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 — Croatia

A research report by BETTER FINANCE

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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 McGuiness 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 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 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.

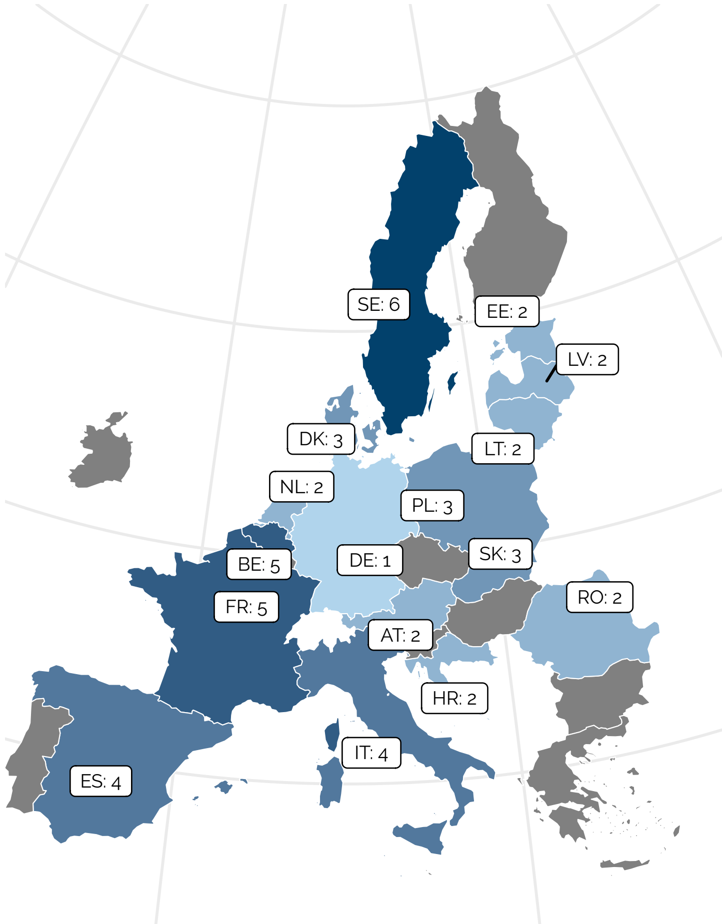
This research report by BETTER FINANCE covers 16 of the 27 European Union (EU) Member States. In each of these countries the team of contributors analyses the costs and performance of up to 6 product categories. Our goal is to calculate, based on publicly available data about these product categories, 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**

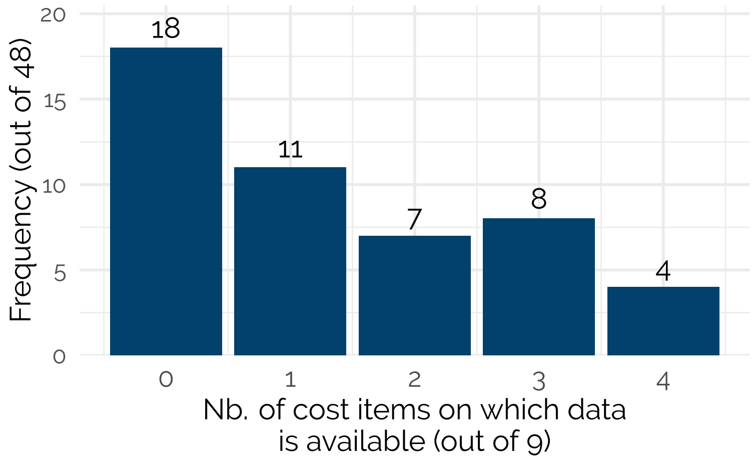


Besides performance data, information on costs is very often patchy and displayed in a way that makes it impossible for investors to compare cost levels across product providers, and for our contributors to aggregate this information at the level of product categories. The reader can appreciate this 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).

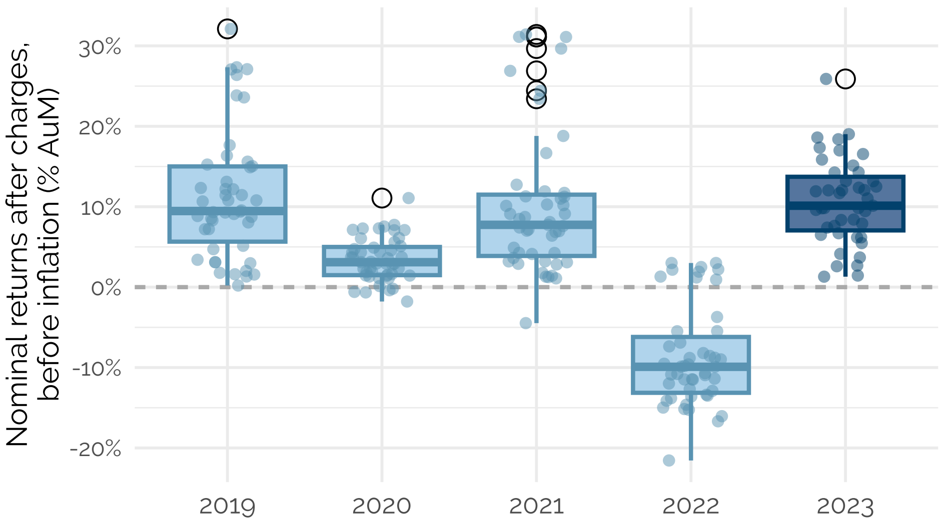
2023: Recovering from the slump

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

[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 (2019–2023)**



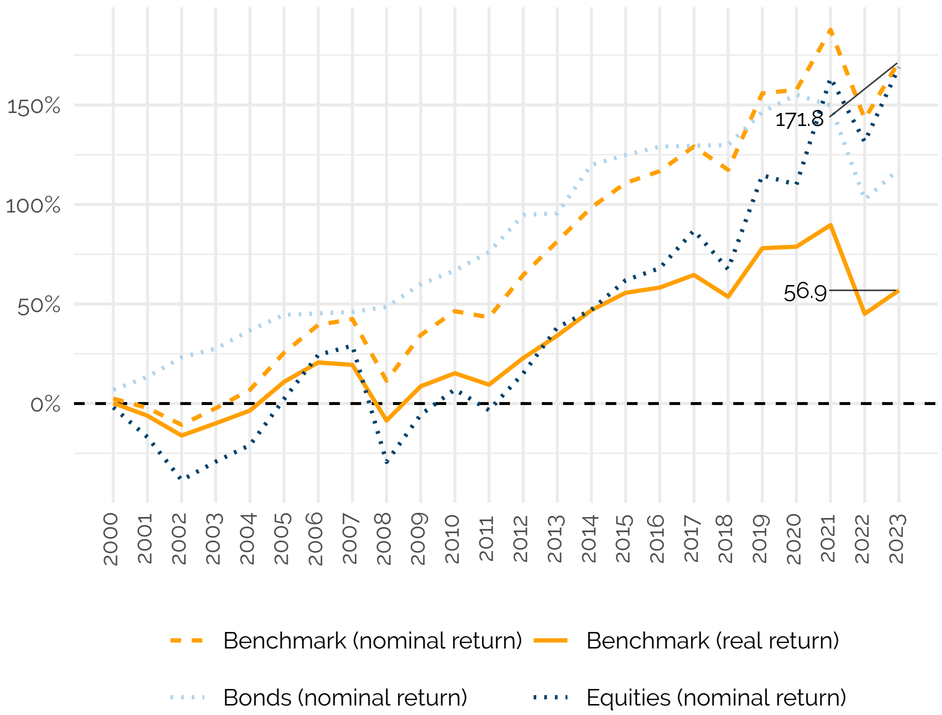
Data: NCAs and sectoral associations (see Country Cases); *Calculations:* BETTER FINANC

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 severly negative median nominal returns (-9.9%) where further depressed by the strongest inflation seen in Europe is 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

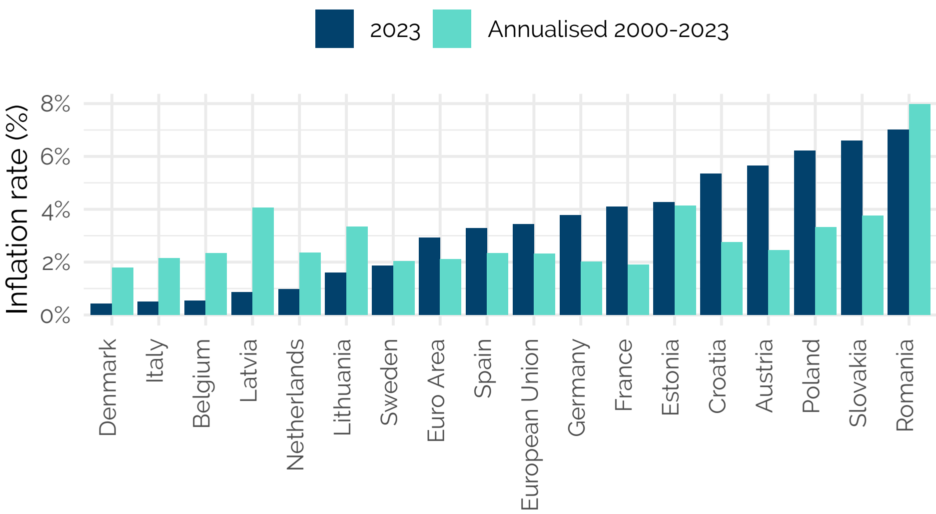
We wish to highlight the good performance of the first PEPP to be included in our study: with a nominal return before charges and inflation standing at +15% and charges amounting to 0.72% of assets under management (AuM), the Slovak PEPP yielded a net return of +14.3% in nominal terms and 7.2% in real terms, largely outperforming its capital markets benchmard (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 annuum 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.

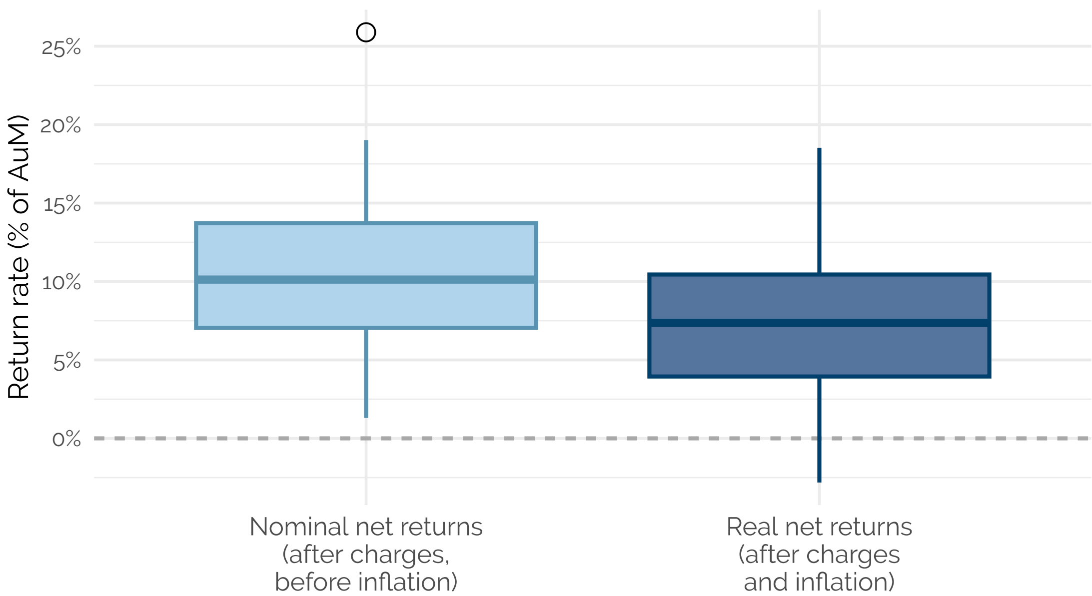
In the meantime, we urge Member State governments to offer the PEPP the same treatment, as regards taxation, subsidies and transferability of accrued pension benefits, that existing national personal pension products enjoy (see our policy recommendation on this topic on Page xvii).

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)

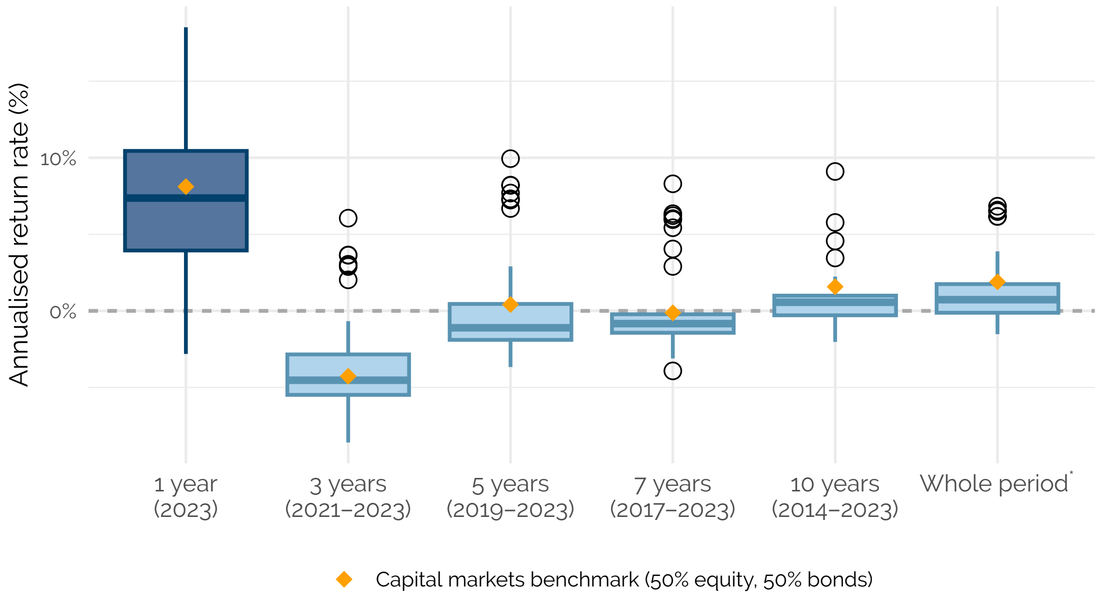


Calculations: BETTER FINANCE

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 devaition 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

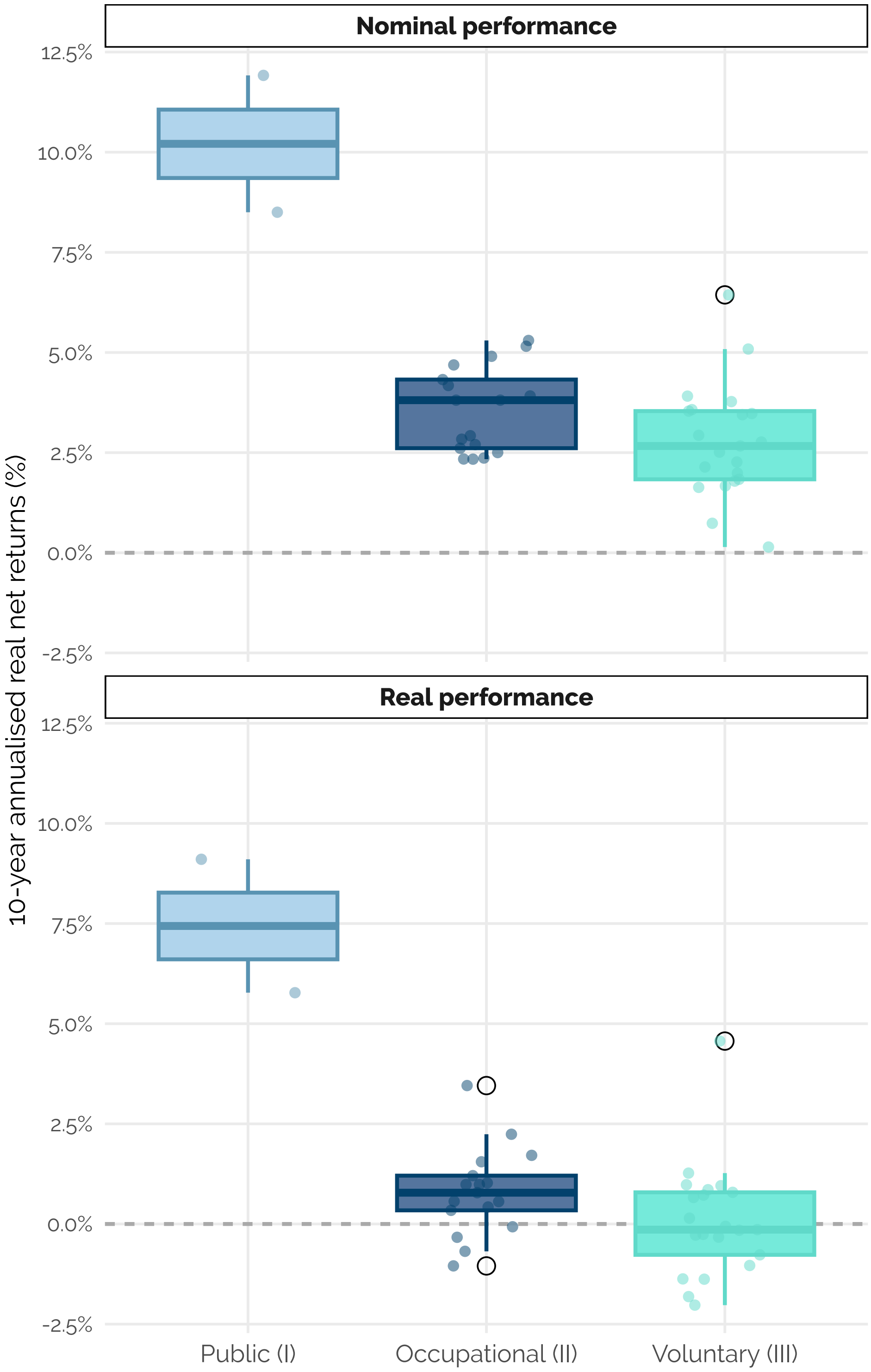
* Whole period varies across products (up to 24 years).

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, 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 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 indsutry, 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 (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 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 3

Croatia

Sažetak

Hrvatska je stvorila tipični mirovinski sustav s 3 stupa, gdje je državno organizirani mirovinski stup temeljen na PAYG-u (preraspodjela doprinosa s radnog na stariju populaciju) nadopunjen obveznim kapitaliziranim mirovinskim sustavom (II. stup) i subvencioniranim (izravno i neizravno)) dobrovoljna mirovinska štednja (III. stup).

Povećanje obuhvata radno aktivnog stanovništva do II. stupa nadoknađuje niska pokrivenost unutar III. stup. To bi moglo donijeti sve veći problem niskog životnog standarda za stanovništvo koje odlazi u mirovinu u budućnosti budući da I. stup osigurava samo 30% stope zamjene, a preostala dva stupa neće moći dodati značajne izvore za pojedince tijekom umirovljenja. Čak i ako je učinak oba kapitalizirana stupa prilično solidan, prilično mali doprinosi i nizak omjer pokrivenosti III. stupa postavlja pitanja o primjerenosti mirovinskog sustava u Hrvatskoj.

Sveukupno, stvarni neto prinosi mirovinskih fondova bili su negativni u 2022. Ako se uzme u obzir cijelo analizirano razdoblje od 21 godine, godišnji prinosi su u pozitivnom području za proizvode II. stupa, ali negativni za proizvode III. stupa, posebno zbog visokih naknada i naknade.

Summary

Croatia has created typical 3-pillar pension system, where the state organized pension pillar based on PAYG (redistribution of contributions from working to elderly population) is supplemented by mandatory funded pension scheme (pillar II) and by subsidized (directly as well as indirectly) voluntary pension saving scheme (pillar III).

Increasing coverage ratio of working population by the second pillar is offset by low coverage within the third pillar. This might bring up the increasing problem of low living standard for retiring population in future as the first pillar provides only 30% replacement rate and remaining two pillars will not be able to add significant sources for individuals during retirement. Even if the performance of both funded pillars is quite solid, rather small contributions and low coverage ratio of the third pillar raises questions about the adequacy of the pension system in Croatia.

Overall, the real net returns of pension vehicles was positive in 2023. If the entire analysed period of 21 years is considered, the annualized returns are in positive territory for Pillar II products, but negative for Pillar III products especially due to the high fees and charges.

Introduction: The Croatian pension system

There have been no major changes in the pension system in Croatia in 2023. However, pension system is a subject of national Recovery and Resilience Plan where the overarching objective of the reform is to improve pension adequacy and sustainability by incentivising longer working lives, strengthening the second pension pillar and increasing the lowest pensions (Council of the European Union, 2021). In 2023, state pensions have increased due to the high inflation.

Table HR.1 – Long-term and pension savings vehicles analysed in Croatia

Product	Pillar	Reporting period *Earliest data*	*Latest data*
Mandatory pension funds	Occupational (II)	2002	2023
Voluntary pension funds	Voluntary (III)	2002	2023

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

	Mandatory pension funds	Voluntary pension funds
1 year (2023)	4.3%	3.9%
3 years (2021–2023)	-3.6%	-6.1%
5 years (2019–2023)	-0.7%	-2.3%
7 years (2017–2023)	0.3%	-1.4%
10 years (2014–2023)	2.2%	1.3%
Whole period	2.2%	1.8%

Data: HANFA, SeeCapitalMarkets, Eurostat; *Calculations:* BETTER FINANCE.

The performance of private pensions (mandatory as well as voluntary) was positive in 2023 both in nominal and real terms mainly due to the pick-up of the world markets and decreasing inflation.

Pension system in Croatia: An overview

Croatian pension system is since 2002 designed on conventional World bank 3-pillar model. Croatian pension system was as of 1 January 1999 reformed by introducing a mixed public-private pension system consisting of three pillars of pension insurance:

- First pillar — compulsory pension insurance based on generational solidarity;
- Second pillar — compulsory pension insurance based on individual capitalized savings;
- Third pillar — voluntary pension insurance based on individual capitalized sav-

ings.

Key facts on the design of the Croatian Pension system is presented in **??**.

Table HR.3 – Overview of the Croatian pension system

Pillar I	Pillar II	Pillar III
Mandatory state pension	Mandatory funded pensions	Voluntary fully funded defined contribution (DC) pensions
Pay-as-you-go (PAYG) principle	Individual accounts	Individual accounts
Coverage: 89.6%	Coverage: 89.63%	Coverage: 22.02%
Managed by the Social Insurance Company	Managed by Pension Assets Management Companies (PAMCs)	
Quick facts		
Retirement age: 65 years for men; 63 years for woman (2023)		
A relatively high old-age dependency ratio of 35.6% in 2022		
Average gross replacement ratio = 30.45% / Average net replacement ratio = 42.10%		
Working population: 1 658 116		
Number of old-age beneficiaries: 630 205		
Gross average monthly salary: EUR 1 590		
Net average monthly salary: EUR 1 150		
Net average pension: EUR 484		
Number of pension companies:	4	4
Number of pension funds:	12	28
Number of members (savers):	2 248 825	443 046

Data: Mirovinsko, 2024.

First pillar: PAYG scheme

The first pillar of pension insurance is called a pillar of generational solidarity based on PAYG redistributional principle, as persons who work pay contributions for pension insurance, whereas such contributions serve for giving pensions to current pension beneficiaries. In addition to contributions collected from insured persons, the first pillar is also funded from the state budget. According to the Pension Insurance Act , insured persons are compulsorily insured in accordance with principles of reciprocity and solidarity for the event of ageing, reduction of working capacity with remaining working capacity and partial or total loss of working capacity, and the members of their families in the event of insured person's or pension beneficiary's death (right to an old-age pension, early retirement pension, disability pension, temporary disability pension, survivors' pension, minimum pension, basic pension).

Funding: the system of generational solidarity is a defined benefits system. The Contribution Act[1] prescribes the obligation to pay contributions for funding of compulsory insurance, including contributions for pension insurance. Contributions are collected by the Tax Administration and the contribution rate for insured persons who are insured only in the first pillar amounts to 20% of gross salary, while the contribution rate for first pillar for insured persons who are insured in both compulsory pillars (first and second pillar) amounts to 15%.

The implementation of pension insurance based on generational solidarity falls within the competence of the *Hrvatski Zavod za Mirovinsko Osiguranje* (HZMO), the Croatian Pension Insurance Institute. The HZMO is the competent institution for exercising the right exclusively from pension insurance based on generational solidarity (first pillar).

The right to an old-age pension payable from the first pillar is acquired by an insured person who has reached 65 years of age, if he/she has completed 15 years of qualifying periods. Insured persons — women in the period from 2014 to 2029 are entitled to an old-age pension at a lower age. In 2023, they could retire at the age of 63 years and 3 months (under the condition of 15 years of service), where the age requirement for each calendar year increases by 3 months until 2029. As of January 1, 2030, women and men can exercise the right to old-age pension benefit under the same conditions, having reached the age of 65 and 15 years of pensionable service, irrespective of the gender of the insured person.

The amount of old-age pension is calculated by multiplying personal points, pension factor and the actual value of pension. The pension factor is determined by the type of pension to be realized, and the actual value of the pension is determined by the Governing Board of the HZMO, based on the data of the Croatian Bureau of Statistics, no later than two months after the end of each half-year. Personal points are calculated by multiplying the average value point with achieved qualifying periods and the initial factor. The initial factor affects the amount of pension in case of old-age pensions and early retirement pensions, so that:

- An old-age pension is increased to insured persons who are granted pension for the first time after the age of 65, and have 35 years of qualifying periods, by 0.34% for each month after reaching the prescribed age for acquiring the right to an old-age pension, but no longer than 5 years,
- An early retirement pension is reduced for the insured persons by 0.2% for each month of early retirement before reaching the statutory retirement age of the insured person for the acquisition of the right to an old-age pension.

The average value point is calculated based on salaries earned over the entire working life in relation to the average annual salary in the Republic of Croatia.

[1] https://zakon.hr/z/365/Zakon-o-doprinosima

The right to an early retirement pension is acquired by an insured person who has reached 60 years of age and completed 35 years of qualifying periods. There are again some exceptions for women. The amount of the old-age pension is permanently reduced for each calendar month of the earlier exercise of entitlement, up to the completed years of life of the insurer prescribed for the acquisition of the right to an old-age pension, linearly by 0.2% for each month of early retirement, i.e. 2.4% per year up to a maximum of 12% for a maximum of 5 years prior to retirement.

Paid old-age pensions are adjusted twice a year in relation to economic trends in the Republic of Croatia. The adjustment rate, applied starting from January 1, 2015, is determined by the variable ratio of the consumer price index and gross salaries of all employees in the Republic of Croatia in the previous year, compared to the year preceding it (70:30, 50: 50 or 30:70, whichever is preferred). From July 1, 2019, it is aligned as follows: from January 1 to July 1 each calendar year according to the 70:30 or 30:70 model.

Second pillar: Mandatory pension funds

The second pillar has been effectively introduced starting January 2002. The second pillar represents individual capitalized savings. Individual savings refer to personal assets of insured persons and the fact that paid funds are recorded in personal accounts, while capitalized savings refer to return on investment achieved upon payment to the selected compulsory pension fund. This form of pension insurance was introduced to expand the source of funding in relation to compulsory pension insurance based on generational solidarity, which sought to achieve greater individual responsibility for the safety of the elderly.

The second pillar includes compulsory insured persons of up to 40 years of age. The rate of contributions for persons insured in the second pillar amounts to 5 % of the gross salary, whereby insured persons may themselves choose a compulsory pension fund and compulsory pension fund category to which they will contribute the said amount. Persons compulsory insured in the first and the second pillar and insured persons who voluntarily chose the second pillar have the right in the process of exercising the right to a pension to choose in which system the pension will be realized, that is, the system which is more favourable for them (opt-out system). Insured persons can:

- Leave the second pillar and get the pension exclusively from the first pillar;
- Stay in the second pillar and get the pension from both pillars (in this case, the pension from the first pillar is determined for the years of service completed by December 31, 2001, with a supplement of 27% and for the years of service completed from January 1, 2002, with a supplement of 20.25 %, determined by the factor of basic pension (0.75%).

Management of savings within the second pillar is carried out through compulsory pension management companies offering pension funds, while the payout phase is carried out exclusively through pension insurance companies. The pension system based on capitalized savings is regulated by two statutory regulations, depending on whether they refer to the phase of accumulation and capitalization of contributions regulated by the Act on Compulsory Pension Funds[2] or the phase of pension payouts regulated by the Act on Pension Insurance Companies.[3] The Central Register of Insured Persons (REGOS) is the competent institution for insurance based on individual capitalized savings (second pillar).

Compulsory pension fund is established by a pension company that manages such fund on its behalf and for the joint account of pension fund members. Pension fund may fall under categories A, B or C, and are managed by the same pension company. Pension funds of different categories have different investment strategies and vary according to membership limitations (considering life expectancy of savers/members), investment strategy and investment limitations. The assumed risk should be the lowest in category C funds, and the largest in category A pension funds.

The right to pension and based on individual capitalized savings – second pillar is realized based on the Decision on Retirement Benefits issued by the HZMO. From January 1, 2019, all insured persons who are insured in both pension pillars can, when they apply for old-age or early old-age pension, select whether they want to receive pension only from the first pillar or pension from both pillars through a personal statement to the REGOS.

For a member of the fund to choose a more favourable pension, REGOS will collect informative pension calculations from the HZMO and the Pension Insurance Company (MOD) and submit them to the home address. If a member of the fund opts for pension only from the compulsory pension insurance based on generational solidarity (first pillar), the HZMO will determine the pension as if the insured was only insured in the I pillar. The selection of this pension means that a member of the fund wants to leave the second pillar, i.e. compulsory pension insurance of individual capitalized savings, and the total capitalized funds from the personal account of the member of the fund are transferred to the state budget. If a member of the fund opts for a combined pension from the first and second pillars, HZMO will determine the basic pension from compulsory pension insurance for generational solidarity and submit to REGOS the data from the Decision. Upon receipt of the Decision, which is provided to REGOS by HZMO, REGOS checks the data from the Decision regarding the status of the future pension beneficiary. It is checked whether the personal account of the future pension beneficiary is opened and whether he or she has exited from the II pillar. After selecting the pension insurance company, REGOS will close the personal account of the member of the fund and transfer the overall funds to the pension insurance company which will contact than the beneficiary for the conclusion of the pension agreement. The compulsory pension company that manages the compulsory pension fund has a deadline of five working days from the date of initiating the closing of the personal account to allocate funds to the payment account for second pillar contributions. Upon settlement of the obligation by the custodian bank, the following working day it is verified whether the funds have been transferred to the account of the legal recipient of funds — the Raiffeisen Pension Insurance Company (currently the only MOD) that will pay the pension on the basis

[2]https://www.zakon.hr/z/708/Zakon-o-obveznim-mirovinskim-fondovima

[3]https://www.zakon.hr/z/712/Zakon-o-mirovinskim-osiguravaju%C4%87im-dru%C5%A1tvima

of individual capitalized savings. REGOS informs the Pension Insurance Company electronically on the data from R-POD form and the amount of transferred funds. Upon receipt of the aforementioned information, the pension insurance company will contact the future pension beneficiary regarding the conclusion of the Contract on pension based on individual capitalized savings.

If the old-age pension from the first pillar is higher than 15% of the minimum pension from the first pillar according to the Pension Insurance Act, the future pension beneficiary from the second pillar can decide on a partial, one-time cash payment of 15% in the gross amount of the total capitalized funds allocated to MOD.

Third pillar: Voluntary fully funded DC pensions

Voluntary pension funds were also introduced in 2002 and completed the three-pillar system. The third pillar is a voluntary pension savings DC-based scheme. Voluntary pension schemes are either offered by voluntary pension funds or can be set up by trade unions and employers, making open and closed funds possible. Open-ended pension funds are open for membership to any natural person interested in becoming a member of an open-ended pension fund, whereas closed-ended pension funds form their membership out of natural persons who are either employed with an employer, or are trade union members, members of associations of self-employed persons or self-employed persons. Voluntary pension funds need to have at least 2000 members two years after being established.

The payment of retirement benefits within the framework of mandatory pension insurance based on individual capitalized savings of members of mandatory pension funds is made by pension insurance companies only. The payment of retirement benefits within the framework of voluntary pension insurance based on individual capitalized savings of members of voluntary pension funds is made by pension insurance companies, but exceptionally, the payment of retirement benefits on a temporary basis may be made by voluntary pension funds under the conditions laid down in the Act on Voluntary Pension Funds.

The collection of funds within the framework of third pillar of pension insurance is carried out through voluntary pension funds, while payouts of pensions are made by pension insurance companies, and, exceptionally, pension companies, that may carry out temporary pension payouts from voluntary pension funds. Pension reform, which entered into force on , has also introduced the possibility of pension payments by the life insurance companies.

There are no limitations on membership. Also, there are no time restrictions on the duration of membership. A member may choose the amount, duration, and dynamics of payments to the fund. Payments are not compulsory and depend solely on payer's current capabilities. The membership in the fund is not terminated by termination of payments or irregular payments. All paid funds are personally owned by a member, no matter who their payer is, and they can be inherited in full. The only condition for using the funds is reaching 50 years of age.

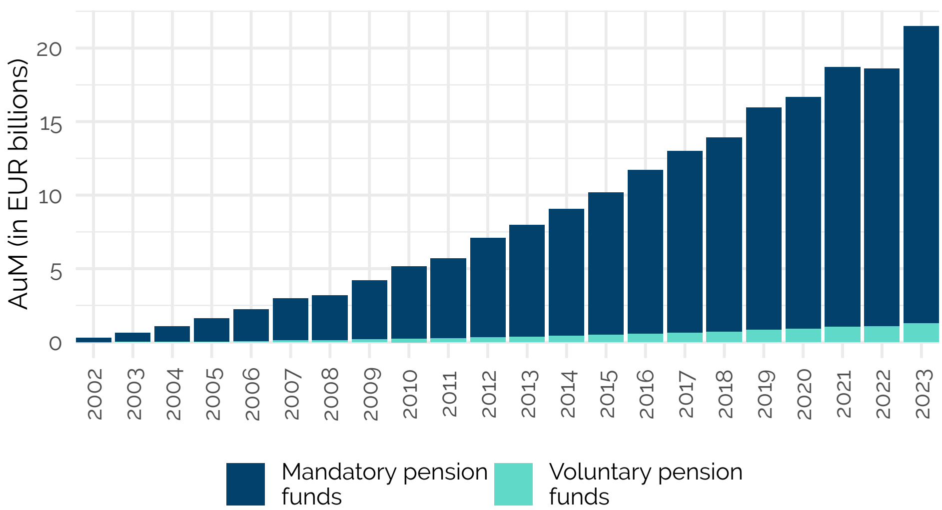
The Act on Voluntary Pension Funds[4] regulates the establishment and operation of voluntary pension funds, while the Act on Pension Insurance Companies regulates the establishment and operation of pension insurance companies, pension schemes and pensions and their distribution. The Croatian Financial Services Supervisory Agency (HANFA) provides supervision over the business of pension insurance companies.

Long-term and pension savings vehicles in Croatia

Croatian pension vehicle in Pillar II and Pillar III are very similar what is considering the design and operation. The differences are in the strictness of the regulation, while the Pillar III pension funds have more liberate regulation.

Figure HR.1 presents the amount of savings under management for both pillars, in billion euros.

Figure HR.1 – AuM of Croatian long-term and pension savings vehicles



Data: HANFA, SeeCapitalMarkets; *Calculations:* BETTER FINANCE.

When inspecting the assets under management, Pillar II pension funds are clearly dominating the market as the contributions flow directly from the mandatory social insurance contributions and cover basically entire working population. Pillar III pension funds are significantly smaller than Pillar II peers, while covering only 20% of working population contributing smaller amounts regularly.

Mandatory pension funds

There have been 4 mandatory pension asset management companies operating in Croatia in 2023:[5]

[4] https://www.zakon.hr/z/709/Zakon-o-dobrovoljnim-mirovinskim-fondovima
[5] *Source:* HANFA, 2024.

1. Allianz ZB d.o.o. društvo za upravljanje obveznim i dobrovoljnim mirovinskim fondovima
2. ERSTE d.o.o. - društvo za upravljanje obveznim i dobrovoljnim mirovinskim fondovima
3. PBZ CROATIA OSIGURANJE d.d. za upravljanje obveznim mirovinskim fondovima
4. Raiffeisen društvo za upravljanje obveznim i dobrovoljnim mirovinskim fondovima dioničko društvo

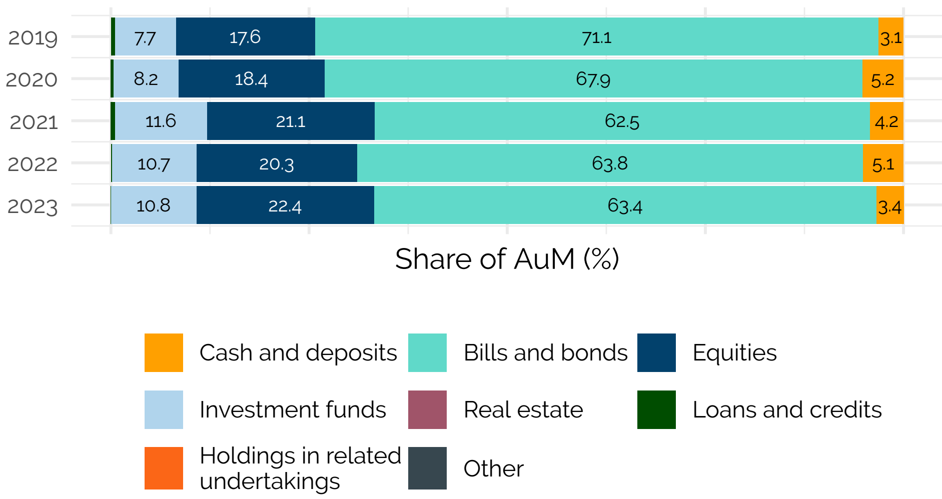
There are 12 mandatory pension funds offered to savers, while each mandatory pension company manages 3 pension funds with different investment strategy:

1. Type "A" mandatory pension fund with riskier investing strategy. Members of this fund can be persons who are at least 10 years old until the age requirements for acquiring the right to an old-age pension are met. At least 30% of the fund's net assets are invested in bonds of the Republic of Croatia, EU or OECD countries. Maximum 55% of the fund's net assets are allocated in shares of issuers from the Republic of Croatia, EU member states or OECD countries and at least 40% of the fund's net assets are denominated in kuna.
2. Type "B" mandatory pension fund — balanced investment strategy. Initially, all members will be members of this fund, unless they choose Fund A or C themselves. At least 50% of the fund's net assets are invested in bonds of the Republic of Croatia, EU or OECD countries. Maximum 35% of the fund's net assets are invested in shares of issuers from the Republic of Croatia, EU member states or OECD countries and at least 60% of the fund's net assets are denominated in kuna.
3. Type "C" mandatory pension fund – conservative investment strategy. It is suitable for older members of the fund who have less than 5 years left to meet the age requirements for acquiring the right to an old-age pension. According to this condition, REGOS will automatically transfer policyholders from the category B fund to the category C fund. At least 70% of the fund's net assets should be allocated in bonds of the Republic of Croatia, EU member states or OECD countries. Investment in shares is not allowed, and exposure to investment funds is limited to 10%. At least 90% of the fund's net assets are denominated in kuna.

Portfolio structure of the mandatory pension funds is presented in Figure HR.2.

Considering the portfolio structure of all mandatory pension fund, most of the investments (almost 64%) are allocated in government and municipal bonds with increasing share of equities. This could also explain positive nominal returns in 2023.

Figure HR.2 – Allocation of Croatian mandatory pension funds' assets



Data: HANFA; *Calculations:* BETTER FINANCE.

Third pillar: Voluntary pension funds

Voluntary pension savings scheme offers more flexibility for providers. There are 4 voluntary pension asset management companies in Croatia:

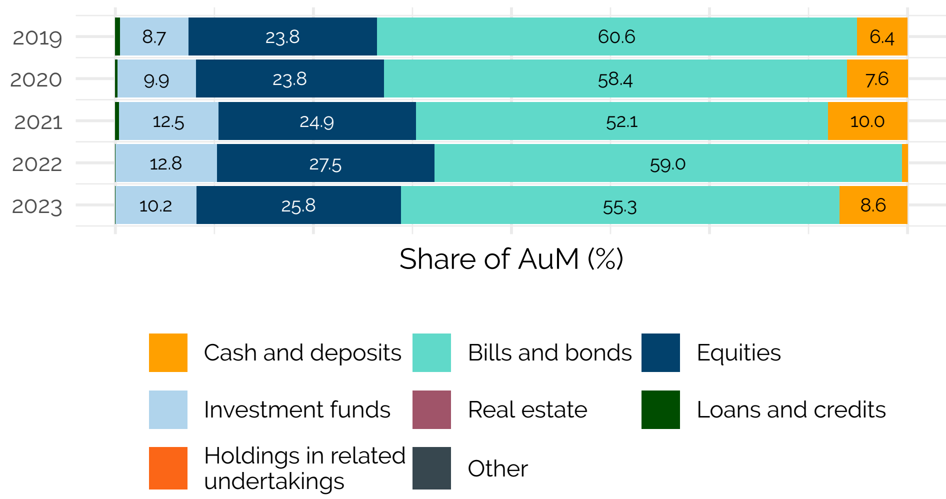
1. Allianz ZB d.o.o. društvo za upravljanje obveznim i dobrovoljnim mirovinskim fondovima
2. CROATIA osiguranje mirovinsko društvo za upravljanje dobrovoljnim mirovinskim fondom d.o.o.
3. ERSTE d.o.o. – društvo za upravljanje obveznim i dobrovoljnim mirovinskim fondovima
4. Raiffeisen društvo za upravljanje obveznim i dobrovoljnim mirovinskim fondovima dioničko društvo

These companies manage mandatory as well as voluntary pension funds. Within the third pillar, the companies can offer open-ended funds to any member as well as closed-ended funds to predefined range of members. Currently (as of December 31, 2023), there have been available data for 17 closed-ended funds and 8 open-ended voluntary pension funds offered to savers. However, open-ended funds manage more than 80% of all pillar III assets.

The portfolio structure of Pillar III pension funds is presented in Figure HR.3.

Voluntary pension funds can be considered more riskier compared to the mandatory pension funds. Almost 20% of assets is allocated into equities and equity based undertaking for collective investment in transferable securities (UCITS) funds and

Figure HR.3 – Allocation of Croatian voluntary pension funds' assets



Data: HANFA; *Calculations:* BETTER FINANCE.

60% in government bonds.

Charges

Charges of mandatory pension funds

Croatian pillar II pension funds managed by 4 companies do exhibit regulated fee policy ensuring relatively low level of fees. Detailed structure of fees of mandatory pension funds offered within the second pillar is presented in Table HR.4.

Table HR.4 – Costs and charges of Croatian mandatory pension funds (% of assets)

Year	Total ongoing charges
2003	0.92%
2004	0.92%
2005	0.98%
2006	0.99%
2007	1.12%
2008	0.89%
2009	0.82%
2010	0.79%
2011	0.69%
2012	0.57%
2013	0.57%
2014	0.57%
2015	0.57%
2016	0.51%
2017	0.44%
2018	0.41%
2019	0.38%
2020	0.35%
2021	0.32%
2022	0.31%
2023	0.30%

Data: Funds' documentation; *Calculations:* BF.

Pillar II mandatory pension funds do exhibit rather complex fee structure, however the total cost indicator is presented in annual financial report of each pension fund. In 2023, mandatory pension fund providers charge management fee of 0.27% p.a., depository fee on average of 0.015% p.a. of total assets under management and entry fee of 0.5% of contributed amount. The exit fee is determined based on the duration of the agreement between the saver and provider. If the duration of the saving agreement is less than 1 year, usually the exit fee of 0.8% of savings is charged. If the duration of the agreement is more than 3 years, no exit fee can be charged.

The year 2023 brought further reduction and diversification of fees based on the fund´s strategy. Introduction of low-cost passively managed pension funds has spurred price battle after 2018, however divergence between the fees started to emerge in 2021 with an average fee level of 0.54% p.a. Lower total expense ratio in 2023 could be explained by higher positive returns.

Charges of voluntary pension funds

Compared to the mandatory pension funds' level of fees, voluntary pension funds fees are significantly higher and amount on average more than 2% p.a. on assets under management.

Obtaining data for voluntary pension funds is quite challenging and only average cost ratio for all voluntary pension funds is available. The fee structure suggests that the total costs are quite dependent on the overall performance and thus the performance-tied fees play key role in the fee structure of voluntary pension funds in Croatia. The average cost ratio has been calculated using the voluntary pension funds' financial statements.

Table HR.5 – Costs and charges of Croatian voluntary pension funds (% of assets)

Year	Total ongoing charges
2003	7.69%
2004	3.18%
2005	2.05%
2006	1.89%
2007	1.82%
2008	1.96%
2009	2.01%
2010	2.04%
2011	2.05%
2012	1.97%
2013	1.96%
2014	1.98%
2015	2.01%
2016	2.04%
2017	2.05%
2018	2.05%
2019	2.04%
2020	2.04%
2021	2.03%
2022	2.04%
2023	1.74%

Data: Funds' prospectuses; *Calculations:* BF.

Pillar III costs and charges are significantly higher compared to the mandatory pension funds offered in Pillar II, when the fee structure is regulated and capped. Higher overall costs do negatively impact the overall performance of Pillar III pension funds.

Taxation

Taxation of the mandatory pension scheme (Pillar II) is of the EET type. Contributions and investment income are tax-exempt, whereas benefits are taxed. The tax allowance for pensioners is 1.7 times higher than for employees, meaning that pensions are only modestly taxed.

At each pension payment, as well as a one-time payment of 15% of the total capitalized funds allocated to mandatory pension funds, the pension insurance company calculates and pays income tax and surtax on income tax in accordance with the Income Tax Act and pays the net amount to the pension beneficiary. Tax rates for pensioners are reduced and are 12% and 18%, depending on tax brackets. Based on the final income tax calculation that is done by the Tax Administration, the pension beneficiary may be required to pay a tax or may be entitled to a refund of overpaid income tax, depending on the received receipts and the personal deductions used in that year.

Voluntary pension savings (Pillar III) are the only form of saving which includes two types of state incentives: state incentive funds and tax incentives for employers. Croatia encourages pension savings and approves the incentive to all members of the third pillar in the amount of 15% of the annual payment, up to a maximum of HRK 5000 (EUR 672), that is, the highest state incentive can amount to HRK 750 (EUR 101). Every resident can exercise the right to receive incentives only during the period that he/she pays compulsory pension insurance. The membership in a voluntary pension fund offers its member the option of voluntary pension savings being paid by his employer. All payments made by the employer in Pillar III of pension insurance up to the monthly amount of HRK 500 (EUR 67.2), that is, up to HRK 6 000 (EUR 806.5) a year, are not considered a salary. That amount is considered a tax-recognized expense or employer's expense. During the pay-out phase, pension benefits are subject to personal income tax. Therefore, we can say that the taxation scheme for Pillar III pension savings is EET with exceptions.

Table HR.6 – Taxation of pension savings in Croatia

Product	Phase			Regime
	Contributions	*Investment returns*	*Payouts*	
Mandatory pension funds	Exempted	Exempted	Taxed	EET
Voluntary pension funds	Exempted	Exempted	Taxed	EET

Source: Own elaboration, 2023.

Performance of Croatian long-term and pension savings

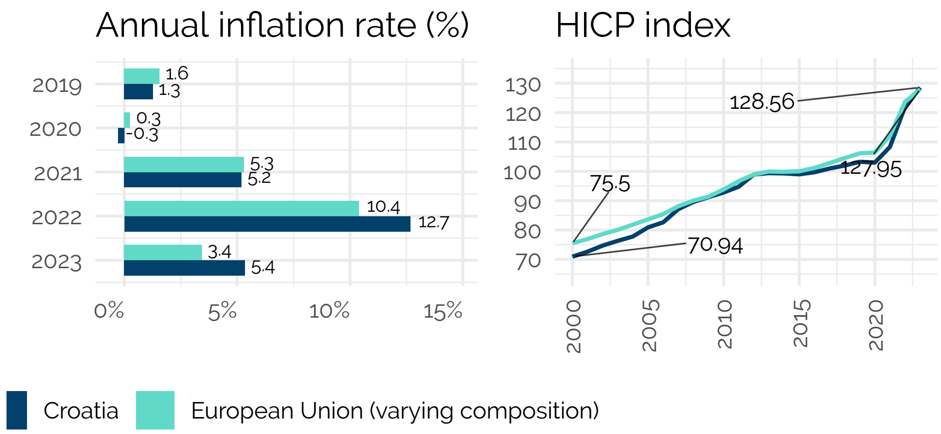
Real net returns of Croatian long-term and pension savings

The ability of the pension vehicle to maintain the buying power is the key feature for savers. Especially in countries, where the historical inflation is higher, the pension providers must adjust the portfolio structure to be able to keep up with local inflationary pressures.

Figure HR.4 – Inflation in Croatia

Period 2000–2023

	Annualised	Cumulated
Croatia	2.8%	91.9%
European Union (varying composition)	2.3%	73.2%

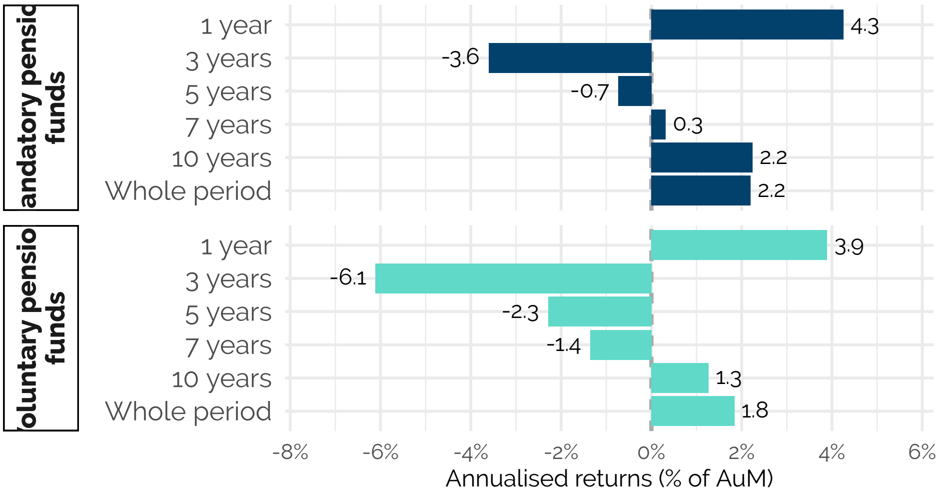


Data: Eurostat, HICP monthly index (2015 = 100); *Calculations:* BETTER FINANCE

Croatian mandatory pension funds have been able to beat the inflation over the analysed period of 2002–2023. This is not the fact for the voluntary pension funds, where the overall cumulative performance after the inflation was negative.

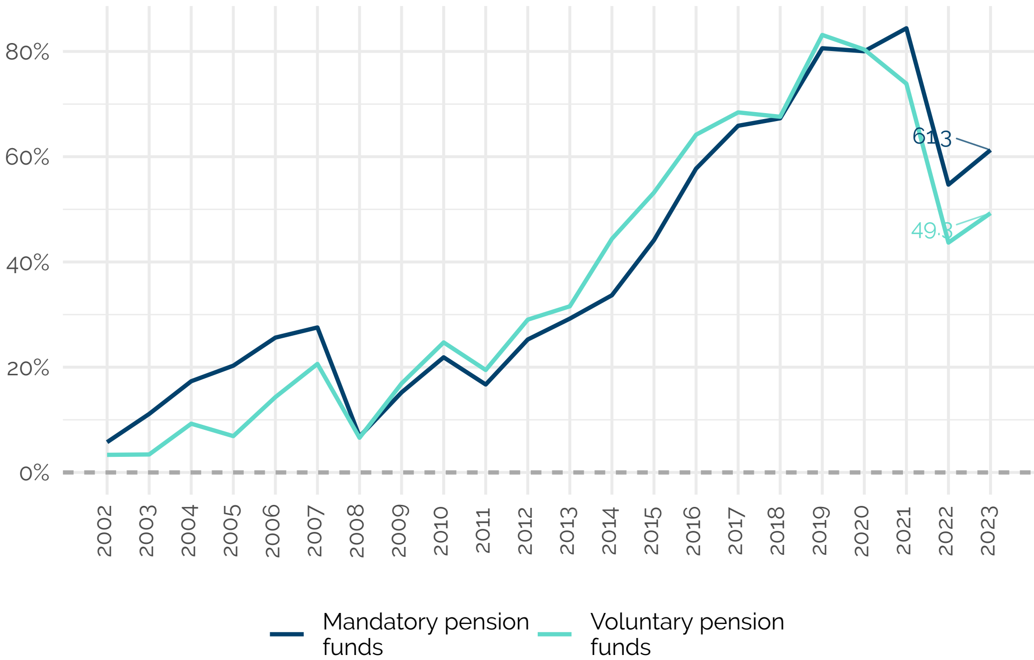
Performance of mandatory and voluntary pension funds before fees and inflation is quite similar. However, when the charges and inflation is applied, the differences occur where the voluntary pension funds record lower returns.

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



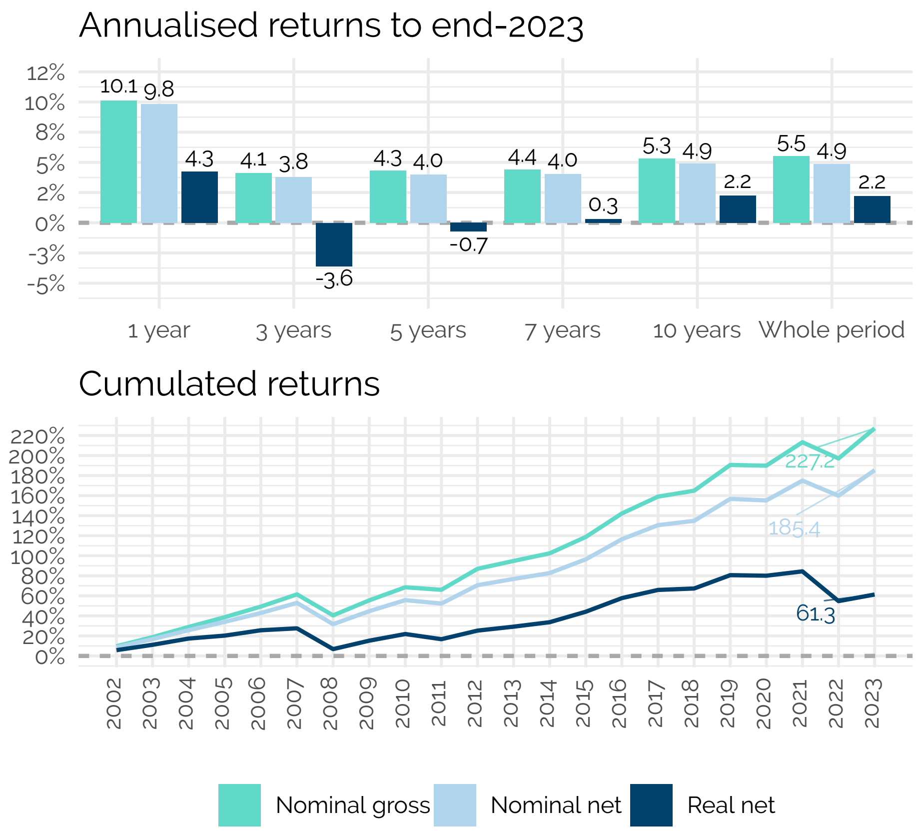
Data: HANFA, SeeCapitalMarkets, Mandatory Pension funds statutes, Voluntary Pension statutes, Eurostat; *Calculations:* BETTER FINANCE, holding periods to end-2023.

Figure HR.6 – Cumulated returns of Croatian long-term and pension savings vehicles (2002–2023, before tax, % of AuM)



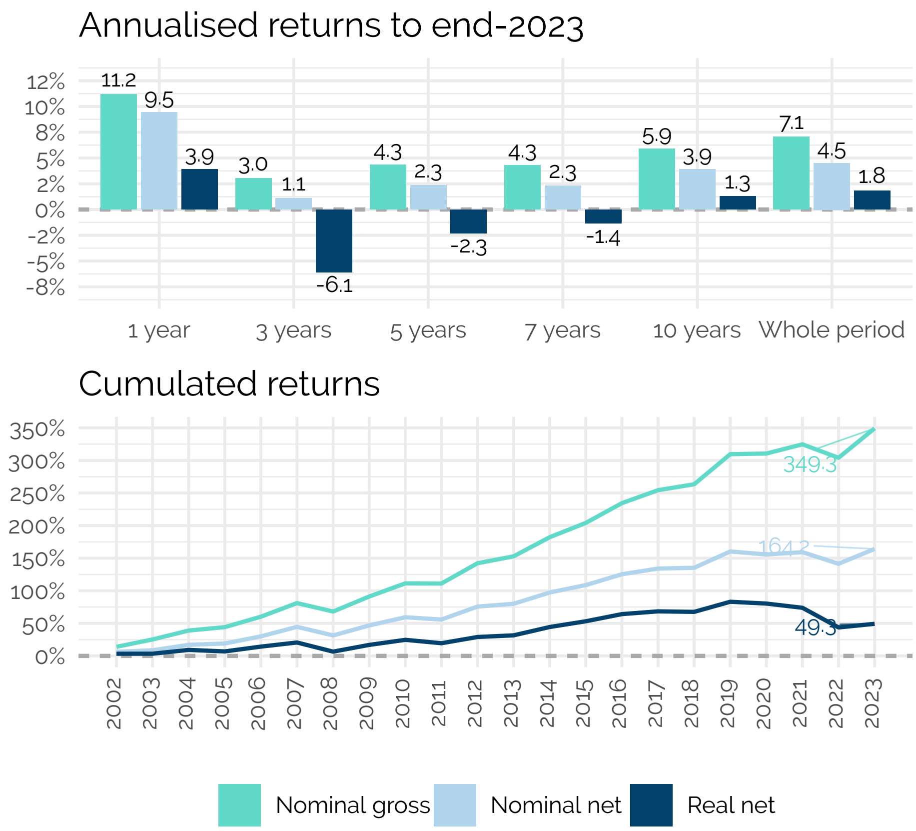
Data: HANFA, SeeCapitalMarkets, Mandatory Pension funds statutes, Voluntary Pension Funds statutes, Eurostat; *Calculations:* BETTER FINANCE.

Figure HR.7 – **Returns of Croatian mandatory pension funds (before tax, % of AuM)**



Data: HANFA, Mandatory Pension funds statutes, Eurostat; *Calculations:* BETTER FINAN
holding periods to end-2023.

Figure HR.8 – **Returns of Croatian voluntary pension funds (before tax, % of AuM)**



Data: SeeCapitalMarkets, Voluntary Pension Funds statutes, Eurostat; *Calculations:* BETTER FINANCE, holding periods to end-2023.

Do Croatian savings products beat capital markets?

In this section, we compare the performance of the mandatory and voluntary pension funds in Croatia to the performance of relevant capital market benchmarks.

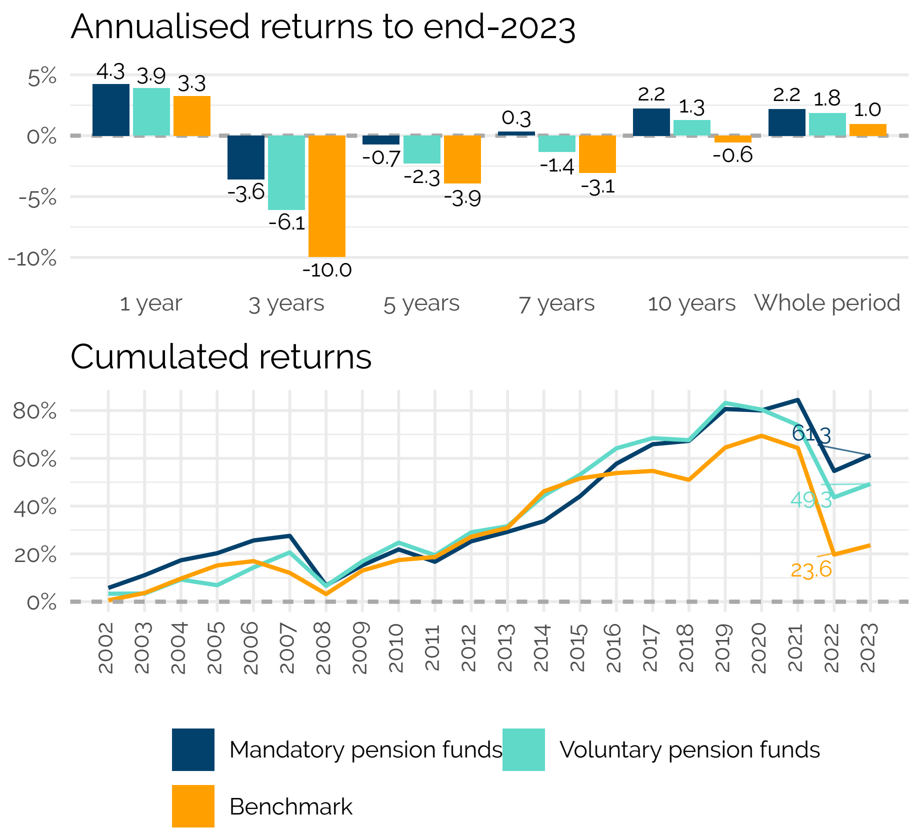
Table HR.7 – Capital market benchmarks to assess the performance of Croatian pension vehicles

Product	Equity index	Bonds index	Allocation
Mandatory pension funds	STOXX All Europe Total Market	Barclays Pan-European Aggregate Index	15.0%–85.0%
Voluntary pension funds	STOXX All Europe Total Market	Barclays Pan-European Aggregate Index	25.0%–75.0%

Note: Benchmark porfolios are rebalanced annually.

Croatian mandatory pension funds have been able to maintain the buying power of savings and beat the respective market benchmark. This is quite visible after the year 2015, when the charges started to drop below 0.5% p.a. and the portfolio structure of the funds became more stable and passively oriented. The opposite is true for the voluntary pension funds, which have not been able to keep up with the market benchmark and on top of it, they were below the inflation index. The main reason can be found in the quite conservative portfolio structure and really high fees compared to other pension vehicles.

Figure HR.9 – **Performance of Croatian mandatory and voluntary pension funds against a capital market benchmark (returns before tax, after inflation, % of AuM)**



Data: HANFA, SeeCapitalMarkets, Eurostat, Eurostat; *Calculations:* BETTER FINANCE, h periods to end-2023.

Conclusions

Croatian pension system offers rather low replacement rates from the state-organized first pillar. This leaves the working population to rely on individual savings and thus the importance of mandatory as well as voluntary pension savings will rise over time and will play a significant role of one's income during the retirement.

Mandatory as well as voluntary pension funds have provided the savers with solid returns over the last 21 years.

Pillar II scheme is compulsory for the working population and thus the coverage ratio as well as benefit ratio will be expected to rise in future. The problem could be seen in rather low coverage ratio within the III. pillar, where only 20% of working population saves for retirement and the pension vehicle do not offer cost-effective way of securing the future income.

Understating the weak points of Croatian pension system (low coverage ratio and relatively low contribution rates for funded schemes), the pension system could be improved by:

- allowing for additional voluntary contributions for mandatory pension pillar on top of 5% contribution rate envisaged by the current law as the II. pillar offers quite solid performance with low cost ratio;
- increase indirect state support and further enhance the tax exemption for III. pillar contributions in order to increase the coverage ratio;
- allow more open competition for voluntary pension funds from the side of PEPP that would offer cost-effective and transparent products.

Overall, the performance of Croatian pension funds could be considered solid, compared to other peers in other countries. However the performance is driven mostly by bond yields of domestic issuers, which would not hold for the longer period.

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