

Will You Afford to Retire?

The Real Return on Long-Term and Pension Savings

2024 Edition



BETTER FINANCE

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

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The Real Return of Long-term and Pension Savings

2024 Edition — Austria

A research report by BETTER FINANCE

COORDINATORS

Sébastien Commain
Ján Šebo

CONTRIBUTORS

Sara Álvarez
Sébastien Commain
Daniela Danková
Laetitia Gabaut
Lisbeth Grænge Hansen
Christian Gülich
Amadeus Malisa
Guillaume Prache
Joanna Rutecka Góra
Ján Šebo
Thomas Url

REVIEWERS

Sara Álvarez
Sébastien Commain
Aleksandra Mączyńska
Ján Šebo
Rina Zhubi

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Executive Summary

Was 2023 the year when European retail investors finally obtain the “fairer deal” that the outgoing European Commissioner Mairead McGuinness wished for them (McGuinness, 2023)? As far as long-term and pension products are concerned, this report presents mixed results. While European capital markets performed strongly in 2023, helping many pension funds and life insurance companies to rebound after a calamitous 2022, we find that many of the products we analyse failed to pass on the benefits of this renewed performance to pension savers. 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 products is how much income they will be able to 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 24 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 2000s and 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

The object of this report is to assess the ability of long-term and pension savings products to at least preserve the purchasing power of European retail investors' savings over more than two decades, and at best increase the real value of these savings, increasing the capital on which European pension savers may rely on to maintain their living standard in retirement. That is why we focus our analysis on time-weighted returns.

The risk of financial losses is inherent in any investment in capital markets: capital markets are volatile—as their performance over the last two years clearly shows (see Figure XS.4). Nevertheless, we share European Insurance and Occupational Pensions Authority (EIOPA)'s view that

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 (European Insurance and Occupational Pensions Authority [EIOPA], 2020, p. 3),

and generalise it to any long-term and pension savings product. Short-term volatility—the alternance of good and bad years—is of little consequence for most pension savers; what matters is the cumulated performance over the life of the contract, the holding period, which often spans more than two decades. Over such long periods, the crucial risks are those arising from cumulated costs—which divert a portion of the accumulated capital towards financial intermediaries profit and loss accounts—and inflation—which progressively erodes the purchasing power of savings. The *real net rate of return* is therefore the main metric of interest for pension savers.

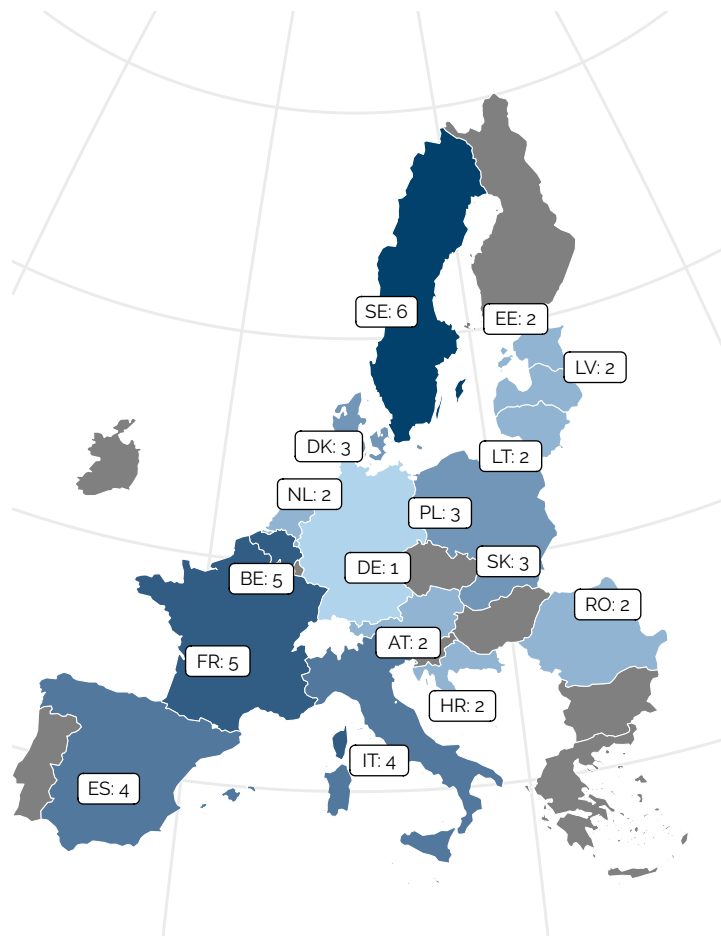
This research report by BETTER FINANCE covers 16 of the 27 European Union (EU) Member States. In each of these countries the team of contributors analyses the costs and performance of up to 6 product categories. Our goal is to calculate, based on publicly available data about these product categories, the *real net return* that long-term and pension savers may expect to obtain from their investments, going back as far as the year 2000. 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. The map in Figure XS.1 shows the countries included in this study, and the total number of product categories analysed in each country.

Assessing the real net return of a category of pensions products requires three classes of information about these products: (a) reliable data about the nominal, gross return of investments made on behalf of pension savers in relation to the total amount of accumulated capital; (b) total costs being levied for the management of these investments (administrative costs of managing the investor's contract, cost of management of investment fund "units", entry fees, exit fees, etc.) and; (c) the rate of inflation in one's country for each year of the investment period.

These are but typical examples of the data availability issues that our team of expert contributors face across countries and product categories. While data about average inflation is easy to come by—thanks, inter alia, to the work of Eurostat—, we can hardly say the same for data about returns and costs. The availability of such data often limits the scope of our study. Reliable information about the average performance of a product category may be unavailable, as is the case of most German long-term and pension saving products, or not fully appropriate for an assessment of what the client actually get, as is the case with Belgium's *Assurance Groupe* products. Costs data are even more difficult to obtain: for many of the product categories we analyse, cost information is too scarce to assess the impact of costs on performance.

Long-time followers of BETTER FINANCE's work on pensions might remember that past editions of the report also included Bulgarian pensions products and may be surprised to see that we analyse no product category in Bulgaria in this report. In the case of Bulgaria, despite BETTER FINANCE's multiple calls to the relevant authorities, essential data necessary to calculate the real net returns of Bulgarian pension savings remain unavailable, forcing us to renounce including any Bulgarian long-term or pension savings product category in our study.

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

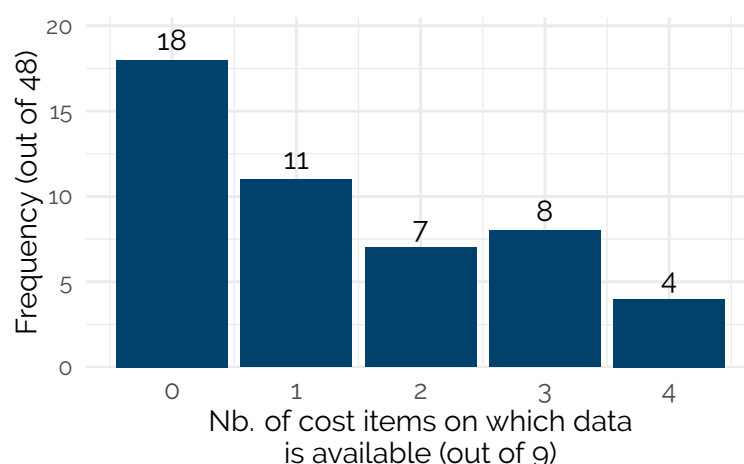


Besides performance data, information on costs is very often patchy and displayed in a way that makes it impossible for investors to compare cost levels across product providers, and for our contributors to aggregate this information at the level of product categories. The reader can appreciate this reality in Figure XS.2: for none of the 48 product categories included in our study could our contributors find data for more than 4 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 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

Figure XS.2 – Availability of cost and charges data for 2023



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 on Page xiii). Costs and performance disclosures are key to properly assess the functioning of the European market for pension savings products.

While opacity on cost and charges presents a challenge for many of the product categories 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, such as that of the Dutch pension funds or the Italian *Commissione di Vigilanza sui Fondi Pensione* (COVIP)'s annual report on pension funds and *Piani Individuali Pensionistici* (PIP).

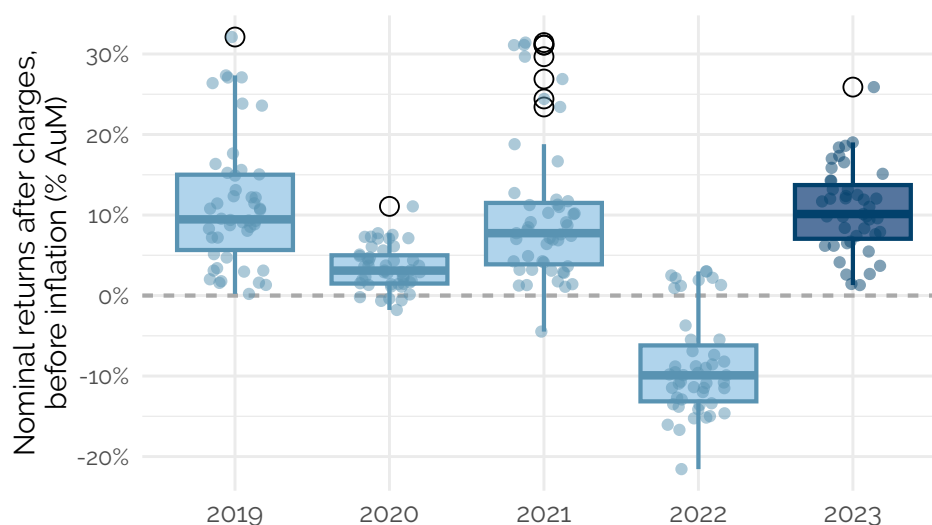
2023: Recovering from the slump

The product categories included in our study generally performed strongly in 2023. All of the 43 product categories for which we could obtain performance data for 2023 had a positive nominal net return. As can be appreciated in Figure XS.3, this performance is in sharp contrast with the previous year, when out of 47 product categories, 38 returned a loss in nominal terms, after charges.¹

These good results reflect the good performance of, in particular, equity markets between January and December 2023, which recovered strongly after the slump of 2022. 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, we calculate the cumulative return of a hypothetical portfolio composed of European equity and bonds in equal proportion, with annual rebalancing. The cumulated return, in nominal terms, of this portfolio dropped by 44.8 percentage points between

¹In 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 (2019–2023)



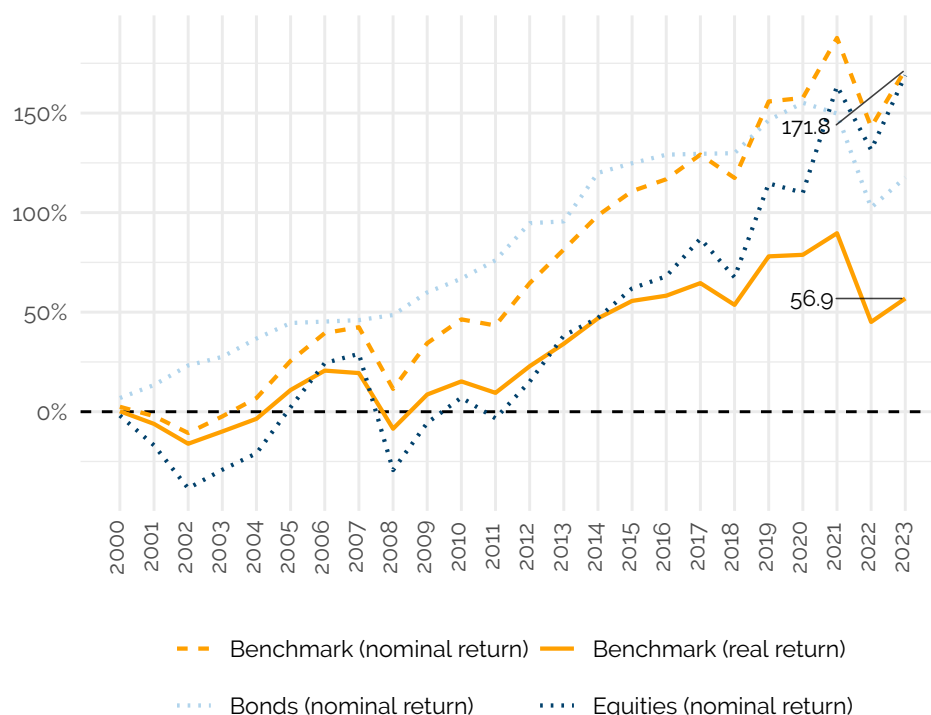
Data: NCAs and sectoral associations (see Country Cases); Calculations: BETTER FINANC

end-2021 and end-2022 before rebounding to 171.8% by the end of 2023. After adjusting for the average inflation across the EU, we obtain a 56.9% real net return, +11.8 percentage points (p.p.) from end-2022.

Inflation, in turn, slowed down in most EU countries in 2023, after the peak of 2022. In 8 of the 16 countries of our study, inflation in 2023 was below the annual average over the period 2000–2003. Nevertheless, for most of our sample, inflation remained high, as can be observed in Figure XS.5. Inflation across the Euro Area, stood at 2.93%, still significantly above the close-to-but-below-2% target of the European Central Bank (ECB).

The result of this combination of strong capital market performance and slowing inflation is a reduced gap between nominal net returns and real net returns for 2023: With a median net return standing at 10.1% in nominal terms and 7.4% after inflation, the gap is reduced to 2.8 p.p. (see Figure XS.6), down from 8.6 p.p. in 2022, when the already severely negative median nominal returns (-9.9%) were further depressed by the strongest inflation seen in Europe in decades, yielding a median real net return of -18.5%. These median values, it should be noted, hide markedly contrasting differences: The maximum performance for 2023, in nominal terms and after deduction of charges, stands at +25.9% (Poland's Employee Capital Plans), while the poorest performance with +1.3% (ironically, that of Italian PIP "with profits" contracts) narrowly avoids returning a loss in real terms thanks to the low level of inflation in Italy (+0.46%).

Figure XS.4 – Cumulated performance of European capital markets (2000–2023)



Pan-European Pension Product (PEPP): First full year of return data

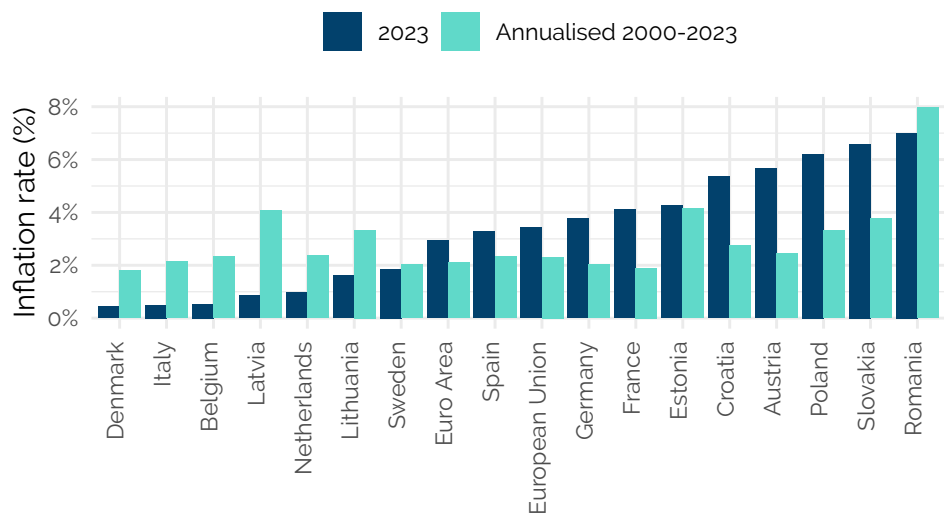
We wish to highlight the good performance of the first PEPP to be included in our study: with a nominal return before charges and inflation standing at +15% and charges amounting to 0.72% of assets under management (AuM), the Slovak PEPP yielded a net return of +14.3% in nominal terms and 7.2% in real terms, largely outperforming its capital markets benchmark (11.8% and 4.9% in nominal and real terms, respectively). Find more information in the Slovak country case in part II of this report.

These data show that the PEPP is indeed a promising personal pension product. The Slovak case shows that it is indeed possible to offer a PEPP under the conditions set by the current PEPP regulation, including the “1% fee cap”, that is, the limiting of fees to 1% of accumulated capital per annum for the Basic PEPP.

BETTER FINANCE will keep monitoring its development not only in Slovakia, but also in Poland—another of the country cases of this report, where PEPP was introduced in the course of the year 2023—and other countries.

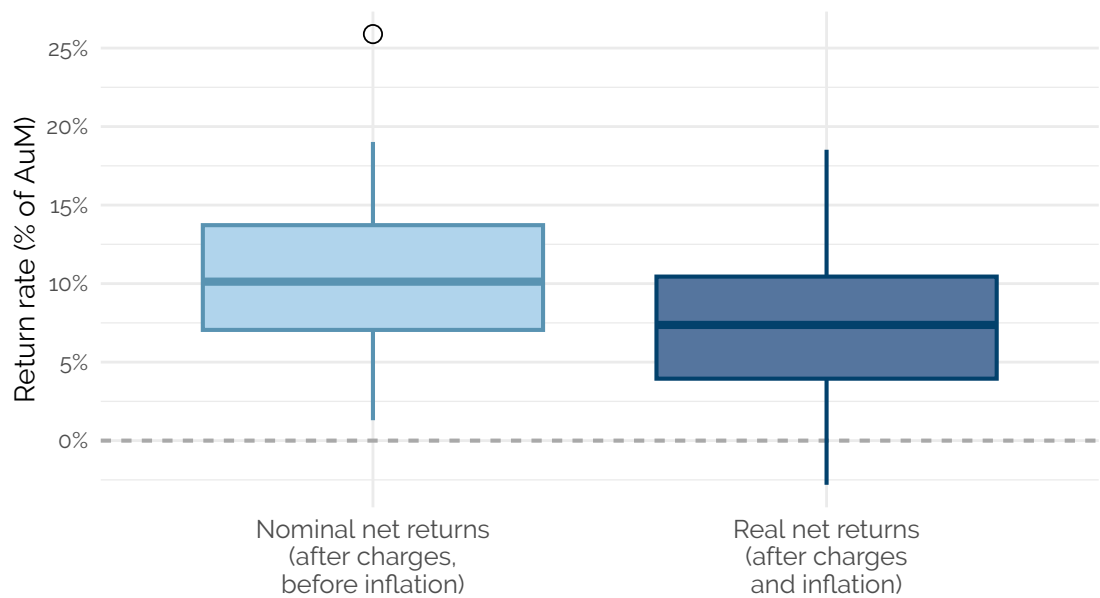
In the meantime, we urge Member State governments to offer the PEPP the same treatment, as regards taxation, subsidies and transferability of accrued pension benefits, that existing national personal pension products enjoy (see our policy recommendation on this topic on Page xvii).

Figure XS.5 – Inflation 2023 vs. 2000–2023 annual average



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

Figure XS.6 – Average 1-year nominal vs. real return in 2023 (after charges, % of AuM)

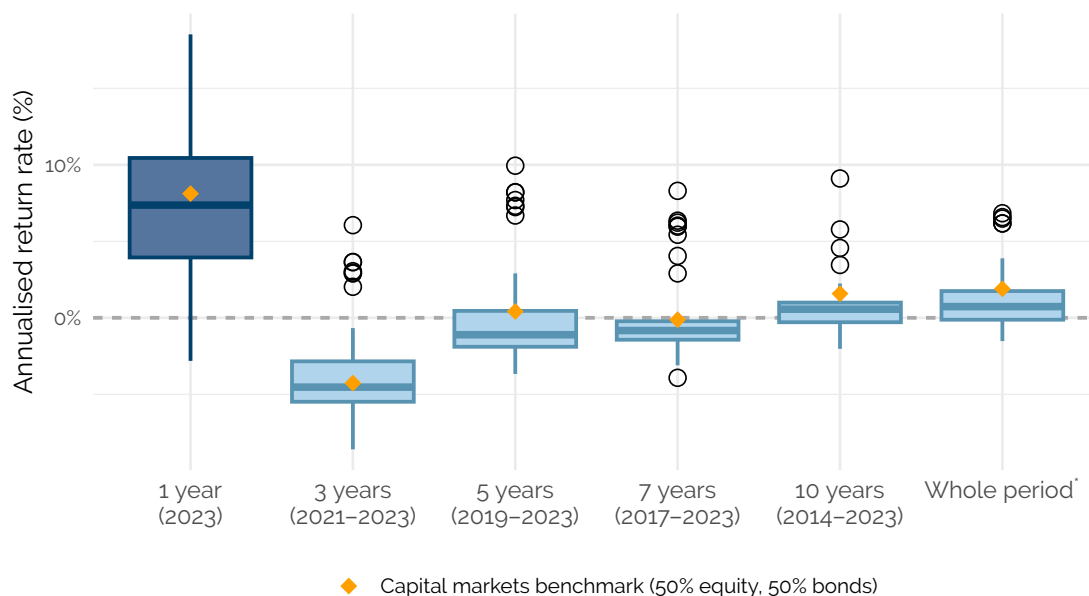


Calculations: BETTER FINANCE

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 24 years (2000–2023).

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



Calculations: BETTER FINANCE; * Up to 24 years, the reporting period varies across products

Figure XS.7 displays the distribution of average performances after charges and inflation of the long-term and pension saving products analysed in our report, over varying holding periods from 1 year (2023) to the whole period for which data could be found ("whole period", up to 24 years). We immediately observe that the capital markets slump of 2022 still weighs down on performance over shorter periods (3, 5 and even 7 years), with annualised rates after charges and inflation negative for a large majority of product categories. Over 7 years (2017–2023), the negative performance of 2022 comes atop that of the year 2018, with the result that only a few outliers manage to yield a positive real net return over that period.

Market volatility, whether upwards or downwards, is cancelled out over longer periods (the standard deviation falls from 4.9 p.p. for 1 year to 2 p.p. for 10 years, see Table XS.1), allowing us to more accurately assess the returns offered by the various product categories. Over 10 years and over whole reporting periods (up to 24 years), we see that the most of the interquartile range (the boxes in Figure XS.7) lies in positive territory. This may seem reassuring, until one notes that over 7 years, 10 years and whole periods, the annualised real performance of our capital markets benchmark (50% equity–50% bonds, rebalanced annually), shown with a yellow diamond in the figure, lies in the top quartile of the returns of product categories (above the

upper bound of the box), meaning that 75% of the product categories fail to beat the benchmark.

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

Holding period	Nb. of product cat.	Median	Mean	Standard Deviation	Best performance	Worst performance
1 year	43	7.4%	7.3%	4.9pp.	18.5%	-2.8%
3 years	47	-4.5%	-3.6%	3.4pp.	6.1%	-8.6%
5 years	46	-1.1%	0.2%	3.5pp.	9.9%	-3.7%
7 years	46	-0.8%	0.0%	2.8pp.	8.3%	-3.9%
10 years	40	0.6%	0.7%	2.0pp.	9.1%	-2.0%
Whole period*	48	0.8%	1.3%	2.3pp.	7.2%	-1.5%

Calculations: BETTER FINANCE

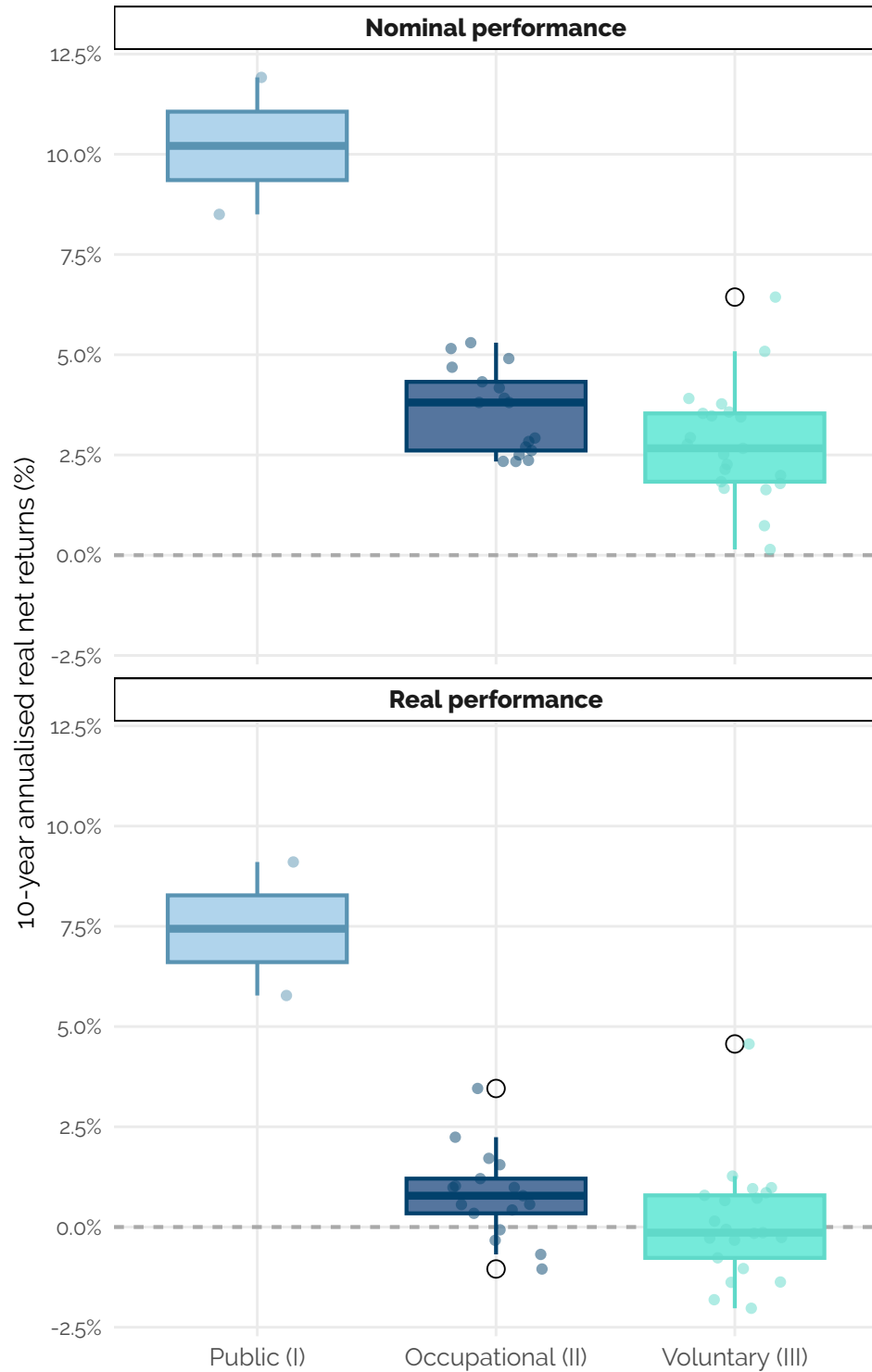
* Whole period varies across products (up to 24 years).

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

Swedish Premium pensions, which show very strong performance compared to the rest of the analysed product categories, are classified as Pillar I but although they are funded, earnings-based pensions that 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.

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).

Figure XS.8 – Average 10-year annualised performance per Pillar



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

Policy recommendations

Policy recommendation 1 — Supervisory reporting and statistics

Step up efforts to collect and disclose data on long-term and pension savings products, both at the national and EU level (ESAs's cost and past performance reports) to empower European citizens as retail investors.

The contributors to this report can testify of the difficult to obtain even basic, aggregated data about long-term and pension products in many EU countries. If a team of expert contributors, with knowledge and experience in the field, find it challenging, how can we expect EU citizens to make any use of these data to assess the performance of their own pension products in relation to the market? Making available full historical data sets of both aggregated and provider-level data would enable non-profit organisations like BETTER FINANCE to provide an independent, consumer-friendly analysis of this market. But national competent authorities (NCAs) could also step up their efforts to create consumer-friendly reports and comparison tools.

Harmonised frameworks for reporting from product providers to NCAs and pension scheme participants already exist for various of the product categories we analyse in this report. These commendable efforts should be assessed through a peer-review process to be organised by the European supervisory agencies (ESAs) in order to identify best practices, but also discard misleading disclosure practices that prevent retail investors to obtain a clear picture of the cost and performance of the products on offer. As part of these efforts to better report on the costs and performance of retail investment products, BETTER FINANCE calls on the 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.

Going further, the EU legislator should draw inspiration from these examples and incorporate into EU law - specifically, the MiFID 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 NCAs to adequately report figures on a quarterly or monthly basis. This should include the constant updating and public reporting of 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.

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 supported 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 (BETTER FINANCE, 2023b, pp. 4–13). The financial industry failure to acknowledge the problem and its intense lobbying efforts to maintain a damaging status quo resulted in the utterly disappointing provisional positions of the Council and, especially, the European Parliament (BETTER FINANCE et al., 2024), which should not be expected to improve outcomes for consumers in any meaningful way. Nevertheless, ignoring the problem will hardly make it disappear, and so we urge all involved policy-makers, supervisors, but also willing representatives of the industry, to keep working towards the generalisation of high-quality bias-free financial advice that EU citizens can rely for their retail investments.

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.

While we are generally disappointed with the current state of the legislative negotiations on the EU's RIS, we urge the co-legislators to adopt these proposals on disclosures. For more information about our recommendations regarding information to investors and prospective investors, see BETTER FINANCE (2023b, 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, 2023a). 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, we urge EU and member state authorities to step up efforts towards the implementation of comprehensive individual pension tracking systems, following the recommendation of the High-Level Forum on the Future of the Capital Markets Union (HLF CMU). These constitute crucial empowering tools, 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 expresses a desire to invest in financial products that consider sustainability criteria and pursue environmental, social and governance (ESG) objectives (2nd Investing Initiative [2DIII], 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 Parliament's proposal, within the framework of the RIS to impose on financial advisors and sales personnel a yearly training requirement on sustainable investing (see BETTER FINANCE, 2023b, 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 — Pan-European Pension Product (PEPP)

Create a friendly environment for the PEPP

This year's report, for the first time, includes cost and performance data on PEPP, as implemented in Slovakia. As previously mentioned, these data are encouraging. Nevertheless, we note that the current environment is not conducive to the take up of this product, despite its intrinsic qualities from the point of view of retail investors:

- As noted by EIOPA:

[t]he higher costs of products considered “competitors” to PEPP may diminish its appeal to potential providers. [...] Offering a cheaper enquotecompetitor product might raise concerns about the risk of product cannibalisation, potentially resulting in a loss of sales and revenue from existing products⁴ (EIOPA, 2024).

Shielded from competition by the opacity of costs and performance disclosures, and the dominant inducements-based distribution system that biases “enquote” towards high-fee products, incumbent providers have little incentives to add a low-cost product to their range of personal pension products.

- Member State governments have generally failed to ensure that PEPP competes on a level playing field with existing personal pension products: rules on tax rebates and subsidies applicable to equivalent personal pension products have only in a few cases been extended to the PEPP, and transferability of accrued personal pension benefits from existing products to PEPP is only possible in a handful of Member States (EIOPA Occupational Pensions Stakeholder Group [OPSG], 2024).

BETTER FINANCE urges policy-makers not to give in to industry pressures to delete

the 1% fee cap for the Basic PEPP. Instead,

- Member States should amend their respective legislations to ensure that PEPP receives the same treatment as any other personal pension product marketed in their jurisdiction.
- EU and Member State authorities must further explore the suggestions put forward by EIOPA in its recent paper to expand the target market for PEPP with a view to offer potential PEPP providers the perspective of greater economies of scale.

Policy recommendation 8 — 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.

In this regard, we consider with interest EIOPA's suggestion, in its paper from September 11, 2024 to enable the use of PEPP as an occupational pension product, in which employers could then automatically enrol their workforce (EIOPA, 2024).

Policy recommendation 9 — 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 10 — 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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Country Case 1

Austria

Zusammenfassung

Rund 90% des durchschnittlichen Alterseinkommens in Österreich stammen aus dem öffentlichen Pensionssystem. Damit ist die Altersvorsorge sehr stark auf die erste Säule konzentriert. Die betriebliche Altersvorsorge wird in erster Linie von Pensionskassen und Versicherungsunternehmen getragen. Direktzusagen sind ein alternatives Instrument deren Nutzung seit Jahren stagniert. Die Möglichkeit für beitragsorientierte Pensionspläne in Pensionskassen und über Versicherungen hat die Verbreitung der betrieblichen Altersversorgung in Österreich gestärkt. Während betriebliche Formen der Altersvorsorge im Laufe der Zeit beliebter wurden, dämpften niedrige Zinssätze und die hohe Liquiditätspräferenz die Nachfrage nach individuellen Lebensversicherungsverträgen. In den Jahren 2002 bis 2023 war die Performance der Pensionskassen real und nach Abzug der Verwaltungskosten positiv. Die annualisierte Durchschnittsrendite lag bei 0,3% vor Steuern. Die Lebensversicherungsbranche verfolgt eine deutlich konservativere Anlagepolitik und erzielte eine durchschnittliche reale Netto Rendite vor Steuern von 1,2% pro Jahr.

Summary

With around 90% of the average retirement income received from public pension entitlements, the Austrian pension system is very reliant on the first pillar. Occupational pensions are primarily offered through pension funds and insurance companies. Direct commitments are an alternative vehicle, but their usage stagnates. The option for defined contribution (DC) plans with favourable tax treatment offered either by pension funds or insurance companies boosted the prevalence of occupational pensions in Austria. While occupational pensions have become more popular over time, low interest rates and a high liquidity preference dampened demand for individual life insurance contracts. Over the years 2002 through 2023, the performance of pension funds in real net terms has been positive, with an annualised average return of 0.3% before tax. The life insurance industry followed a distinctly more conservative investment policy and achieved an average annual net real return before tax of 1.2%.

Introduction: The Austrian pension system

The main vehicles for old age provision within the second and third pillar are insurance companies and pension funds. The performance of pension funds in real terms remains positive over the whole period from 2002-2023, with an annualised average real return of 0.3% after service charges and before taxation. Especially the difficult years in 2002, 2007, 2008, 2011, 2018 and 2022 dampened the investment performance considerably. High inflation rates continue to reduce the real return in 2023 but the nominal performance was good enough to replenish part of the fluctuation reserves that was used up in 2022.

The average real rate of return on investments by insurance companies benefits from the conservative asset allocation with strong holdings of government bonds. This allowed insurers to avoid large losses in years with a financial market crisis and to reach an average real rate of return of 1.2% annually after service charges and before taxation. Low nominal yields on government bond investments in combination with the rate hiking cycle and unexpectedly high inflation rates depressed net real rates of return after 2015 and in particular over the last three years.

Table AT.1 shows the categories of products for which real net returns are calculated in this chapter. The annualised nominal, net and real net rates of returns for the Austrian retirement provision vehicles are summarised in Table AT.2: They are based on different holding periods: 1 year, 3 years, 5 years, 7 years, 10 years and since inception (2002).

Table AT.1 – Long-term and pension savings vehicles analysed in Austria

Product	Pillar	Reporting period	
		<i>Earliest data</i>	<i>Latest data</i>
Pension funds	Occupational (II)	2002	2023
Life insurance	Voluntary (III)	2002	2023

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

	Pension funds	Life insurance
1 year (2023)	0.5%	-2.8%
3 years (2021–2023)	-5.4%	-3.8%
5 years (2019–2023)	-1.2%	-1.8%
7 years (2017–2023)	-1.5%	-1.1%
10 years (2014–2023)	-0.1%	-0.1%
Whole period	0.3%	1.2%

Data: Fachverband Pensionskassen, Financial Market Authority, Eurostat; *Calculations:* BETTER FINANCE.

Pension system in Austria: An overview

The Austrian pension system consists of three pillars:

- Pillar I: Mandatory Public Pension Insurance
- Pillar II: Voluntary Occupational Pensions
- Pillar III: Voluntary Individual Pensions

The mandatory public pension insurance covers most of private sector employees (Pillar I). Civil servants have their own pension system which will gradually converge towards the public pension insurance system. The self-employed belong to a separate mandatory system. The public pension system works as a PAYG scheme and was founded in 1945. The system covers 4.4 million people or 97.9% of the gainfully employed (2023). In 2023, all employees—except civil servants—were subject to a contribution payment of 22.8% of their income before taxes, with contributions shared between the employer (12.55%) and the employee (10.25%). If insured persons continue to work after their mandatory retirement age, the contribution rates will be halved. Civil servants pay a contribution of 12.55% of their gross wage and the self-employed pay 18.5% of their profit before taxes into the pension system. The Austrian pension system will be fully harmonized across all insured persons by 2050. The public pension system has an income ceiling (maximum contribution basis) up to which contributions apply, income above this level is exempted from contributions but the ceiling also limits the pension benefit level. In 2023 the ceiling was between EUR 6 060 and EUR 7 070, depending on the employment status. About 5% of the gainfully employed achieve an income above these ceilings. The theoretical gross pension replacement rate at the median income level for persons entering the labour market at age 22 corresponds to 74.1% of the average lifetime income while the net pension replacement rate is at 87.4% (Organisation for Economic Co-operation and Development, 2023). Both theoretical replacement rates will be reached after 43 years of uninterrupted employment with earnings always at the average income level. Effective replacement rates are likely to be lower because careers are not continuous and life-time income profiles are not flat. Due to pension reforms gradually taking effect, the effective replacement rates are expected to fall for future pensioners. Nevertheless, high replacement rates for many of the gainfully employed limit the demand for occupational as well as private pension plans.

Accompanying a series of public pension reforms between 2003 and 2006 which implemented reductions in the expected benefit level, the Austrian government introduced the premium subsidised pension plan to make private old-age provision more attractive. This scheme became very popular until 2012 with 1.64 million contracts signed but it lost attraction after the government halved the premium subsidy in 2012 (to 4.25% of the premium paid) and after investment yields collapsed during the financial crisis in 2007. By 2023, only 0.8 million contracts were still active.

Table AT.3 – Overview of the Austrian pension system

Pillar I	Pillar II	Pillar III
Mandatory Public Pension Insurance	Voluntary Occupational Pensions	Voluntary Personal Pensions
Practically all gainfully employed persons are subject to pension contributions of 22.8% of income before taxes	Employers can establish an occupational pension system of their preference	Supplement particularly for high earners
Means tested minimum pension	Direct commitments, pension funds, occupational life insurance. About 50% of employees are entitled	Life insurance with a coverage of about 50% of private households. The state-aided old-age insurance features 0.9 mln. contracts
Pension level depends on life time income (various kinds of supplementary insurance months are accounted, cf. motherhood, unemployment, military service)		
Mandatory pay-as-you-go (PAYG)	Voluntary defined benefit (DB) or defined contribution (DC)	Voluntary DC
Quick facts		
Statutory retirement age is 60 (women) and 65 (men)		
The average effective age of retirement was 60.2 for women and 62.2 for men (2023, including invalidity pensions and early retirement schemes but excluding rehabilitation benefits).		
At 87.4% the theoretical net replacement rate in 2023 was considerably higher than the OECD average (61.4%).		
The mandatory public pension system covers 4.37 mln. insured persons and pays pensions to 2.50 mln. beneficiaries	The voluntary occupational pension system covers 1.71 mln. entitled persons and pays pensions to 0.27 mln. beneficiaries	Voluntary personal pension plans cover 3.34 mln. entitled persons and pay pensions to 0.18 mln. beneficiaries
The average pensioner receives 90% of his retirement income from public pensions	The average pensioner receives 4% of his retirement income from an occupational pension	The average pensioner receives 6% of his retirement income from a personal pension

¹ Organisation for Economic Co-operation and Development (OECD) data.

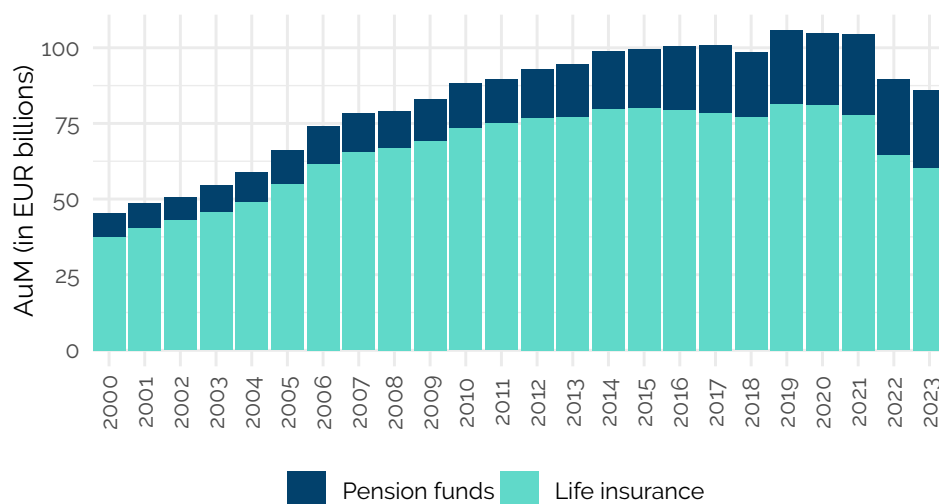
Long-term and pension savings vehicles in Austria

Private pensions are divided into voluntary occupational and voluntary personal pensions. About 6.5% of today's retirees receive regular benefits from an occupational or personal pension. This figure is made up by 4% of retirees receiving benefits from an occupational pension and 2.5% of retirees receiving annuities from a personal pension plan (Url & Pekanov, 2017). Given today's number of active plan members these shares can be expected to have increased substantially over time.

Occupational pension vehicles (Pillar II): At the beginning of 2003, the system of severance payments was replaced by mandatory contributions towards occupational severance and retirement funds (*Betriebliche Vorsorgekassen*). While the old severance payment regulations continue to apply to existing employment relations, employment contracts established after the end of 2002 feature mandatory contributions of 1.53% of gross wages to these funds. The main characteristics of severance payments have been transferred to the new system, i.e. in case of dismissal the fund will pay out the accumulated amount. Beneficiaries, however, may voluntarily opt to use this instrument as a tax-preferred vehicle for old-age provision. Less than one percent of the beneficiaries use this option. We, therefore, do not count occupational severance and retirement funds as pension vehicles in the following.

Life insurance and pension insurance contracts: Life insurance policies are signed by private persons who pay contributions over an agreed period into their own pension account. The insurance company administrates the account and manages the accumulated assets. At the end of the contribution period, either a lump-sum amount is paid out to the insured person or alternatively, the insurer converts the accumulated capital into an annuity.

Figure AT.1 – AuM of Austrian long-term and pension savings vehicles



Data: Financial Market Authority; Calculations: BETTER FINANCE.

Second pillar: Direct Commitments, pension funds and collective life insurance

Occupational pension plans are typically provided on a voluntary basis by firms, only a few collective bargaining agreements include an obligation for member firms of the respective sector. Employers can also choose the coverage and the vehicle of their pension plan. There are three types of occupational retirement schemes:

- direct commitments funded by book reserves;
- pension funds, and;
- several types of life insurance schemes.

Each of these schemes has advantages and drawbacks. While direct commitments create a stronger link between employees and the firm, the future pension payments are subject to bankruptcy risk and, during the accumulation phase, the firm must either manage the assets backing the book reserves or seek some sort of reinsurance. External vehicles like pension funds or life insurance contracts imply less bonding because the vesting period is much shorter, but they also outsource the effort of investment choice and annuity payments to a financial intermediary. The design of a voluntary pension plan is at the full discretion of the employer, but usually an arrangement with the firm's workers council is necessary.

Over the last decades many firms switched from direct commitment schemes to pension funds. On the one hand, this was a strategy to reduce the cost of existing defined benefit pension schemes by switching to defined contribution plans, and on the other hand, these efforts made balance sheets shorter and cleaned them from items unknown to international investors.

Direct commitments (*Direktzusage*)

Direct commitments are pension promises by the employer to the employee that are administrated within a firm. These types of arrangements dominated until the 1980s, when several large bankruptcies or near bankruptcies revealed their fragility. The main two characteristics of this arrangement are direct administration of the pension obligation within the firm and a defined benefit type of the pension plan: the pension level is related to the wage level of employees. The plan administration comprises the computation of individual pension obligations and the respective book reserves, their coverage by invested assets, as well as the annuity payment. Nevertheless, many activities can be outsourced to actuaries, investment funds, and insurance companies. Pension claims based on direct commitments are not subject to any reinsurance requirement, but the reserve funds dedicated to back book reserves are protected from creditors. Besides outsourcing, the *Insolvenz-Entgelt-Fonds* provides a further safeguard for entitled employees and pensioners to bankruptcy risk. This fund is a public fund covering wage entitlements by employees in case of bankruptcy. Currently, the *Insolvenz-Entgelt-Fonds* covers a maximum of 2 years of benefit payments or accrued entitlements (*Insolvenz-Entgeltsicherungsgesetz*, § 3d). Due to their voluntary character and a lack of supervision the incidence of direct

commitments is hardly documented.

Pensions funds (*Pensionskassen*)

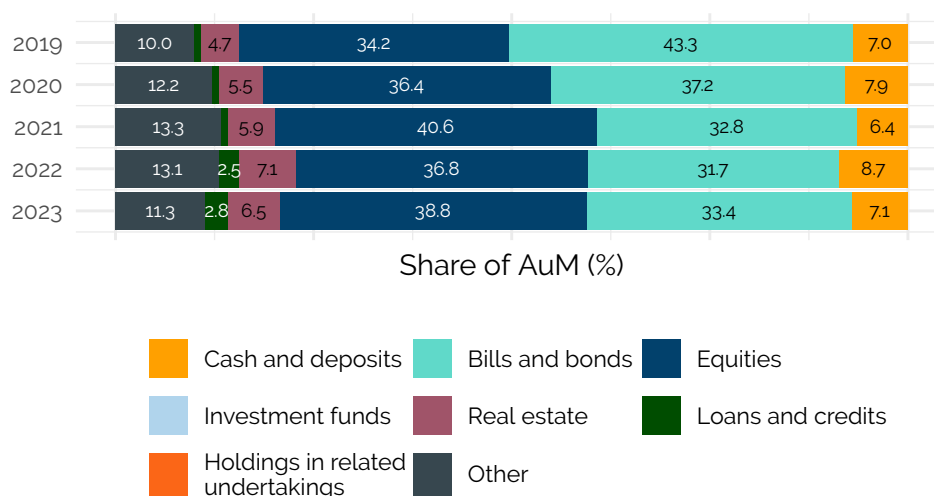
Pension funds are specialised financial intermediaries providing only services related to occupational pensions, i.e. they collect contributions, manage individual accounts, invest the accumulated capital, and they pay out an annuity to beneficiaries. Pension funds were introduced in 1990 with the Occupational Pension Law and the Pension Fund Law (*Betriebspensions- und Pensionskassengesetz*) which established a general legal basis for occupational pension schemes including pension funds. These laws facilitated the outsourcing of asset management and accounts administration from direct commitment systems into pension funds. This made individual pension entitlements transferable between companies, it made possible additional contributions by employees, but it also enabled firms to switch from defined benefit to defined contribution pension plans. By now, most pension plans are of the defined contribution type and beneficiaries are directly exposed to investment risk as well as to changes in mortality risk. For example, plan members whose entitlement was converted from a direct commitment into an entitlement vis-a-vis a pension fund still suffer from investment losses shortly after transferring the assets into pension funds around the year 2000 because the imputed interest rates used at that time were overly optimistic (Url, 2003).

Pension funds may be either multi-employer pension funds, i.e. they are open to all firms, or alternatively, they may be firm-specific pension funds (single-employer pension funds) administering the pension plan for a single firm or a holding group. Over the last couple of years, many firm-specific pension funds have been merged into multi-employer pension funds by constructing independent risk and investment pools like UCITS. Pension funds are subject to supervision by the Austrian Financial Market Authority and they feature investment advisory boards, where representatives of workers and employers can advance their opinion on the investment strategy. Nevertheless, the results from asset-liability management strategies dominate the portfolio choice of pension funds.

Pension funds offer primarily annuities because lump-sum payments are restricted to accounts with very small accumulated assets. Pension funds have to offer accounts with guaranteed long-term yields on investment linked to the market yield of Austrian government bonds, although this option lost attractiveness due to the high costs of guarantees and a substantial weakening of the extent of the guarantee. The guarantee is backed by the own capital of the pension fund and by a minimum return reserve fund financed by contributions from beneficiaries (*Mindestertragsrücklage*). In case of bankruptcy of the pension fund, all entitlements are protected by separate ownership of the assets associated to each account (*Deckungsstock*).

Direct insurance

Firms can alternatively sign a contract with a life insurance company. This contract is either subject to the regulation covering occupational pensions (*Betriebliche Kollektivversicherung*) or it is designed as a life insurance policy and is subject to the regulation for life insurance products. Insurance companies also underwrite risks

Figure AT.2 – Allocation of Austrian pension funds' assets

Data: Financial Market Authority; Calculations: BETTER FINANCE.

embedded in direct commitments. Direct insurance of occupational pension plans implies that the sponsoring firm will pay contributions into a life insurance contract with employees as beneficiaries. In this case, the firm outsources the management of personal accounts and assets, as well as the annuity payments to an insurance company.

The number of working and retired persons holding a life insurance policy is almost double the number of members in occupational pension plans. Despite high public pension levels and the voluntary character of occupational pensions, their use is comparatively widespread in Austria. There are two reasons for this: (1) the public sector offers an occupational pension scheme, and (2) occupational life insurance policies benefit from a tax loophole. Contributions up to EUR 300 annually are tax-exempt—as per § 3/1/15 of the *Einkommensteuergesetz* (EStG), the Income Tax Act—and as a result around 634 000 contracts have been signed until 2023. Given the small pension wealth accumulated in these accounts, one cannot expect reasonable annuity payments resulting from this vehicle.

The *Betriebliche Kollektivversicherung*, on the other hand, provides occupational pensions with a favourable tax treatment up to 10% of individual gross wages. It is regulated according to the Occupational Pension Law, but this vehicle allows for more substantial long-term guarantees usually offered by classic life insurance contracts. Insurers also freeze mortality tables at the date of joining the pension plan.

Third pillar: Classic and Unit-linked life insurance

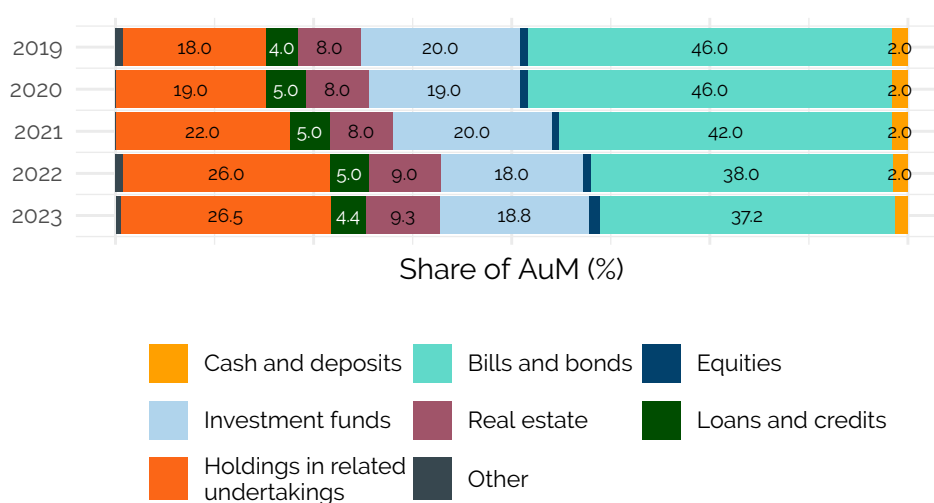
There are two types of insurance contracts available which can be distinguished according to who bears the investment risks. Insured persons with a unit-linked policy assume the investment risk and must choose their investment portfolio. Classic life insurance products, on the other hand, offer a minimum return guarantee but

investment decisions are delegated to the insurance company. The maximum possible guaranteed rate of return is regulated by the Austrian supervisory authority; currently, this rate is fixed at 0% per annum (since July 1, 2022; BGBl. II Nr. 354/2021). Investment returns in excess of the guaranteed level are distributed across insured persons as variable profit participation.

The major public pension reforms between 2003 and 2006 left many private employees, employers, and civil servants with a lower expected public pension payment. As a compensation the Austrian government introduced the premium subsidised pension plan (*Prämienbegünstigte Zukunftsvorsorge*). Originally the premium was fixed at 9.5% of the annual contribution, but in 2012, fiscal consolidation measures resulted in a halving of the subsidy rate; it is currently fixed at 4.25%. Additionally, the yield on investment is fully tax-exempt. Premium subsidised pension plans have a minimum contract length of 10 years. The portfolio choice for the assets of subsidised pension plans is restricted by law. A minimum share of the assets must be held in equities listed on underdeveloped stock exchanges. This measure was targeted to foster investment at the Vienna stock exchange, but it resulted in highly concentrated investment risk. The strict regulation of investments has been weakened over the past years allowing for example life cycle portfolios with a reduction of the equity exposure when the retirement date of entitled persons comes closer.

The halving of the subsidy premium in 2012 and substantial losses on stock exchanges during the years 2008 and 2022 reduced the demand for this pension saving vehicle. The number of contracts is falling and contracts with the shortest possible duration of ten years have been mostly terminated with a lump-sum payment. This triggers an exit from the annuity phase with a mandatory repayment of the subsidy. In 2023 the number of new contracts declined to 7 454; with 71 500 contracts expiring in that year, the number of active contributors declined to 0.8 million persons.

Figure AT.3 – Allocation of assets invested in Austrian life insurance contracts



Data: Financial Market Authority; Calculations: BETTER FINANCE.

Charges

Charges of pension funds

Information on all types of charges for occupational and private pension products are hard to obtain. Within direct commitment systems, pensions are of the defined benefit type and firms cover all expenses. The remaining vehicles for occupational pensions are subject to some degree of competition between financial intermediaries, although most pension funds are owned by alliances of banks and insurance companies. Because occupational pension plans are always group products, i.e. the individual entitled person has only limited or even no choice during the savings and annuity phases, these products have a cost advantage over individual pension plans. Large firms also receive quantity discounts or customised tariffs with lower administrative charges. In Table AT.4, administrative charges and investment expenses for pension funds are expressed as a percentage of the funds' total invested assets. There are no data published on acquisition costs. Since the year 2019, a substantial reduction in charges has been recorded by the OECD.

Table AT.4 – Costs and charges of Austrian pension funds (% of assets)

Year	Admin. and mgt. fees
2005	0.14%
2006	0.15%
2007	0.15%
2008	0.16%
2009	0.17%
2010	0.17%
2011	—
2012	—
2013	0.16%
2014	0.17%
2015	0.18%
2016	0.18%
2017	0.18%
2018	0.19%
2019	0.12%
2020	0.10%
2021	0.11%
2022	0.12%
2023	0.11%

Data: OECD Pension indicators; *Calculations:* BF.

Charges of life insurance products

The costs of acquisition and administration for life insurance products are published by the Financial Market Authority. Acquisition costs amount to roughly one tenth of total premium income (see Table AT.5). Since January 1, 2007, the Insurance Contract Law includes a provision that acquisition fees have to be distributed over at least the first five years of the contract length. Before 2007 it was possible to charge the full acquisition fee in the first year, making the cancellation of a life insurance contract extremely costly. Administration costs are presented as a ratio to the mean of the invested assets.

Since January 1, 2017, every consumer receives a piece of short product information (KID) before signing an insurance contract. These information sheets are standardised and contain details of individual charges and investment fees allowing a better comparison of offers.

Table AT.5 – Costs and charges of Austrian life insurance contracts (% of assets unless otherwise specified)

Year	Acquisition fees	Admin. and mgt. fees
2005	11.28%	0.43%
2006	11.49%	0.38%
2007	11.10%	0.38%
2008	10.66%	0.38%
2009	9.97%	0.37%
2010	10.75%	0.36%
2011	11.01%	0.39%
2012	11.68%	0.33%
2013	11.37%	0.32%
2014	10.67%	0.33%
2015	10.80%	0.33%
2016	11.49%	0.35%
2017	10.44%	0.36%
2018	10.27%	0.37%
2019	10.57%	0.37%
2020	10.85%	0.38%
2021	10.91%	0.37%
2022	11.01%	0.40%
2023	11.73%	0.44%

Data: Financial Market Authority; *Calculations:* BF. % of premiums

Taxation

The taxation of old-age provision varies over different vehicles and depends mainly on the history associated to the vehicle. For example, the taxation of occupational pensions is very much oriented towards the treatment of direct commitments, which

were the first vehicle used for occupational pensions. Direct commitments work like a deferred compensation and therefore they are only taxed in the year of the payment. This corresponds to a system with tax-exempt contributions, tax-exempt capital accumulation, and (income) taxed benefits (EET system). This philosophy carries over to contributions paid by the employer into a pension fund or a group insurance product following the pension fund regulation (*Betriebliche Kollektivversicherung*). Contributions to pension funds and group insurance products (*Betriebliche Kollektivversicherung*) are subject to a reduced insurance tax of 2.5%. Contributions by employees are fully taxed but the resulting annuity is subject to reduced income taxation.

Contributions to classic life insurance products are not tax deductible and are subject to an insurance tax of 4%. During the capital accumulation phase all investment returns are tax-exempt, and the taxation of benefits depends on the pay-out mode. Lump-sum payments are tax-free while annuities are subject to (reduced) income taxation. Additionally, premium subsidised products carry a premium based on the contribution, the capital accumulation phase is tax-exempt, and benefits are also tax free if they are converted into an annuity. Url and Pekanov (2017) provide a survey of the tax treatment of all vehicles for old-age provision using the present value approach as suggested by the OECD (Organisation for Economic Co-operation and Development [OECD], 2015, 2016). This approach compares the tax treatment of each vehicle to the tax treatment of a standard savings account. Expressed as a ratio to the present value of contributions, the tax advantage of employer payments into pension funds amounts to 20%, i.e. the value of the tax subsidy corresponds to one fifth of life-time contributions. The lowest tax advantage results for life insurance products with an annuity payment. In this case, the tax subsidy makes up for 7% of life-time contributions. The maximum tax advantage is associated with occupational life insurance policies subject to § 3/1/15 EStG. In this case, the subsidy amounts to 60% of lifetime contributions, however, payments into this vehicle are restricted to a negligible EUR 300 per year.

Table AT.6 – Taxation of pension savings in Austria

Product	Phase			Regime
	Contributions	Investment returns	Payouts	
Pension funds	Exempted	Exempted	Taxed	EET
Life insurance	Taxed	Exempted	Taxed	EET

Source: EStG.

Performance of Austrian long-term and pension savings

Real net returns of Austrian long-term and pension savings

Due to the defined benefit character of pensions derived from direct commitments and because accumulated assets for direct commitments have the narrow purpose

of protecting individual pension claims in case of a firm bankruptcy, we do not compute pension returns for this vehicle. Furthermore, the asset class in which firms can invest are restricted to government bonds issued by OECD member countries.

The way of taxing contributions, investment returns, and pension payments varies according to the vehicle chosen, the party paying the contribution, i.e. employers or employees, and the personal income tax break of the retiree (see Page 11. For this reason, we cannot compute a general after-tax return for Austria. Instead, we present the:

- nominal returns before charges, inflation, and tax;
- nominal returns after charges but before inflation and tax;
- real returns after charges and inflation but before tax

for the two most important vehicles, i.e. pension funds and classic life insurance policies. The returns on classic life insurance policies are also representative for occupational pension plans using life insurance products under the occupational pension law (*Betriebliche Kollektivversicherung*).

Inflation in Austria reached its peak early in 2023 and fell over the course of the year. The disinflation process in Austria was slower as compared to the euro area, mainly due to a weaker response to falling energy prices and a stronger pass-through of wage increases into service prices. Furthermore, some important components of the consumer basket— like rental expenses— are fully indexed to changes in the HICP in Austria. On average this resulted in an inflation differential towards the euro area of 2.3 p.p.. At year-end the inflation rate was at 5.7%.

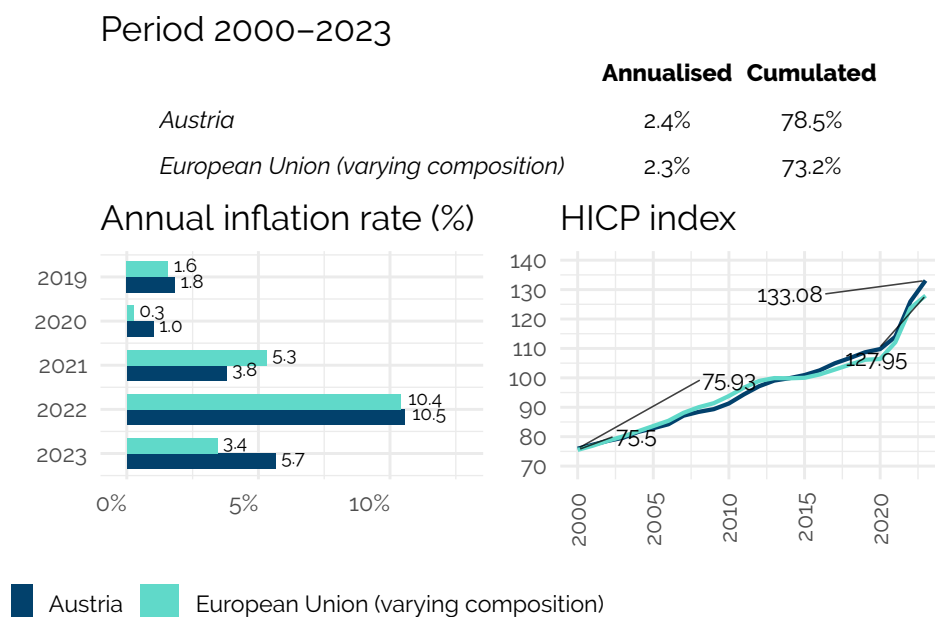
Pension funds

Figure AT.5 shows the returns on assets held by pension funds. In the case of a defined benefit pension plan, investment returns are important for the sponsoring firm because if the return falls short of the imputed interest rate used for the computation of the expected pension level, the firm will have to provide additional contributions covering the shortfall. On the other hand, if a defined contribution pension plan has been established, the beneficiaries bear the risk of a shortfall in the realised return on investment, and consequently, the realised pension level falls below its expected value.

Information on the performance of pension funds is published continuously by an independent third party, the *Oesterreichische Kontrollbank*,¹ following a standardised procedure. Aggregate returns are available for pension funds and for multi- and single-employer pension funds. The long-term performance of firm-specific pension funds is about 0.3 p.p. higher as compared to multi-employer pension funds. The difference results probably from a less risk-oriented investment style implemented by multi-employer pension funds, due to the wider usage of return guar-

¹<https://www.oekb.at/kapitalmarkt-services/unser-datenangebot/veranlagungsentwicklung-der-pensionskassen.html>

Figure AT.4 – Inflation in Austria

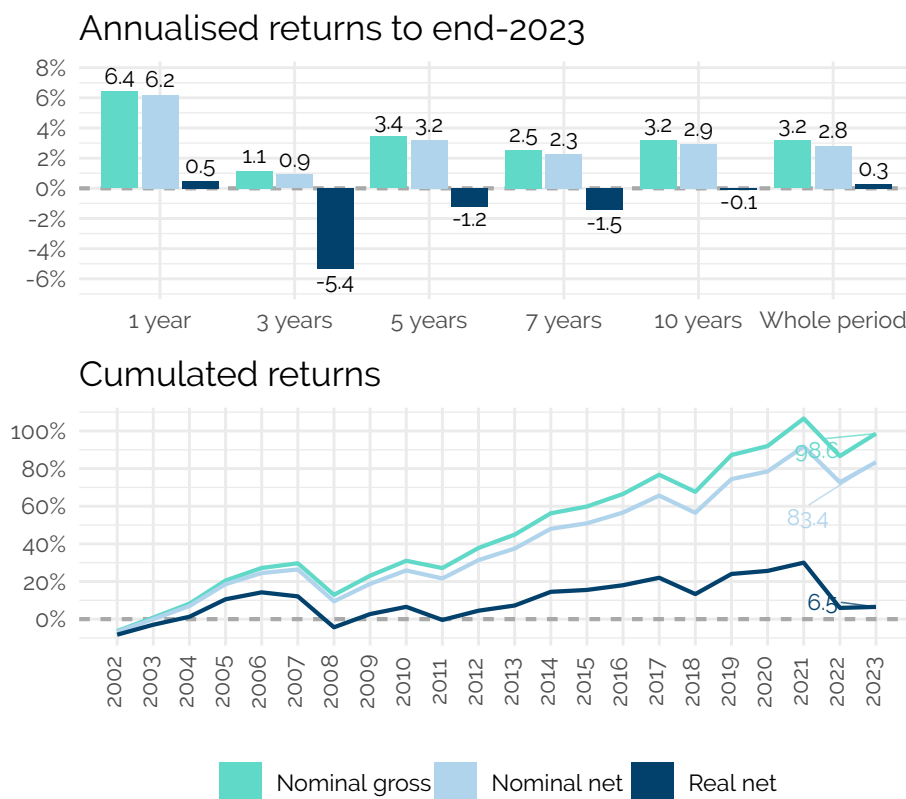


Data: Eurostat, HICP monthly index (2015 = 100); Calculations: BETTER FINANCE

antees in multi-employer pension funds. Nominal investment returns after charges but before inflation and taxes result from the subtraction of administrative charges and investment charges of pension funds as presented in the section on charges. Real returns are computed by adjusting for the HICP inflation rate in Austria.

The Financial Market Authority publishes the asset allocation of pension funds as of year-end (Österreichische Finanzmarktaufsicht [FMA], 2024). Due to the good performance of share prices last year, the portfolio in 2023 continues to be dominated by equity investments (38.8%) with debt securities ranking second (33.4%). After the tumultuous year 2022, yields on risky assets became calmer again and fund managers started to reduce their cash holdings (7.1%). Real estate investment (6.5%), on the other hand, took a hit from higher the interest rates on credit and the associated lower valuation of future rental income revenues. Pension funds still diversify their portfolio into the banking business by issuing loans and credits (2.8%). The remainder was mixed throughout smaller asset categories (see Figure AT.2). Given the strong exposure to equity, we find several years with negative returns, i.e. investment losses. Specifically, during the years after the bursting of the dot-com bubble (2000), the international financial market crisis (2007), and the public debt crisis in the euro area (2011), but also in 2018 and 2022, when both bond and equity markets lost value. Despite attractive nominal returns in 2023, continuing high inflation eroded the real return. Nevertheless, between 2002 and 2023 pension funds achieved an annual average net real yield on investment of 0.3%. This corresponds to a nominal average excess return over Austrian government bonds of 1.2 p.p..

Figure AT.5 – Returns of Austrian pension funds (before tax, % of AuM)



Data: Fachverband Pensionskassen, OECD Pension indicators, Eurostat; Calculations: BETTER FINANCE, holding periods to end-2023; Note: Charges estimated by mean value 2002-2010 and 2013-2019.

Life insurance contracts

The return on investment in the classic life insurance industry is regularly computed by the Austrian Institute of Economic Research (WIFO). This computation excludes unit-linked contracts because the investment risk is borne by the insured and returns are usually retained within mutual funds and reinvested. The calculation of investment returns is based on investment revenues of the insurance industry and the related stock of invested assets in classic life insurance as provided by the Financial Market Authority. The method uses the mean amount of invested capital over the year as the basis for the computation and is documented in Url (1996). The charges used to correct the yield for administrative expenses are based on Table AT.5. Real returns result from the adjustment of nominal returns using the HICP inflation rate for Austria (Figure AT.4). Figure AT.6 shows the nominal gross, nominal net and real net returns of Austrian life insurance policies.

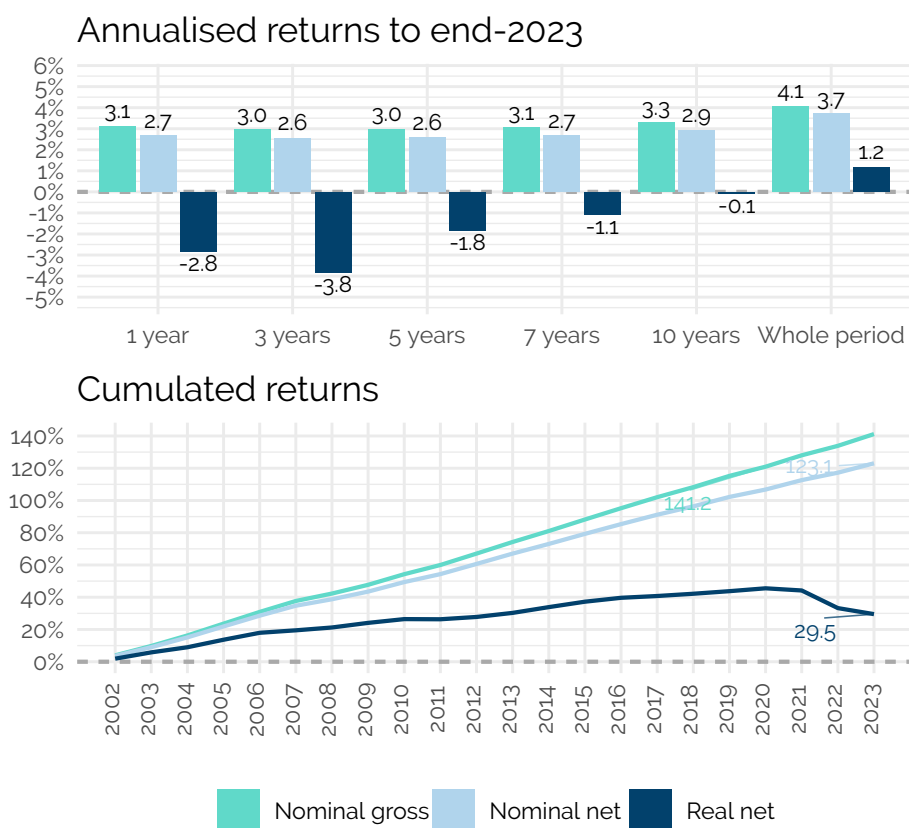
Obviously, nominal gross returns in the insurance industry are less volatile than in the pension fund industry. The main reason for this divergence is the more conser-

vative asset allocation of insurance companies, i.e. they invest more heavily in bonds (37%) and the share of collective investments in their portfolio (19%) is also concentrated in bonds-oriented investment funds, creating a high exposure to fixed-interest securities (FMA, 2024). Another important asset class in the insurance industry are shareholdings in related undertakings (27%), which are usually not listed on a stock exchange. Property investments sum up to 9% of the assets, while equity holdings form just 1.3% of the portfolio (Figure AT.3). This gives insurance companies small exposure to volatile asset categories and consequently their investment performance is steadier.

The particular way of distributing investment returns in classic insurance policies makes their performance even more steady for beneficiaries. Insurance companies separate their investment income into two parts. The first part serves to cover underwritten minimum return guarantees and it is immediately booked towards the individual account. Any excess return will be distributed over a couple of years through the build-up and reduction of profit reserves. By transferring accumulated profit reserves smoothly into individual accounts, insurance companies make the individual accrual of investments returns less dependent on current capital market developments although asset values are marked to market.

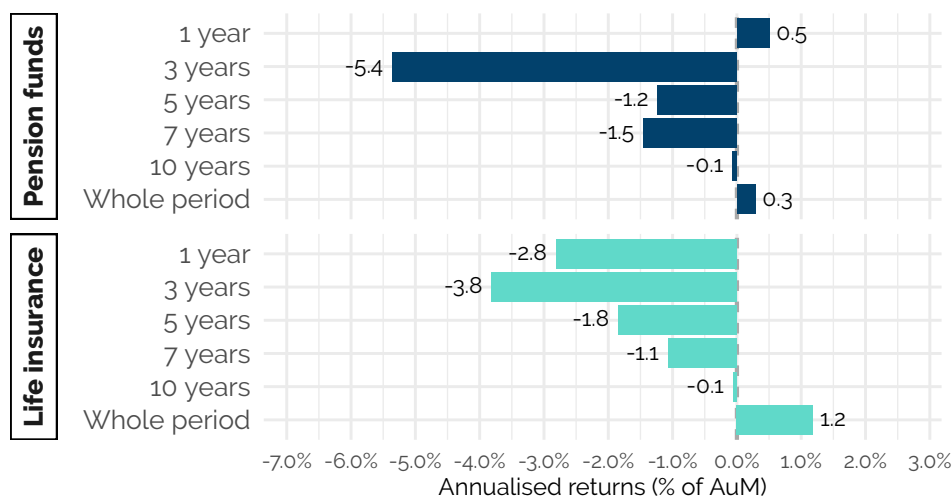
Over the course of 2023, the 10-year government bond yield (benchmark) in the euro area rose by up to 70 basis points, but due to the restrictive monetary policy stance followed by the ECB, the yield curve remained negatively sloped. Bond portfolios with a short duration benefit in such an environment and offer opportunities to improve performance. Insurance companies managed to increase their nominal return in 2023 but yields continue to be in the lower range while the high rate of inflation turned real returns negative. The long-run net real return on insurance investments declined to 1.2%. This corresponds to a nominal average excess return over Austrian government bonds of 2.2 p.p.. The performance continues to exceed that of pension funds.

**Figure AT.6 – Returns of Austrian life insurance contracts
(before tax, % of AuM)**



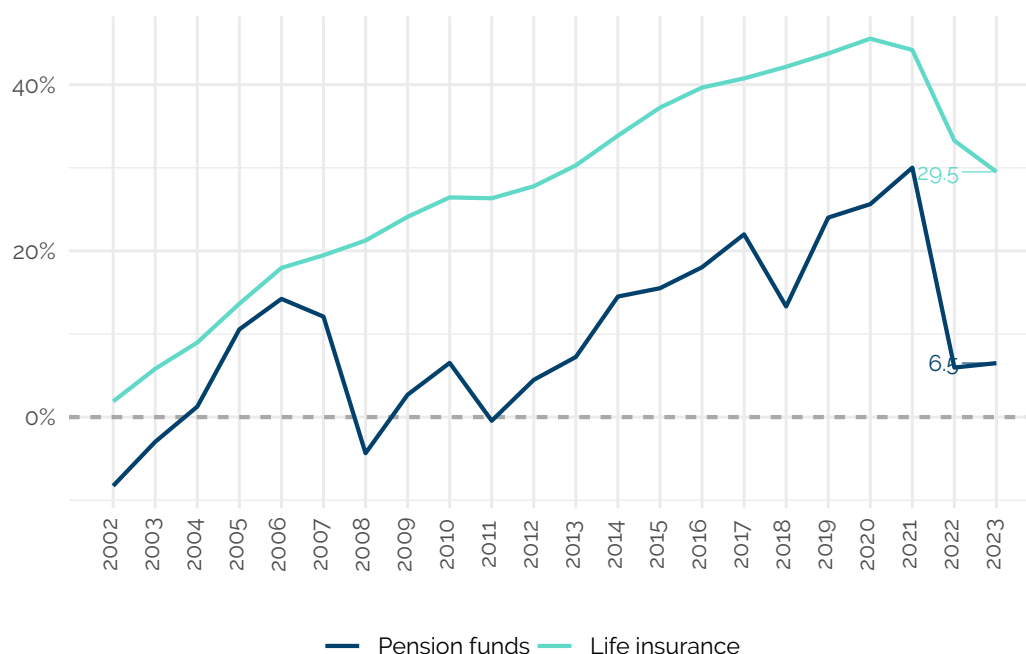
Data: Financial Market Authority, Eurostat; Calculations: BETTER FINANCE, holding period to end-2023; Note: Charges estimated by mean value for the years 2002-2004..

Figure AT.7 – Annualised returns of Austrian long-term and pension vehicles over varying holding periods (before tax, % of AuM)



Data: Fachverband Pensionskassen, Financial Market Authority, OECD Pension indicators Eurostat; Calculations: BETTER FINANCE, holding periods to end-2023.

Figure AT.8 – Cumulated returns of Austrian long-term and pension savings vehicles (2000–2023, before tax, % of AuM)



Data: Fachverband Pensionskassen, Financial Market Authority, OECD Pension indicators, Eurostat; Calculations: BETTER FINANCE.

Do Austrian savings products beat capital markets?

In the long run, pension funds and life insurance products reached excess returns over the yield of Austrian government bonds in the size of 1.2 and 2.2 p.p., respectively. Another possible yardstick are yields from benchmark portfolios with equal holdings of equity and bonds (see Table AT.7). The net real return of pension funds in 2023 was beaten by the benchmark portfolio by 5.3 p.p.. The real excess return of pension funds over the benchmark portfolio between 2002–2023 was -1.9 p.p., i.e. the performance was lagging the benchmark portfolio (Figure AT.9).

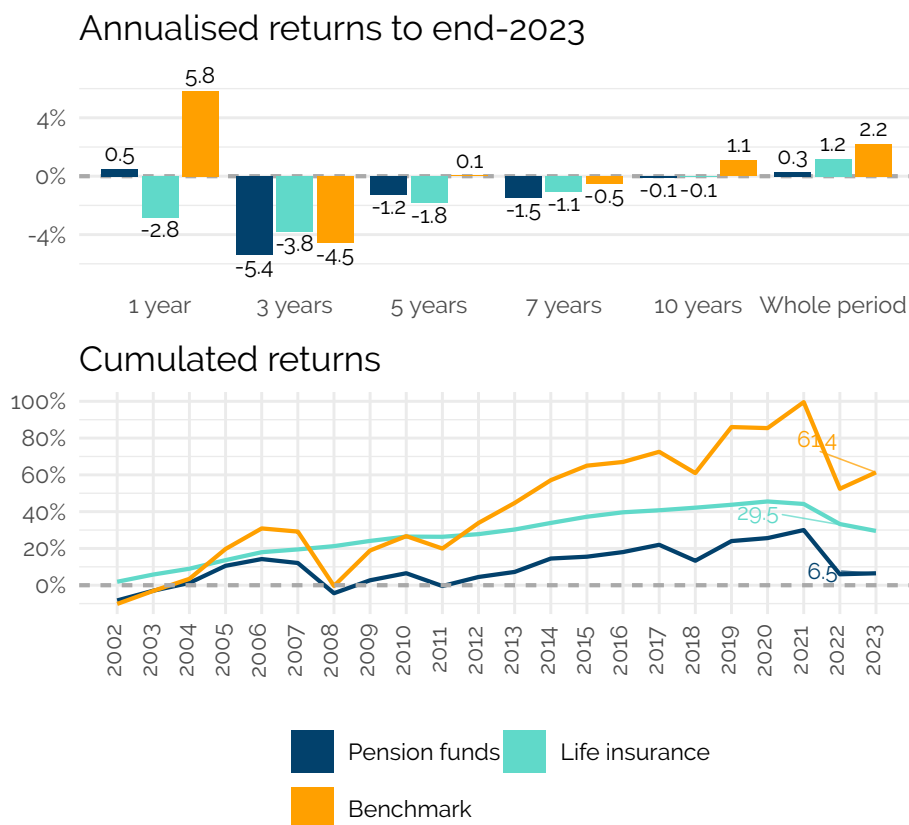
Table AT.7 – Capital market benchmarks to assess the performance of Austrian pension vehicles

Product	Equity index	Bonds index	Allocation
Pension funds	STOXX All Europe Total Market	Barclays Pan-European Aggregate Index	50.0%–50.0%
Life insurance	STOXX All Europe Total Market	Barclays Pan-European Aggregate Index	50.0%–50.0%

Note: Benchmark portfolios are rebalanced annually.

The more cautious investment strategy of the insurance industry goes along with a very small share of equity in their portfolio. Consequently, the real excess return of life insurance products was substantially below the benchmark portfolio (-8.7 p.p.) in 2023. In the long run, the performance of life insurance products is almost identical to the benchmark portfolio. From 2002–2023, the real excess return of life insurance products was -1 p.p., i.e. lower than the benchmark portfolio.

Figure AT.9 – Performance of Austrian pension funds and life insurance against a capital market benchmark (returns before tax, after inflation, % of AuM)



Data: Fachverband Pensionskassen, Financial Market Authority, OECD Pension indicator Eurostat; Calculations: BETTER FINANCE, holding periods to end-2023.

Conclusions

The performance of pension funds in real terms remains positive over the whole period from 2002-2023, with an annualised average real return of 0.3% after service charges and before taxation. Especially the difficult years in 2002, 2007, 2008, 2011, 2018 and 2022 dampened the investment performance considerably. The favourable nominal result in 2023 allowed pension funds to replenish exhausted fluctuation reserves but the purchasing power of retirees took a further blow from persistently high inflation. Except France, all major stock exchanges have seen their valuation increase over the first half of 2024, offering a good earnings outlook for pension funds.

The average real rate of return on investments by insurance companies benefits from a conservative asset allocation with strong government bond holdings. This allowed insurers to avoid large losses in years with a financial market crisis and to reach an average real rate of return of 1.2% annually after service charges and before

taxation. Low nominal yields on government bond investments in combination with unexpectedly high inflation pushed net real returns into negative territory between 2021 and 2023. Insurance companies benefit from the long duration of their investment portfolio, i.e. they still own bonds featuring high interest coupons. With the ECB unwinding its Asset Purchase Program (APP) since July 2023 and reducing its reinvestment of assets under the Pandemic Emergency Purchasing Program (PEPP), bonds can be expected to yield higher returns over the next years. Meanwhile the negative yield curve creates an incentive to hold bond portfolios with short duration, thus limiting the expected return close to money market rates. Given weak survey data on consumer confidence private households will retain their high liquidity preference and reduce their demand for classic life insurance. Premium subsidised pension insurance is also in low demand because subsidies were halved in 2012 and realised investment returns were disappointing over the last years.

By now, the forecasted economic upturn for 2024 has proved to be overly optimistic. High wage settlements in 2023 did not lead to a boom in private household consumption, rather households preferred to reduce their indebtedness and increase short-term deposits. At this stage of the business cycle, firms will be reluctant to offer additional voluntary occupational pension contracts, so the number of beneficiaries is likely to stagnate in 2024, while private demand for life insurance products will remain low. However, the labour market remains tight. Large cohorts enter the corridor age allowing for early retirement, or they will pass the mandatory retirement age. Given the shortages for qualified labour, firms may consider extending payment packages with immediate impact on their employees, like voluntarily overpaying collective wage contracts or providing fringe benefits in terms of more flexible working hours.

The opportunity to offer defined contribution plans has certainly boosted the spread of occupational pensions in Austria. Within pension funds 98% of the entitlements are now defined contributions plans, while occupational pensions based on insurance contracts are exclusively of the defined contribution type. Currently, no measures to promote occupational or individual pension plans are discussed in Austria. Moreover, the establishment of the legal basis for the PEPP in Austria has not yet entailed any corresponding offers from the financial services industry.

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