provision (IORPs) (BETTER FINANCE, 2023b). In occupational pension schemes too, managers should provide pension scheme participants with the information necessary to keep track of their pension benefits and effectively plan their savings and investments to ensure adequate levels of retirement income.

Finally, EU authorities should follow-up on the recommendation of the High-Level Forum on the Future of the Capital Markets Union (HLF CMU) to establish individual pension tracking systems, enabling individuals to keep track of their accumulated pension rights across employers and across borders.

Policy recommendation 4 – Sustainability

Provide clear, intelligible information on the sustainability of European long-term and pension savings and investments.

An increasing number of retail investors express a desire to invest in financial products that consider sustainability criteria and pursue environmental, social and governance (ESG) objectives (2° Investing Initiative [2DII], 2020). Despite significant progress in recent years, much remains to be done to provide retail investors with an investing environment that accommodates both their financial and sustainability preferences.

First, EU policymakers should increase their efforts to develop a clear, precise, and standardised taxonomy of economic activities. This taxonomy should be grounded in scientific analyses and address all three major aspects of sustainability: environmental, social and governance (ESG). These efforts should also include the development of a **well-designed EU-wide Ecolabel for retail investment products** that avoids the pitfalls of existing national labels.

EU policy-makers should also address the short-termism of the financial industry by reinforcing the consistent linkage between sustainability and long-term value creation. **It must be clearly**

emphasised that exemplarity with regard to investor protection rules first and ensuring decent returns for individual investors is compatible with investing in a way that respects environment and society. To this end, clear and intelligible ESG disclosures should be combined with financial disclosures, preferably integrated into one document providing savers and investors with a holistic picture of the products they buy.

Finally, EU and national policymakers should require sustainability and ESG knowledge and training for board members in long-term and pension savings vehicles, as well as for financial advisors and sales personnel distributing such products. Regarding the latter, BETTER FINANCE supports the European Commission's RIS proposals regarding the knowledge and competence of financial advisors and sales personnel but urges additional training specifically dedicated to sustainable investing (see BETTER FINANCE, 2023a, pp. 12–13).

Policy recommendation 5 — Asset allocation

End the fixed-income bias in the asset allocation of long-term savings.

Prudential rules, designed to protect investors against the risk of excessive risk-taking leading to financial losses, require pension fund managers and life insurance providers to allocate a significant portion of participants' and policyholders' funds into fixed-income assets, particularly sovereign debt from EU Member States.

However, in doing so, these rules excessively restrict the possibility for long-term and pension savers to take advantage of investment opportunities in equity markets, which, while more volatile, also offer higher yields in the long term.

Regulations governing long-term and pension savings should not discriminate against long-term equity investments. Specifically, life-cycling strategies that adjust risk to the investment horizon of the saver should enable managers to invest a substantial portion of younger investors' contributions or premiums in equity market instruments (as is the case of Sweden's Premium pensions, in particular the AP7 Såfa fund).

Policy recommendation 6 — Taxation

Stop penalising taxation of long-term and pension products.

Taxation on pensions, whether on contributions, returns, or payouts, should be based on real values rather than nominal ones. Taxes should be applied to values adjusted for inflation, using the harmonised index of consumer prices (HICP). To recoup the value of pension pots, at least occupational schemes (Pillar II) should apply an "EEE" regime. Pillar II contributions should be deductible from the income base tax.

Policy recommendation 7 — Auto-enrolment

Introduce auto-enrolment in occupational pensions.

The active labour force should be automatically enrolled in a default pension fund, with the option to withdraw or switch provider at no additional cost. Romania, Sweden, Slovakia and other serve as best practice examples: This auto-enrolment ensures that working individuals start saving early and consistently for their retirement, reducing the risk of insufficient income in retirement. This was also a recommendation of the HLF CMU.

Policy recommendation 8 — Suspensions

Allow savers to defer contributions to pensions without penalties.

Savers should be allowed to suspend payments into a pension savings or life insurance plan without incurring a penalty. In an era characterised by uncertainty, it can never be assumed that an individual will always have an income sufficient to cover their immediate needs as well as pay their premium or set contribution towards their pension plan. When an individual, for whatever reason, cannot, for a short period of time, contribute to their pension product, they should not be faced with the choice between foregoing their pension plan or paying a penalty. Instead, they should be able to suspend payments and resume as soon as they have a new income stream.

Policy recommendation 9 — Insurance guarantee schemes

Urgently establish harmonised insurance guarantee schemes in the EU.

EU citizens are partially covered against the default of product manufacturers through Directive 2014/49/EU on deposit guarantee schemes (DGSs) and Directive 97/9/EC on investor compensation schemes (ICSs). However, many pension savers across the EU lack an appropriate protection for insurance-based investment products (IBIPs), a shortcoming of the EU's protection regime that is particularly problematic as IBIPs (such as life insurance) are predominant in some pensions systems in the EU (e.g., in France).

BETTER FINANCE calls on the EU legislator to revamp the project for a Regulation on insurance guarantee schemes (IGSs), which should mimic the rules of the DGS Directive, and urgently harmonise protection against defaults at a minimum level across the EU.

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