Will You Afford to Retire?

The Real Return on Long-Term and Pension Savings

2024 Edition

BF 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 — Germany

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.

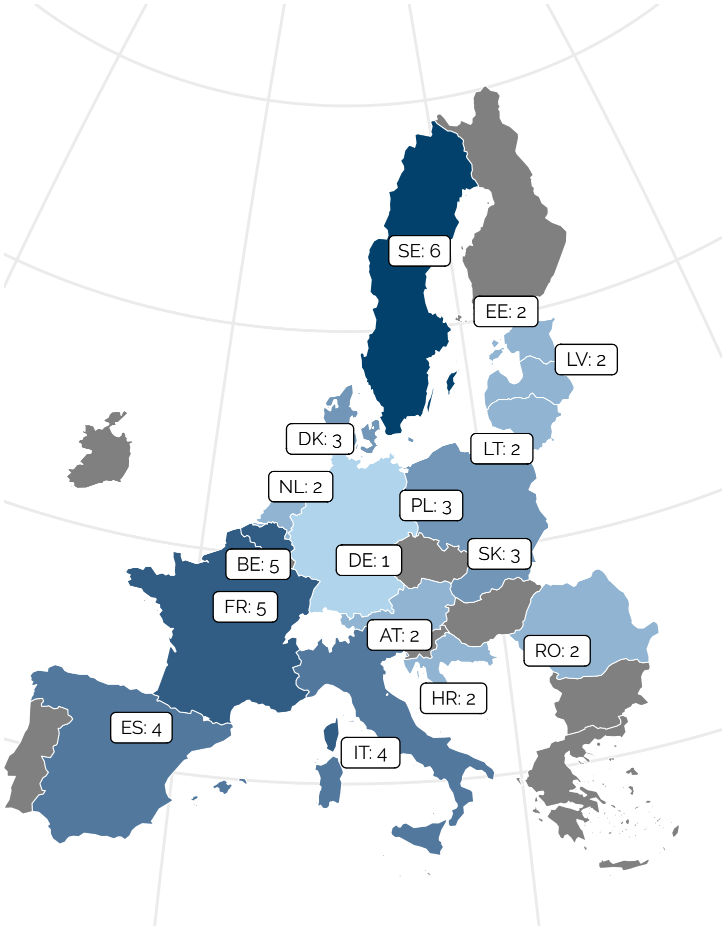
This research report by BETTER FINANCE covers 16 of the 27 European Union (EU) Member States. In each of these countries the team of contributors analyses the costs and performance of up to 6 product categories. Our goal is to calculate, based on publicly available data about these product categories,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

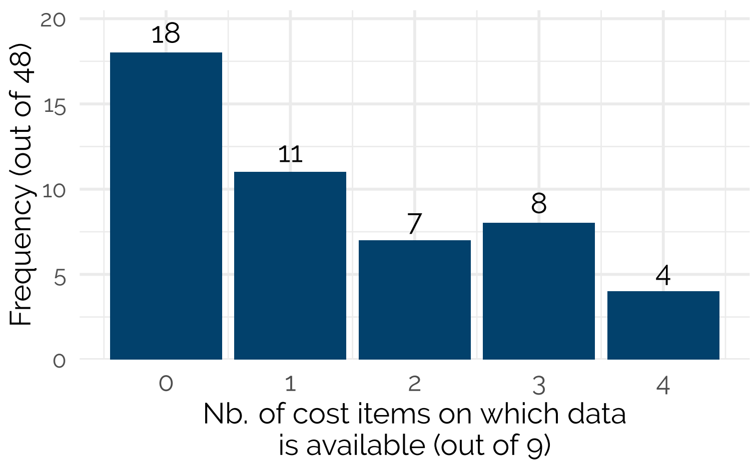


Besides performance data, information on costs is very often patchy and displayed in a way that makes it impossible for investors to compare cost levels across product providers, and for our contributors to aggregate this information at the level of product categories. The reader can appreciate this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

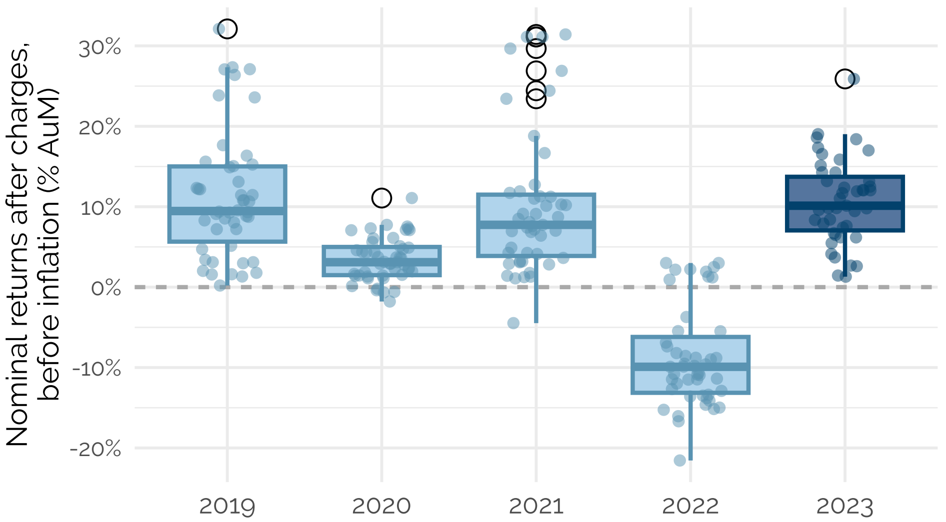
2023: Recovering from the slump

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)**



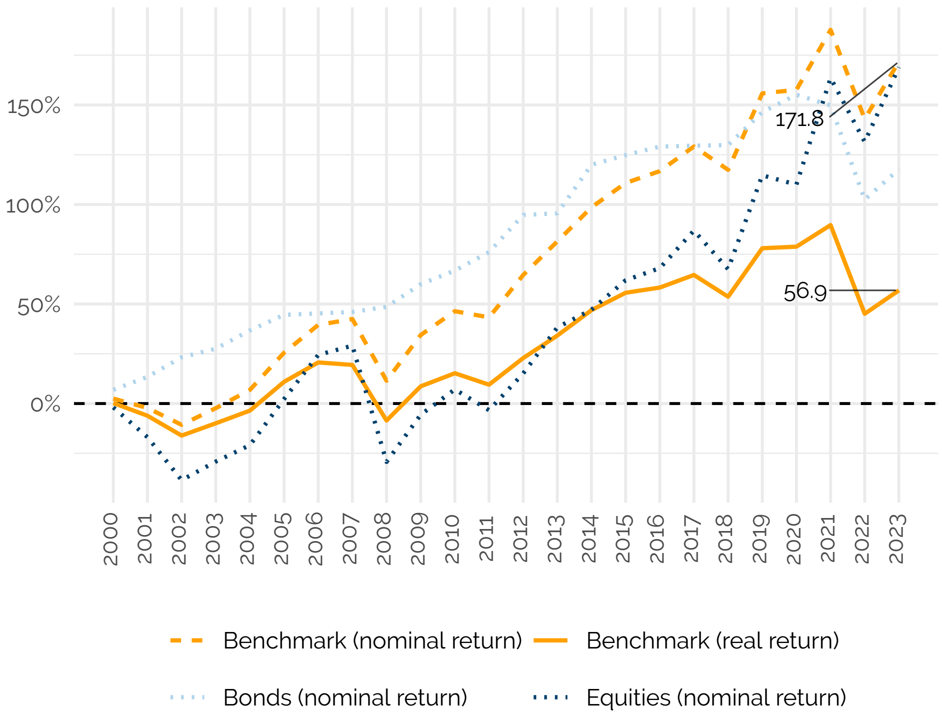
Data: NCAs and sectoral associations (see Country Cases); *Calculations:* BETTER FINANC

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

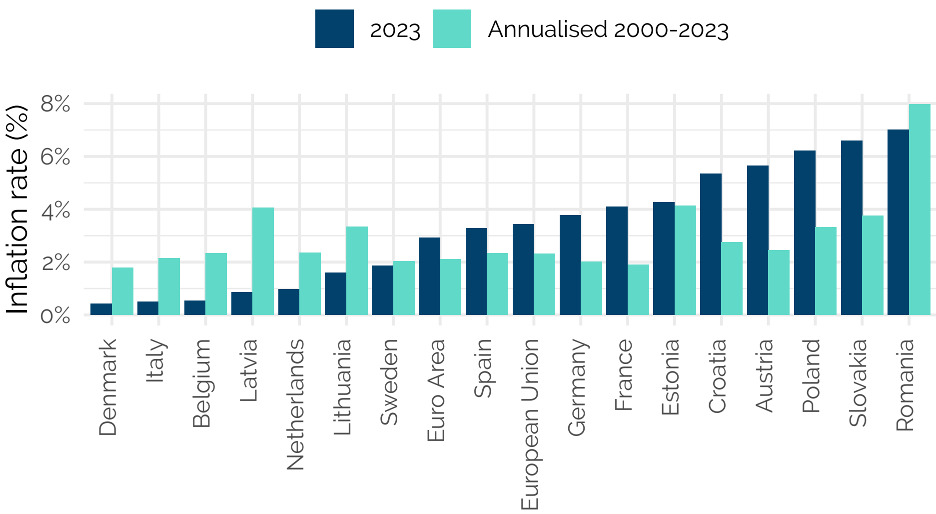
We wish to highlight the good performance of the first PEPP to be included in our study: with a nominal return before charges and inflation standing at +15% and charges amounting to 0.72% of assets under management (AuM), the Slovak PEPP yielded a net return of +14.3% in nominal terms and 7.2% in real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

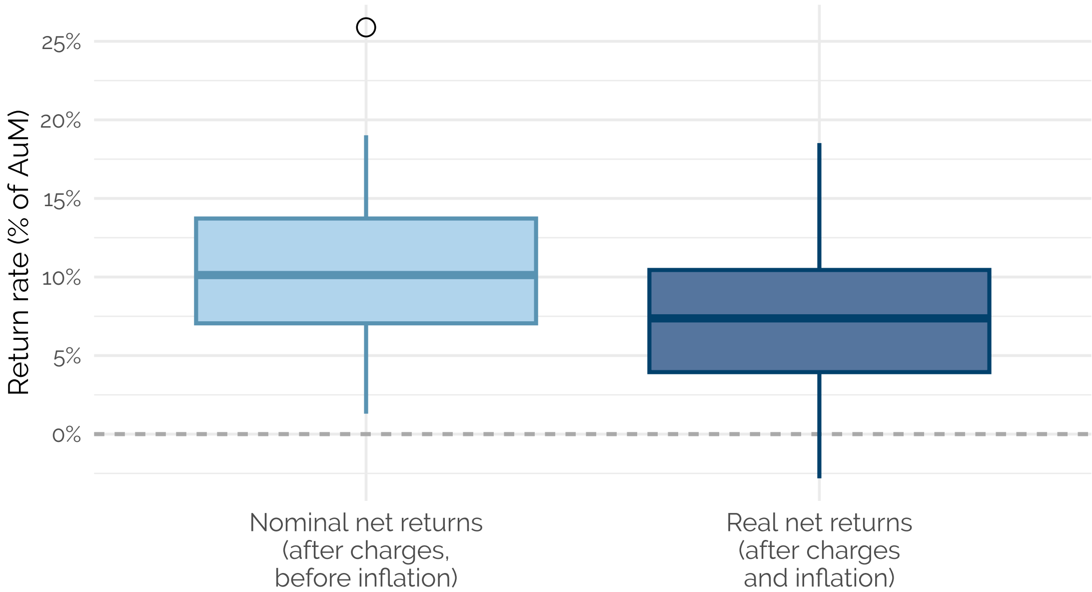
In the meantime, we urge Member State governments to offer the PEPP the same treatment, as regards taxation, subsidies and transferability of accrued pension benefits, that existing national personal pension products enjoy (see our policy recommendation on this topic on Page xvii).

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)**

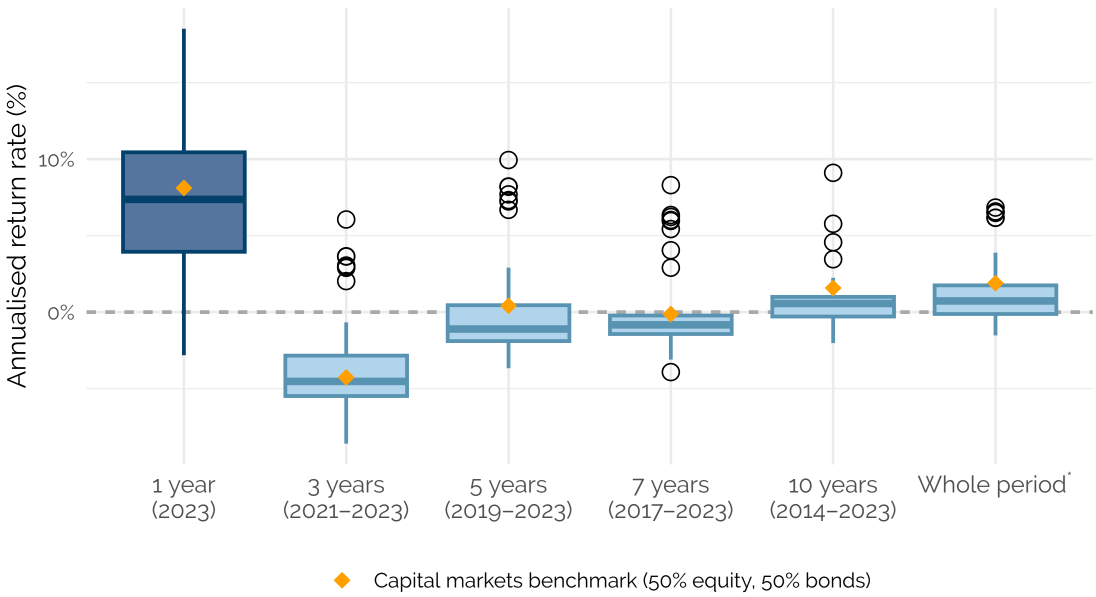


Calculations: BETTER FINANCE

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 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%

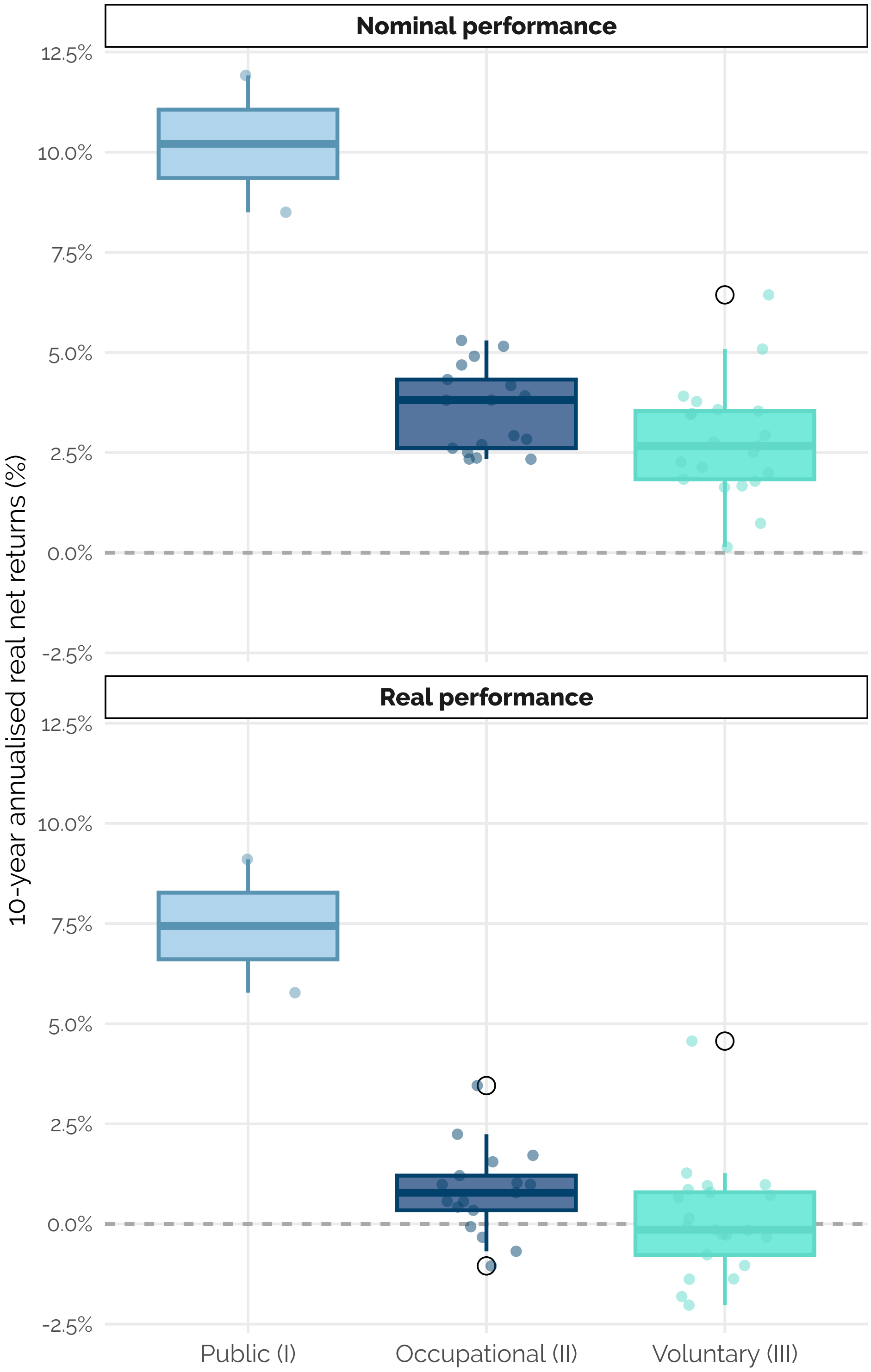
Calculations: BETTER FINANCE
* Whole period varies across products (up to 24 years).

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 6

Germany

Zusammenfassung

In Deutschland verfügen die Lebensversicherer bei der privaten und betrieblichen Altersvorsorge über eine dominante Position. Pensionskassen und Pensionsfonds als Einrichtungen betrieblicher Altersvorsorge (EbAv) spielen eine weniger wichtige Rolle im Vergleich zu anderen EU-Mitgliedsstaaten. Durch die Niedrigzinsphase der 2010er Jahre hat ein tiefgreifender Wandel von Garantieprodukten zu Kapitalmarkt näheren Produkten stattgefunden. Dieser Trend dürfte auch durch die Zinswende seit 2021/22 nicht wieder rückgängig gemacht werden.

Nachdem über Jahre die Inflation in Deutschland häufig unter dem EU-Durchschnitt gelegen hatte, wird die nun höhere Inflation für die Altersvorsorgesparer für einen dramatischen Verlust an langfristiger Kaufkraft sorgen, falls sie nicht eingedämmt werden kann. Als besonders problematisch müssen die hohen Kostenbelastungen der Lebensversicherer, insbesondere durch die Vertriebsvergütungen, angesehen werden.

In den letzten Jahren hat es intensive öffentliche Debatten über die Reform der staatlich geförderten Altersvorsorge, namentlich der Riester-Rente, gegeben. Deren Neugeschäft ist seit einigen Jahren praktisch zusammengebrochen, ihr Bestand nimmt sogar ab. Endgültige Entscheidungen für diese notwendige Reform durch die aktuelle "Ampel-Koalition" in Berlin fehlen aber bisher.

In der Gesetzlichen Rentenversicherung besteht ein massives Problem der langfristigen Finanzierbarkeit auf Grund des fortschreitenden demographischen Wandels und sozialpolitisch motivierter Rentenerhöhungen der letzten Jahre. Der Konflikt zwischen Schuldenbegrenzung der öffentlichen Finanzen und sozialpolitischen Ambitionen dürfte sich in Zukunft immer weiter verschärfen...

Summary In Germany life insurers play a dominant role in the private and occupational retirement provision sectors. Amongst occupational pensions, "Pensionskassen" and "Pensionsfonds" (IORPs) are less prominent compared to other EU member states. Due to the low interest rate environment of the 2010s, a significant shift occurred from pension products with guarantees to those with reduced guarantees or hybrid investments. The reversal of the Euro key interest rates in 2021/22 is unlikely to reverse this trend.

For years, inflation in Germany was lower than the EU average. However, the current higher inflation rate will result in a dramatic loss of long-term purchasing power for policyholders if inflation cannot be reduced. It is particularly concerning to consider the impact of distribution costs of life insurers on the real return.

In recent years, there have been intensive public debates, especially regarding the Riester Pension, which is a state-subsidised private pension product. Their new business has significantly declined, and their portfolio has even decreased. Yet, final decisions on the necessary reforms have not yet been taken by the current Federal Government.

The mandatory First Pillar Pension System faces a significant challenge in maintaining its long-term financial balance due to demographic change and socially favourable increase of payouts. The conflict

of objectives between limiting public debt and generous welfare policies will become increasingly pronounced in the future…

Introduction: The German pension system

German life-insurers publish rather detailed figures on new business and their portfolios, both in terms of the number of contracts and the gross written premiums (GWPs) for various sub-categories of life and pension products. Their association, *Gesamtverband der Versicherer* (GDV) only publishes aggregate figures on costs and net returns of their assets under management. Average figures for gross returns of life-insurance products are published by the NCA, the *Bundesanstalt für Finanzdienstleistungsaufsicht* (BaFin). Therefore, calculations following the methodology of this report can only be done in aggregate for life-insurers. However, more detailed figures on other occupational pension product providers (mainly IORPs) will be outlined based on additional sources.

At the product level, policyholders have access to detailed information on costs and performance scenarios. This information is provided through various pre-contractual information documents based on EU regulation—for IBIPs—and/or national law—for occupational and state-subsidised pension products.

With the end of the low-interest-rate phase, primarily in the 2010s, the following main developments can be confirmed for the German life insurance and pension products market:

- Continuously growing GWP, but decreasing since 2022;
- Continuously growing market share of products with reduced guarantees, hybrid or unit-linked products (instead of classical guarantees during the accumulation phase);
- Continuously growing market share of pension products replacing traditional life-insurance. However, at the same time, we need to consider these two additional assessments:
- Ongoing high level of costs (especially for distribution channels);
- Constant decrease of gross average returns (*Gesamtverzinsung*) with the exception of the year 2023.[1]

The basis for these statements will be outlined in the following paragraphs and tables.

One of the major issues in the public debate on the reform of the pension system as a whole was the rise and subsequent stagnation of new business of the so-called *Riester* Pension. This particular state-subsidised private pension product was introduced in 2001 by the Federal Minister of Labour at the time to equalize some restrictions in the First Pension Pillar System established by the Federal Government. After a modest start, the Riester Pension experienced significant growth starting in

[1]Total bonus of life insurances in Germany in 2023 — private annuities: 2.26%; capital life: 2.31%. https://de.statista.com/statistik/daten/studie/168461/umfrage/ueberschussbeteiligung-der-lebensversicherer-seit-1995

Table DE.1 – Long-term and pension savings vehicles analysed in Germany

Product	Pillar	Reporting period *Earliest data*	*Latest data*
Life insurances	Voluntary (III)	2000	2023

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

	Life insurances
1 year (2023)	-2.2%
3 years (2021–2023)	-4.7%
5 years (2019–2023)	-2.4%
7 years (2017–2023)	-1.7%
10 years (2014–2023)	-0.8%
Whole period	0.5%

Data: GDV, Eurostat; *Calculations:* BETTER FINANCE.

2005, primarily due to increased state allocations and changes in distribution remuneration rules. Another boost occurred in 2008 when not only annuity insurances, investment funds, and bank saving plans were admitted as pension products, but also a form of home loan savings plan known as *Wohn-Riester*.

By 2013, the threshold of 16 million contracts for all four categories of the Riester Pension had been reached, with approximately half of eligible employees participating and over 10 million insurance contracts issued. However, it soon became evident that there was no further growth in new business.

On the one hand, the increasingly persistent low-interest-rate environment of the 2010s was undoubtedly a major factor contributing to this stagnation, because the Riester Pension included a 100% minimum return guarantee on the gross premiums paid until the start of the payout phase. As a result, all product providers had to allocate a significant portion of their investments to fixed-income securities during the contribution phase, limiting their ability to fully capitalise on the booming stock markets during that period. On the other hand, there was an ongoing discussion on high costs, particularly concerning commissions for distributors, which did not stop.

All in all, it is fair to conclude that the Riester Pension was successful in terms of its social policy objectives. Low-income earners and families with children mostly benefited from direct state allocations, while high-income earners could profit from tax returns. However, neither the state authorities nor the different product providers and their distributors could dispel the widespread public scepticism regarding the real returns, with low benefits and high distribution costs during the accumulation phase, and lower amounts in the payout phase. In April 2024 for the first time the Federal Ministry of Finance published statistics on the pay-outs of Riester Pensions. In 2022 the average of the monthly pay-outs amounted to EUR 132. The ministry stressed that this low figure is mainly due to short contribution periods up to now and in the long run pay-outs will increase. Consumer protectors criticized these figures by stressing the low "return on investment" and over-calculated life-expectancies by life-insurers; (see Krieger, 2024; [BMFI], 2024)

The result of these various contradictory developments was clear: the peak was reached in 2017 with 16.6 million contracts concluded, and from that year onwards, not only did new business stagnate, but there was a real loss in GWP and contracts.[2] The proportion of contracts with premium exemptions increased to nearly 20%, and by 2023, the total number of contracts had once again fallen below the threshold of 16 million (exactly 15.51 million contracts). The public debate was increasingly dominated by the question "reform or abolishment" of the Riester Pension, and below, we will explore possible solutions that could be implemented.

Pension system in Germany: An overview

Germany belongs to those EU member states where the mandatory first pillar state pension system *Gesetzliche Rentenversicherung* (GRV) constitutes the most important part of the retirement provision. Therefore, occupational and private pension products primarily serve as additional retirement income sources. Besides these explicit pension products, for decades, home ownership (*Immobilienbesitz*) and asset allocation in securities, bank deposits, and so on (*Vermögensbildung*), have constituted the other non-insurance-based pillars of retirement provision (*Altersvorsorge*).

The GRV is supplemented by other pension regimes designed for specific professional groups (mostly self-employed) and employees of public administrations at the local, regional, and federal levels (first pillar bis pension systems). In 2005, through the reforms of the so-called *Rürup-Kommission*[3] certain mechanism for adjusting the levels of mandatory contributions and payouts were introduced in order to cope with the impending long-term demographic changes.

But in the following years – regardless of the party collation in power at the federal level –additional social welfare legislation (including pension "add-ons" for mothers, the low-income sector, individuals with lengthy contribution histories, etc.) has led to nearly 25% of necessary contributions for first pillar pensions being funded by tax payers, amounting to nearly 100 billion Euros annually. The overall expenditure of the First Pillar Pension Scheme reached approximately 340 billion Euros in 2021. This places a significant financial burden on all taxpayers, and a financially sustainable solution has yet to be found, as the main demographic challenges are expected to have an increasingly significant impact from the mid-2020s onwards (Bundesministerium für Arbeit und Soziales [BMAS], 2022, and earlier editions; German Council of Economic Experts, n.d., especially in 2016, chapter 7 and 2020, chapter 6, for a detailed analysis of the reforms and counter-reforms of the GRV see).

[2] The exact figures are provided in the next section.

[3] see section on taxation on Page 22.

With over 16 million occupational pension contracts, more than 18 million contracts for state-subsidised private pensions (*Riester* and *Rürup* pensions) and over 20 million private annuities in 2023 (for a total population of more than 80 million inhabitants) it is obvious that the insurance and pension sectors play a dominant role in voluntary retirement provision in Germany. This will be analysed more in detail in the following paragraphs, especially taking into consideration the strongly negative impacts of the low-interest-rate phase, mainly in the 2010s, and the risks of inflation from 2021/22 onward for the real returns of the future retirees and beneficiaries (Deutsche Rentenversicherung, 2021, for a general overview of state-subsidized and private pension plans; and Deutsches Institut für Altersvorsorge, n.d., for current analysis of private retirement provision, asset allocation and retail investor behaviour).

As a consequence of the federal elections in September 2021, the new so-called “traffic light” coalition was formed in Berlin (red: Social Democrats, yellow: Liberal Party, and the Greens). The Liberal Party, led by Mr Christian Lindner, who now serves as the Federal Minister of Finance, had proposed to introduce a so-called *Aktien-Rente* (“Pension by Shares”). This proposal bore similarities to the Swedish State Pension Fund Model, where individual contributors have the option to directly invest in shares or other capital market products within the framework of this public fund.

However, due to ongoing negotiations within the government coalition, this original concept was transformed into a completely new legislative proposal, the so-called *Generationenkapital* (“Generational Capital”). This new concept basically consists in a transfer of EUR 10 bln. per year from 2024/2025 onwards, for at least 10 years by the federal budget to a newly founded public foundation. This foundation is to invest its capital in the global financial markets and to retransfer its gains to the First Pillar Pension System. The objective is to stabilize the obligatory pension contributions by employees and employers in the long term. Unsurprisingly, the credibility of this legislative proposal sparked an intense public debate (see, for instance, Deutsche Aktuarvereinigung e.V. [DAV], 2024).

Related to occupational pensions only minor legal changes were proposed in spring 2024 (like enlarged possibilities for companies to participate at a “pure DC” pension scheme even they are not part of the initial collective agreement; see, e.g.,“Betriebsrente wird modernisiert” (2024) and the analysis of the draft law in “Zwischen Stärkung, Wurf und Abwarten” (2024)).

Additionally a new committee of experts from the government and external stakeholder groups, including insurers, investment companies, state consumer representatives and academics, was finally established in December 2022. The final report of this expert committee was published in July 2023 (see Bundesministerium für Finanzen [BMF], 2023).

One of major recommendations from this expert committee is not to abolish the Riester Pension, but to reform it through several measures, some of which include the following:

- Extension of eligibility to include self-employed individuals.
- Greater flexibility for product providers and policyholders during the contribution phase, by reducing the impact of the minimum return guarantee.
- Authorization of not only lifelong annuities but also temporary annuities during the payout phase.

Every citizen should have the possibility to establish a "private retirement account" into which they can consolidate all pension contracts eligible for state subsidies. Independent comparison websites should be created to provide pre-contractual information on aspects such as risk diversification, guarantee models, costs, real returns, etc. These measures are intended to encourage the development of basic, simplified pension products, with limitations placed on fees for changing product providers during the accumulation phase. But until August 2024, despite several public statements, no legislative proposal was published by the Federal Ministry of Finance.[4]

Additionally, in February 2021, the law for the new national digital pension tracking system (PTS)—*Digitale Rentenübersicht*—entered into force. This innovation aligns with similar initiatives in other EU member states that aim to provide citizens with an overview of all entitlements in the three basic pension pillars. After an initial trial phase, the PTS officially launched in June 2023 with a reduced number of participating institutions and companies, with plans for further continuous expansion.[5]

Only in subsequent Pension Reports will it be possible to analyse which of the recommendations from the expert committee for the reform of the Riester and other pension plans will be adopted, and to what extent the new digital pension tracking system is welcomed and used by the future retirees and current beneficiaries.

[4]Some general indications were announced by a high representative of the Federal Ministry of Finance at a conference on life insurances in August 2024: product standardization, possible online distribution without obligatory advice, no inclusion of other biometric risks than longevity, no obligatory annuitisation, no cap of costs, etc., see "Neue geförderte Altersvorsorge wird konkreter -" (2024).

[5]Cf. Website of the national Digital Pension Tracking System (*Digitale Rentenübersicht*): https://www.rentenuebersicht.de/DE/01_startseite/home_node.html

Table DE.3 – Overview of the German pension system

Pillar I	Pillar II	Pillar III
Mandatory State Pension System (GRV)	Mostly voluntary occupational pension schemes	Voluntary individual annuities
All persons subject to social security charges contributed 18.7% of their gross income to the scheme	Employees have the right to a deferred compensation arrangement – employers have the right to choose the scheme	Mainly supplement of Pillars I and II Pension Plans
Additional special pension regimes for self-employed and employees of the public administrations on local, regional and federal levels.	Occupational Pensions are offered by five different "implementation vehicles" (*Durchführungswege*), partly supervised by the NCA, BaFin.	*Riester* pensions or *Rürup* pensions (state-subsidized) and life-long annuities provided by life insurers.
Mandatory for all employees who are subject to social security contributions	Voluntary or by collective agreement (employers / trade unions)	Voluntary
PAYG (*Umlagefinanzierung*)	defined benefit (DB), defined contribution (DC), hybrid	Annuities with classical or reduced guarantees, unit-linked or hybrid products
Quick facts		
Coverage (active population): 90% Gross replacement rate: 41.5%[1]	16.55 million contracts in 2023,[2] i.e. a little bit more than 30% of employees have an occupational pension plan.	About 15.5 million *Riester* contracts, 2.7 million *Rürup* contracts plus more than 20 million private annuity contracts in 2023.

[1] Organisation for Economic Co-operation and Development (OECD) data.
[2] GDV data.

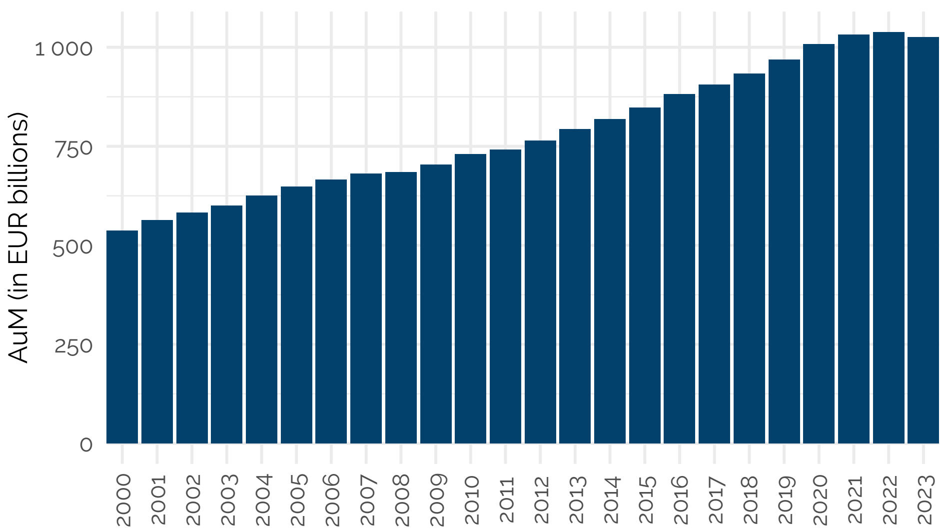
Long-term and pension savings vehicles in Germany

With regard to occupational and private pension products, life-insurers are the most important institutional investors when compared to IORPs and investment funds companies. For 2023, the following total AuM figures for these institutional investors had been published (Bundesanstalt für Finanzdienstleistungsaufsicht [BaFin], 2024a, p. 9; Bundesverband Investment und Asset Management e.V. [BVI], n.d.):

- Life-insurers: EUR 1 003.7 bln.;
- *Pensionskassen* (IORPs): EUR 206 bln.;
- *Pensionsfonds* (IORPs): EUR 58.7 bln.;
- Retail Investment Funds: EUR 1 458.8 bln. (including exchange-traded funds (ETFs), real estate funds and funds of funds, March 2024).

The figure for life insurers includes "direct insurances" (pillar II), state subsidised private pension plans (*Riester* and *Rürup* pensions), and private annuities (pillar III). The main reason for this particularity is that German life insurers are not only authorised to consolidate all their assets under one common investment portfolio, notwithstanding the source of capital (premiums from policyholders, loans, credits, bonds, dividends, etc.) to build their technical reserves. Additionally separate compartments for technical reserves are obligatory only for partially or fully unit-linked products, one-off contribution products or purely biometrical products.[6] Figure DE.1 illustrate the development of total AuM for life-insurers from 2000 to 2022:

Figure DE.1 – AuM in German life insurance contracts

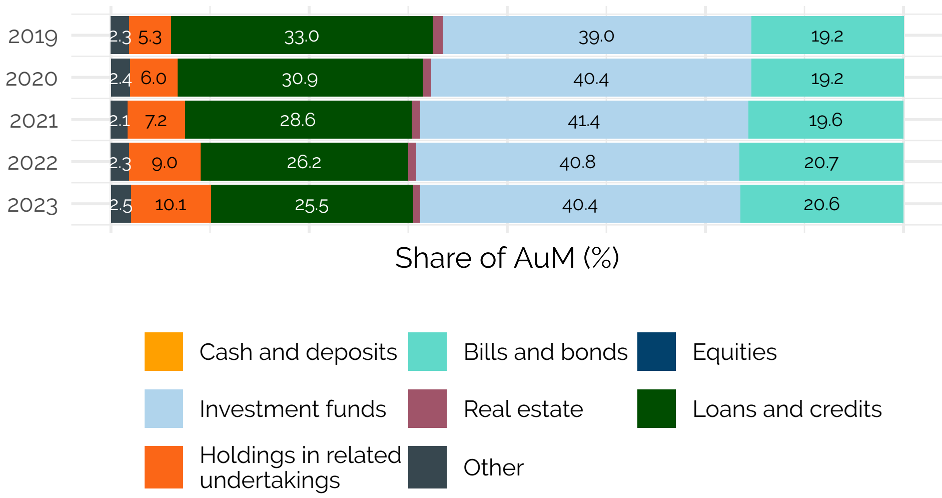


Data: GDV; *Calculations:* BETTER FINANCE.

[6]For more details on the specific legislation on investments (*Kapitalanlagen*) and technical reserves (*Sicherungsvermögen*) go to the BaFin website: https://www.bafin.de/EN/Aufsicht/VersichererPensionsfonds/Kapitalanlagen/kapitalanlagen_node_en.html

These figures clearly show that despite two global financial market crises (in 2008/09 and in 2020), life insurers have been able to slowly but consistently grow their assets under management. This is partly due to the fact that many retail investors or policyholders still equate "security" with "guarantees". In times of significant stock market downturns this may be an "experienced" attitude. However, it is also true that the "low for long" interest rate phase in the 2010s had a significant impact on the life insurers as well, as Table DE.4 shows.

Figure DE.2 – Allocation of assets invested in German life insurance contracts



Data: GDV; *Calculations:* BETTER FINANCE.

These tables show a strong ambiguity. On the one hand, life insurers achieved a constant growth of their AuM for many years which can be interpreted as a success of their reputation as institutional investors among retail investors and policyholders. Despite the gradual decline in net returns on their AuM, they have managed to maintain positive returns. From a consumer's perspective, this may not seem highly detrimental, as long as inflation rates remained lower, but such a purely "nominal" view neglects the danger of "missed opportunities" for returns compared to stock markets.

This ambiguity has not gone unnoticed by an increasing part of retail policyholders, as evidenced by the fact that traditional life-insurance products based on guarantees lost their dominant position. Instead hybrid and unit-linked products, as well as products with reduced capital guarantees, have become more prominently important in new business. Of course, this shift was driven by life insurers themselves, because during the very low-interest-rate phase, especially in the second half of the 2010s, they sought to reduce the obligatory capital requirements linked to guarantees. This will be outlined more in detail in the next paragraph.

Table DE.4 – Net interest rates of German life-insurers' AuM (2000—2023)

Year	Net interest rate
2000	7.51%
2005	5.18%
2010	4.27%
2011	4.13%
2012	4.59%
2013	4.68%
2014	4.63%
2015	4.52%
2016	4.36%
2017	4.49%
2018	3.59%
2019	3.92%
2020	3.74%
2021	3.57%
2022	2.16%
2023	2.27%

Data: GDV

Second pillar: Implementation Types of Occupational Pension Plans

The main distinction of the German occupational pension system, in contrast to that of most other EU member states, is that the so-called institutions for occupational retirement provision (IORPs) do not play a dominant role. In the Netherlands, for example, IORPs like pension funds command a market share in occupational pensions of at least 70%, while the German IORPs (*Pensionskassen* and *Pensionsfonds*) together only reach a market share of about 25% in this pillar of retirement provision.

The reason for this difference is that three other "implementation types" of occupational pension plans have been dominant in the past and continue to play a significant role today: "book reserves" (or "direct pension commitments" / *Direktzusagen*) offered by employers, "support funds" (the oldest type of occupational pension saving institutions like mulutal companies, often founded by the employers / *Unterstützungskassen*) and so-called "direct insurances" (*Direktversicherungen*) offered by life insurers and supported by a special tax regime for both employers and employees. IORPs such as *Pensionskassen* (PK) and *Pensionsfonds* (PF) only began to gain momentum from 2002 onward, following favourable changes to the tax regime. "Book Reserves" and "Support Funds" are not subject to the supervision of BaFin, but most of them reinsure their pension savings, and reinsurers are supervised by the NCA (for more details on the five "implementation types" of occupational pensions, see BaFin, 2012).

A little more than 30% of all employed persons in Germany are members of an occupational pension scheme (for more details, see BMAS, 2020, 2022).

Table DE.5 – Total numbers of occupational pensions in Germany (mln. contracts, 2000—2023)

Year	Direct insurances	Reinsured occ. Pensions	*Pensionskassen*	*Pensionsfonds*	Total
2002	5.83	1.80	0.45	0.02	*8.10*
2005	5.85	2.27	2.67	0.08	*10.87*
2010	6.75	2.76	3.38	0.32	*13.21*
2015	7.74	3.28	3.75	0.53	*15.30*
2016	7.89	3.34	3.74	0.47	*15.44*
2017	8.11	3.47	3.71	0.49	*15.78*
2018	8.37	3.52	3.69	0.52	*16.10*
2019	8.49	3.52	3.68	0.56	*16.25*
2020	8.57	3.58	3.63	0.60	*16.38*
2021	8.69	3.63	3.57	0.56	*16.45*
2022	8.80	3.66	3.51	0.60	*16.57*
2023	8.78	3.71	3.41	0.65	*16.55*

Data: GDV.

Table DE.6 – GWP of *Pensionskassen* and *Pensionsfonds* (EUR mln., 2015—2023)

Year	*Pensionskassen*	*Pensionsfonds*
2015	2 818.7	1 836.5
2016	2 724.3	1 367.6
2017	2 623.0	1 515.5
2018	2 495.2	756.4
2019	2 406.4	1 329.3
2020	2 294.5	1 038.3
2021	2 237.9	1 296.6
2022	2 024.9	2 231.1
2023	1 923.1	1 098.7

Data: GDV.
GWP of Direct Insurances are not disclosed separately.
Figures are sometimes rectified in the following year.

To some extent, the five different financing methods compete with each other,[7] although it is also possible to combine two or more types. Both employers' and employee's contributions to occupational pensions are usually voluntary, mostly

[7] Just one example: surprisingly in October 2020 Allianz announced that its *Pensionskasse* will go into run-off and will offer only "Direct Insurances" from 2022 on. It was the second biggest PK in Germany with more than 838 000 future beneficiaries and more than 27 500 current beneficiaries (balance sheet: EUR 12.8 billion) in 2018. The main raison for this decision was the ongoing low interest rate phase and the problem of guarantees given. If one of the biggest players in the national market takes such a step, it was interpreted as a sign that other smaller IORPs could follow. Cf. comment in Bazzazi (2020).

through a mechanism known as "salary conversion" or *Entgeltumwandlung.* However, employers have to offer at least a direct insurance pension contract, so that employees may benefit from tax advantages (deferred taxation) and savings on social security contributions if they choose to contribute. When there is a binding labour agreement, occupational pensions are generally organised for entire industrial sectors, and employees do not have the right to demand different occupational pension provisions. Many collective agreements also oblige employers to participate financially in occupational pension plans and restrict the employer's ability to choose a different scheme. Occupational pensions are structured as deferred compensation, and contributions are subsequently exempt from taxation and social security contributions up to certain limits. This, in turn, reduces claims on the statutory first pillar pension system.

Table DE.7 – Assets under Management by *Pensionskassen* and *Pensionsfonds* (EUR bln., 2005—2023)

Year	*Pensionskassen*[1]	*Pensionsfonds*[2]
2005	86.2	—
2006	92.6	—
2007	98.9	13.4
2008	104.2	12.7
2009	107.9	16.3
2010	109.6	24.0
2011	115.8	25.0
2012	123.3	26.5
2013	131.0	26.6
2014	139.1	29.5
2015	147.7	29.4
2016	154.1	31.7
2017	162.2	32.4
2018	168.5	40.8
2019	176.9	45.5
2020	184.5	51.1
2021	192.9	54.0
2022	200.2	54.7
2023	206.0	58.7

Data: ADD SOURCES.
[1] Mostly the rectified figures in the Annual Report of BaFin of the following year were taken.
[2] AuM on behalf of employees and employers.

Pensionskassen and *Pensionsfonds* fall under the category of institutions for occupational retirement provision (IORPs) and are regulated under Directive EU/2016/2341 (the "IORP Directive"). However, there is a unique aspect in the national supervisory insurance law: *Pensionskassen* (PK) have the option to choose a different purely national supervisory regime, a choice mainly exercised by those PKs considered competitive IORPs (*Wettbewerbs-Pensionskassen*). This allows them to offer their pension plans to an unlimited number of employers, similar to specialised occupational pension insurers. Somewhat misleadingly, this option is called "deregulated" IORPs.

Table DE.8 – Amounts of net pay-outs (after obligatory social contributions, before taxes) of occupational pensions in Germany in 2019

Amount (EUR)	Men (%)	Women (%)
1000>	17	3
500-1000	17	11
200-500	25	23
<200	41	63

Data: Arbeitsgemeinschaft für betriebliche Altersversorgung e. V. (aba); *Calculations*: BETTER FINANCE.

These figures show that for nearly half of men and nearly two thirds of women, payouts from occupational pensions do not represent more than a small "add-on" to their first pillar pensions. Unfortunately, it is the national legislator itself that plays a significantly negative role in determining the effective payout amounts (cf. next section on charges on Page 19).

Similar to private annuities offered by life-insurers, occupational pensions, too, were largely dominated by pension schemes based on guarantees,[8] and only the "low for long" interest rate phase of the 2010s could break this dogma at least partly. From 2018 onwards, a new law authorised so-called "Pure Defined-Contribution" pension schemes (*Reine Beitragszusage*), but it took another four years for collective agreements to be reached to implement at least three of these new pension plans, which can be offered by *Pensionskassen* (PK), *Pensionsfonds* (PF), or "direct insurances".[9]

The persistent challenge of shifting away from the traditional mindset of equating "security" with "guarantees", both among employers and trade unions as well as employees, remains a crucial task for broader financial education efforts aimed at promoting an "investment" or "shareholder culture" (*Aktienkultur*).

Third pillar: Private life-long annuities with and without state subsidies

In contrast to private lifelong annuities offered by life insurers, there are two categories of private pension products that are "certified" as eligible for specific state subsidies and which are therefore classified differently from a purely legal point of view:

- *Rürup* Pensions (which can be offered by life insurers and investment companies): Pillar I.

[8] For more details on the different options to offer occupational pensions (*Versorgungszusagen*) with and without certain minimum payouts or guarantees (similar to life-insurers) and the importance of the sponsors, see Arbeitsgemeinschaft für betriebliche Altersversorgung (n.d.).

[9] For more details on the "Law strengthening occupational pensions", cf. **FFSA2012WhatAretheDifferencesbetweentheVehiclesforOldAgeProvision<empty citation>** and Arbeitsgemeinschaft für betriebliche Altersversorgung (aba, 2017).

- *Riester* Pensions (which can be offered by life insurers, investment companies, banks and real estate loan and savings institutions): Pillar II.

For the sake of simplicity, we have included them in the chapter on the third pillar private pensions, which can be justified because the main contributors are retail investors and policyholders.

The main reason *Rürup* Pensions are legally classified as belonging to Pillar I pensions is the stringent framework they operate within, especially with regard to the payouts. Contributions are allocated for monthly life-long annuities, starting with the retirement phase at the age of 62 (or at the age of 60 for contracts concluded before 2012), and there is no possibility of lump-sum payments. The benefits are personal, thus non-transferable, and cannot be disposed of or converted into capital.

Rürup pensions, specifically designed for self-employed individuals and freelancers who were not eligible for state-supported pension savings before its establishment, are advantageous for those with higher revenues because of the high tax-exempt savings amount. They take the form of annuity contracts that are, in contrast with *Riester*, non-redeemable. It is also possible to subscribe to *Rürup* pension contracts that invest in investment funds through savings plans. Such contracts can be designed with or without capital guarantees.

Rürup Pensions were introduced in 2005. Table DE.9 shows the number of concluded contracts from inception to the present day.

Table DE.9 – Number of *Rürup* pensions (or *Basisrente*, million contracts)

Year	Nb. of contracts
2005	0.1480
2010	1.2770
2015	1.9750
2020	2.3960
2021	2.4770
2022	2.5740
2023	2.6976

Data: GDV.

Rürup pensions receive subsidies from the state exclusively through broad tax exemptions during the contribution phase. For more details on these particular provisions, please refer to the chapter on taxation below.

In contrast to *Rürup* Pensions subscribers of *Riester* pension plans receive state subsidies through both direct allocations and tax reimbursements when certain thresholds are met. The amount received depends on personally invested contributions. Allocations are at their maximised when the total contributions to a *Riester* product (that is, personally invested contributions plus allocations) reach at least 4% of the individual's previous year's income, up to a maximum of EUR 2 100.

The allocations add up to EUR 175 per adult (according to the pension law of summer

2017), plus EUR300 for each child born since 2008 and EUR 185 for those born before 2008. Subscribers that are younger than 25 receive a bonus of up to EUR 200 at the moment of subscription to a *Riester* product. The minimum contribution to receive the full allocations is EUR60 per year. If the calculated minimum contribution for a low-income earner is less than EUR 60, this minimum contribution of 60 euros must nevertheless be paid in order to receive full support. If an individual contributes less than their minimum requirement (4% of the previous year's income, with a maximum of EUR 2 100, minus any applicable allocation, but at least EUR 60 per year), their subsidies are reduced proportionately.

Riester pension benefits can be paid out starting at the age of 62, or at the age of 60 for contracts concluded before 2012. Subscribers have the option to convert the invested capital into a life annuity, or choose a programmed withdrawal, where up to 30% of the accumulated savings can be paid out as a lump-sum. Furthermore, at least one fifth of the accumulated savings is reserved for life annuities starting at the age of 85. For more details on all these specific provisions, please refer to the chapter on taxation below, with additional references.

As already pointed out in the Introduction, four types of pension products are allowed for *Riester* pension plans:

- Bank savings plan (*Banksparplan*): These contracts are typical long-term bank savings plans with fixed or variable interest rates.
- Annuity contract (*Rentenversicherung*): These *Riester* plans, offered by insurance companies, come in three forms. There are traditional annuity contracts with guaranteed returns and additional bonuses. Additionally, there are hybrid contracts where a part of the retirement savings is invested in investment funds. They consist of both a guaranteed part and a unit-linked part that depends on the performance of the investment funds.
- Investment fund savings plan (*Fondssparplan*): Savings are unit-linked and invested in investment funds chosen by the subscriber from a pool of funds proposed by a financial intermediary or the investment company. The intermediary or the investment company has to at least guarantee that the invested money, along with the state's subsidies, are available at the time of retirement. In the case of premature withdrawals, a loss of capital is possible.
- Home loan and savings contract (*Wohn-Riester/Eigenheimrente*): These contracts take the form of real estate savings agreements. This is the most recent type of *Riester* scheme and is based on the notion that rent-free housing at old age is a sort of individual retirement provision comparable to regular monetary payments.

Riester pension plans were introduced in 2001. Table DE.10 shows the number of concluded contracts from inception to the present day.

These figures clearly demonstrate what was already outlined in the Introduction: the most important "breakthrough" in *Riester* pension plans took place from 2005 to 2011,

Table DE.10 – Number of *Riester* pensions (mln. contracts)

Year	Annuity contracts	Bank savings plans	Investment fund savings plans	Home loan and savings contracts	Total
2001	1 400	—	—	0	*1 400*
2002	2 998	150	174	0	*3 322*
2003	3 451	197	241	0	*3 889*
2004	3 557	213	316	0	*4 086*
2005	4 524	260	574	0	*5 358*
2006	6 388	351	1 231	0	*7 970*
2007	8 194	480	1 922	0	*10 596*
2008	9 285	554	2 386	22	*12 247*
2009	9 995	634	2 629	197	*13 455*
2010	10 484	703	2 815	460	*14 462*
2011	10 998	750	2 953	724	*15 425*
2012	11 023	781	2 989	953	*15 746*
2013	11 013	805	3 027	1 154	*15 999*
2014	11 030	814	3 071	1 377	*16 292*
2015	10 996	804	3 125	1 564	*16 489*
2016	10 931	774	3 174	1 691	*16 570*
2017	10 881	726	3 233	1 767	*16 607*
2018	10 827	676	3 288	1 810	*16 601*
2019	10 773	627	3 313	1 818	*16 531*
2020	10 687	592	3 297	1 793	*16 369*
2021	10 672	546	3 263	1 730	*16 211*
2022	10 514	529	3 200	1 650	*15 893*
2023	10 254	511	3 153	1 593	*15 511*

Data: Bundesministerium für Arbeit und Soziales (BMAS).

when allocations had reached their final highest levels, and additional real estate savings plans were introduced. Subsequently, the public debate on costs and low returns intensified,[10] resulting in a decline in new business, which nearly came to a complete stop from 2018 onwards. The future of *Riester* pension plans will hinge on the implementation of innovations recommended by the new expert commission of the Federal Ministry of Finance in July 2023.

Besides these state subsidised private pension plans, there is a substantial market for life insurances and private annuities that have benefited from special tax regimes established for decades. In the following chapter on taxation, we will delve into the significant impacts of the fundamental change in the tax regime to deferred taxation for all pension pillars since 2005. First, however, we will focus on the quantitative changes amongst the various categories, differentiating between traditional life insurance and life-long annuities, as already indicated in the Introduction.

[10] One of the first criticisms was published by German Institute for Economic Research (DIW Berlin) in 2012, see Deutsches Institut für Wirtschaftsforschung (2012).

In Germany the main distinction between life insurances and "annuity insurance" (*Rentenversicherungen*) lies in their coverage of different biometric risks: Life insurance covers the death risk (with a fixed insured sum) while annuities cover the risk of longevity (through a life-long pension). Of course, it is possible to combine the two biometric risks: life insurances usually offer (at the end of the accumulation phase) the choice between a lump sum payout or a life-long pension (*Kapitalwahlrecht*), and the same applies to deferred annuity contracts, that include the accumulation phase (in contrast to "immediate annuities" [*Sofortrenten*]) based on a lump sum contribution). When a policyholder of an annuity chooses the life-long pension option, it is mostly possible to include a period during which the pension will be paid to another person fixed in the contract, in case the policyholders dies shortly after the beginning of pension payouts (usually this period is limited to ten years: *Rentengarantiezeit*).[11] As the inclusion of a *Rentengarantiezeit* will increase the calculated costs of the biometric risk coverage, in consequence the payouts for the annuity will be reduced proportionately.

Additionally, there are pure risk or term life insurances (*Risiko-Lebensversicherungen*) that solely cover the risk of death without including an investment component in the premium. Usually these contracts are concluded for a fixed period, and if the insured loss (i.e. the death risk) does not occur, there are no payouts either during the term or at the end of the contract period.

Table DE.11 displays, based on statistics from GDV, long-term trends in the number of contracts among life insurances, annuities, and term life insurances.

Table DE.11 – Number of life insurance, annuities and term life insurance contracts

Year	Life-insurances (%)	Annuities (%)	Term life-insurances (%)	Total number of contracts (mill.)
2000	72%	12%	16%	*87.6*
2005	58.6%	26.1%	15.3%	*94.2*
2010	47.5%	38.9%	13.6%	*90.5*
2015	38.1%	46.7%	15.2%	*86.7*
2020	28.2%	55.1%	16.7%	*83.4*
2021	26.7%	56.8%	16.5%	*82.7*
2022	25.2%	58.4%	16.4%	*81.8*
2023	23.9%	59.2%	16.9%	*81.4*

Data: GDV.

The most notable change that can be observed is the slow, but constant loss of market share of traditional "capital life-insurance". Their market share of new business (in terms of the number of contracts) was only 7.0% in 2022, the lowest figure

[11] For more details on these basic differences, go to the Information Sheet ("Private Rentenversicherung") of the German Association of Insured (BdV): https://versicherungscheck.bundderversicherten.de/de/hilfe-und-informationen/alterssicherung-bav-kapitallebensversicherung-rentenversicherung.html.

ever recorded (due to the rise of interest rates this market share increased to 7.4% in 2023). This is in stark contrast to annuities which grew up to represent 46.1% of all life-insurance categories (in 2023). Within the annuities category, unit-linked products had a market share of 14.1%, hybrid products or those with reduced guarantees accounted for 26.2% and products with classical guarantees constituted 5.9%. In contrast to these growing figures, pure unit-linked life-insurances reached a market share of only 1.8% in 2023. These figures clearly show that German policyholders shifted away from traditional 100% capital guarantees whilst also avoiding full capital market risks without any guarantees (Gesamtverband der Versicherer [GDV], 2024a, pp. 10-11, Tabelle: Lebensversicherung – Zeitreihe eingelöster Neuzugang, Anzahl in Tausend, Anteile in Prozent).

Charges

Germany belongs to those EU member states in which the commission-based distribution channels for life-insurances as well as for all other insurance classes are the most important ones. Unfortunately the publicly available figures do not show the real impact of these charges on pensions on the level of the product category in a transparent way. Prospective policyholders or beneficiaries are, of course, informed about the total distribution costs through various pre-contractual information documents when they have selected a particular pension product from pillar II or III.

Charges of life insurances: The burden of commissions

Related to occupational pensions, acquisition fees are mainly relevant for "direct insurances" and so-called "competitive" IORPs. Since "direct insurances" are offered by life-insurers, costs are usually lower than the average figures for life-insurers outlined in this paragraph below (mainly due to collective contracts with the employer, which differ in each particular case). In contrast to most *Pensionskassen*, so-called "competitive" IORPs (*Wettbewerbs-Pensionskassen*) may offer their contracts to an unlimited number of employers or sponsors. According to BaFin in 2021, there were about 20 "competitive" out of a total of 134 *Pensionskassen*.

While the lack of comparability at the level of product categories is a concern,[12] this does not mean that prospective and ongoing members and beneficiaries of these IORPs are not informed about acquisition and administration costs by the product providers. The national legislator has established strict provisions regarding the disclosure of costs based on EU regulations (IORP II Directive) and additional national supervisory laws (as well in the pre-contractual information documents as during the contribution and/or pay-out phases by the Pension Benefit Statements, and in the annual business reports).

Unfortunately, the most important burden on beneficiaries of occupational pensions

[12] BaFin regularly publishes figures on distribution and administration costs of *Pensionskassen* as well in total for all PK as for particular PK via special Excel tables (tables 240 and 260 included in the "Statistics on Insurers – section: Pensionskassen"), but these tables can only be found and interpreted by very experienced policyholders with a highly advanced level of financial education (https://www.bafin.de/SharedDocs/Downloads/DE/Statistik/Erstversicherer/dl_st_22_erstvu_pk_va.html).

is imposed by the national legislator: in 2004, the Social Democrat Minister of Health introduced mandatory contributions from beneficiaries of occupational pensions to public health insurance. These mandatory contributions reduce the payouts by about 15% (only monthly payouts up to EUR 176.75 in 2024 are exempted). Many actions have been taken against this law, but no federal government, regardless of the party coalition in power, has revised this law until now. This conflict can be considered a fundamental conflict between two pillars of the social security system (health versus pensions), with health as the "winner" over pensions.

Charges of life insurances: The burden of commissions

Table DE.12 shows that there seems to be—in total—a slow, but constant decrease of the burden of acquisition and administration fees over the last 20 years

Table DE.12 – Costs and charges of German life insurance contracts (% of assets unless otherwise specified)

Year	Acquisition fees*	Admin. and mgt. fees
2000	5.60%	3.50%
2001	5.50%	3.50%
2002	5.40%	3.50%
2003	5.00%	3.40%
2004	4.50%	3.30%
2005	5.60%	3.20%
2006	4.90%	3.00%
2007	5.20%	2.90%
2008	4.90%	2.80%
2009	5.20%	2.70%
2010	5.10%	2.40%
2011	5.00%	2.40%
2012	5.00%	2.40%
2013	5.10%	2.30%
2014	5.00%	2.20%
2015	4.90%	2.30%
2016	4.80%	2.30%
2017	4.70%	2.30%
2018	4.60%	2.30%
2019	4.40%	2.10%
2020	4.50%	2.10%
2021	4.50%	2.10%
2022	4.70%	2.40%
2023	4.50%	2.50%

Data: GDV; *Calculations:* BF. * % of premiums

But this impression of a slow but constant decrease in the total sum of charges is somewhat misleading from a consumer perspective, because, unlike retail investment funds, life insurers do not rely solely on the ongoing premiums of policy holders. As shown in Figure DE.2, life insurers have access to a wide range of diverse sources of income (for example, life insurers are issuers of their own corporate bonds), which are all included in the total amount of AuM.

Therefore, usually, acquisition fees of life insurers are calculated in relation to the GWP for new business each year, while ongoing administrative fees are determined based on the total premiums earned each year. These percentage figures are shown in Table DE.12. But these percentage figures do not disclose the real cost problem of life-insurers. By looking at the absolute amounts of these costs, displayed in Table DE.13, it becomes obvious that over the last 20 years, acquisition fees have consistently been three to four times higher than administration fees.

Table DE.13 – **Absolute amounts of acquisition and administration costs of life-insurers (EUR bln.**

Year	Acquisition costs (EUR bln.)	Administration costs (EUR bln.)
2000	6.696	2.143
2005	7.323	2.305
2010	7.987	2.100
2015	7.162	2.040
2016	7.055	1.989
2017	6.840	1.995
2018	7.037	2.027
2019	7.540	2.035
2020	7.720	2.075
2021	8.349	2.107
2022	7.986	2.223
2023	7.892	2.220

Data: GDV.

The conclusion is clear: the commission-based distribution channels are the real cost drivers for life-insurers. In 2022 and 2023, the reduction of the total amount of acquisition costs (in absolute figures) is simply due to the fact that new business sharply declined (compared to 2021; measured as a percentage of GWP of new business the figures are stable).

Additionally, it is worth noting that GDV only discloses the total sums for these costs, rather than detailed figures for the various product categories such as occupational direct insurances, state-subsidised *Riester* and *Rürup* pensions, or private classical, unit-linked and hybrid annuities. While there are many costs and returns analyses conducted by scientific institutes, private rating agencies, economic and financial magazines, and BaFin (2022b), these figures are not regularly published. To compare calculated costs, one must rely on pre-contractual KIDs (based on EU regulations for private life insurances and annuities), or the pre-contractual "Product Information Sheets" (PIB, based on national legislation) for *Riester* and *Rürup* pension contracts, similar to occupational pensions.

Taxation

In 2002, the Federal Constitutional Court (*Bundesverfassungsgericht*) took the fundamental decision to force the legislator to introduce "deferred taxation" as the new system for pension taxation. This new system exempts contributions from taxation and taxes only the pay-outs (from TEE, *vorgelagerte Besteuerung*, to EET, *nachgelagerte Besteuerung*). This fundamental change had to be applied to all three pillars of the pension system. As a result, the federal government established a scientific committee under the leadership of Finance Professor Bert Rürup (*Rürup-Kommission*). This commission worked out the details and presented its report in 2003. Due to this crucial reform, which entered into force in 2005, life insurances lost their unique privilege of non-taxed lump sum payouts, which constituted one of the major reasons for their overwhelming success in distribution practices up to that year.

Table DE.14 – Taxation of pension savings in Germany

Product	Phase			Regime
	Contributions	*Investment returns*	*Payouts*	
Life insurances	Exempted	Exempted	Taxed	EET

Source: German tax authority.

First pillar pensions

Following the proposals of the *Rürup-Kommission*, a transitional period of 35 years began in 2005 to implement the shift from the TEE to the EET regime. In 2005, for all pensions which started that year, 50% of the total payout amount was taxed at the individual tax rate. This percentage of the total payout amount subject to taxation increased by 2% each year until 2020, and from 2020 onwards by 1% per year, in order to reach 100% of the payouts in 2040 for new pension recipients each year. For reasons of social justice, there is a downward cap to exempt low pensions from any taxation (*Rentenfreibetrag*). At the same time there is an algorithm to reduce the taxation of mandatory contributions to the pensions system over time (for more details on the taxation system, see Deutsche Rentenversicherung, n.d.).

Occupational pensions (Pillar II)

Payouts from *Pensionskassen* and Direct Insurances which started before 2005 typically remain exempt from any taxation (at least five years of contributions and a twelve-year contract duration). Payouts from any kind of implementation type of occupational pension plans that started in 2005 or later are fully taxed based on the individual tax rate.

Contributions to all five "implementation types" of occupational pensions are exempt from mandatory contributions to the social security system up to a certain limit (in 2024, this limit is set at EUR 3 624 as *Beitragsbemessungsgrenze*: this limit represents 4% of the income up to which employees have to pay mandatory contributions to the First Pillar Pension System). The double of this amount, which in 2024 is EUR 7 248, is exempt from taxes when making contributions to PK, PF and Direct Insurances. Additionally, there is even a full exemption from taxes without any limit for contributions, if these are made for book reserves or support funds (for more information, see Deutsche Rentenversicherung, n.d.).

Private Pension Plans state subsidised (*Riester* and *Rürup* Pensions)

Following the principle of deferred taxation (EET) contributions are exempt from taxes up to certain limits. For *Riester* pension plans, the maximum limit is EUR 2 100 per year (or 4% of the personal gross income / year for lower incomes). For *Rürup* pension plans this maximum limit is much higher (in 2024 up to EUR 27 565, which is linked to a special regulation of the first pillar pension system).

In the payout phase both types of these state subsidised private pension plans are fully subject to the individual taxation rate (for more information see Bund der Versicherten [BdV], n.d.).

Life-insurances and private annuities

Contributions are no longer tax-deductible as special expenses and have to be made from taxed income. The benefits of life insurances (i.e. the difference between contributions and total pay-outs) are taxed during the retirement phase at the general tax rate of 25% (like for all investment returns), but there are some limited possibilities to recover a portion of these taxes through the individual yearly tax declaration.

Furthermore, it is important to differentiate between whether the insurance benefit is provided as a one-time lump-sum payment or if a lifetime annuity payment is chosen. In the case of lump-sum payouts, if the contract has been in force for at least 12 years and the insured is older than 60 years, or 62 years (for contracts subscribed to after 31 December 2011), only 50% of the earnings are subject to taxation (*Halbeinkünfteverfahren*). If these conditions are not met, the full earnings are taxed.

In the case of private life-long annuities, additional tax relief is possible, depending on the age of the first retirement payout, as outlined in the tax table. For instance, if the retiree is 60 years old, 22% of the earnings are subject to taxation, and at the age of 65 only 18% (*Ertragsanteilbesteuerung*, for more information on the tax regime for life insurance and private annuities, see Leine, 2023).

Performance of German long-term and pension savings

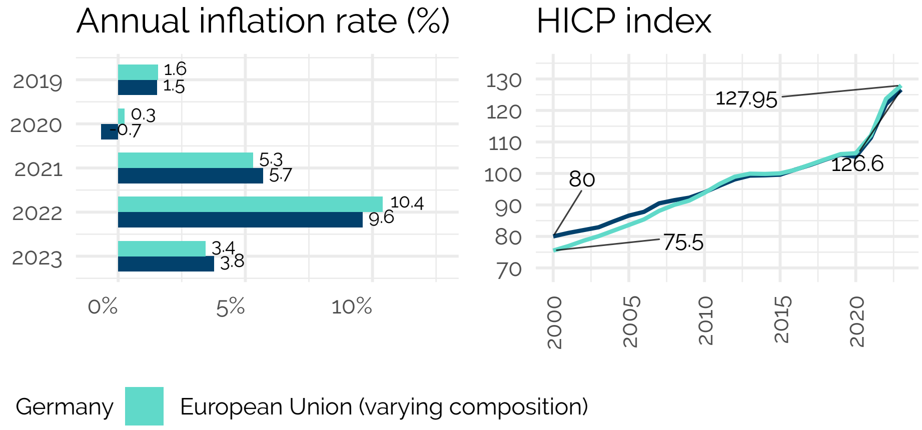
Real net returns of German long-term and pension savings

When examining the inflation figures in Germany (see Figure DE.3), it is obvious that for a very long time—especially during the first decade after 2000—inflation rates were at most as high as the EU average, often even lower. However, a dramatic change started in 2021. Germany does not belong to those EU member states most severely affected by the sudden and sharp rise in inflation rates (like the Baltic countries for example), but there are specific national reasons for the inflation increase exceeding the EU average. In 2021/22, the main reason was the full impact of the rise of energy prices caused by the strong dependency on petrol and gas from Russia, which had to be replaced after the onset of the Russian war against Ukraine in February 2022. In response, the Federal Government decided to help private households with substantial additional allocations in order to mitigate the direct impacts of this sudden price "attack" on family finances. In 2023 inflation strongly decreased in comparison to 2022, and the main driver of inflation shifted to food costs. In second place, the increasing salaries of employees in certain industry and artisan sectors, partly supported by trade union demands, are additional drivers of inflation (Siedenbiedel, 2023; Statistisches Bundesamt [DESTATIS], n.d.).

Figure DE.3 – Inflation in Germany

Period 2000–2023

	Annualised	**Cumulated**
Germany	2.0%	61.7%
European Union (varying composition)	2.3%	73.2%

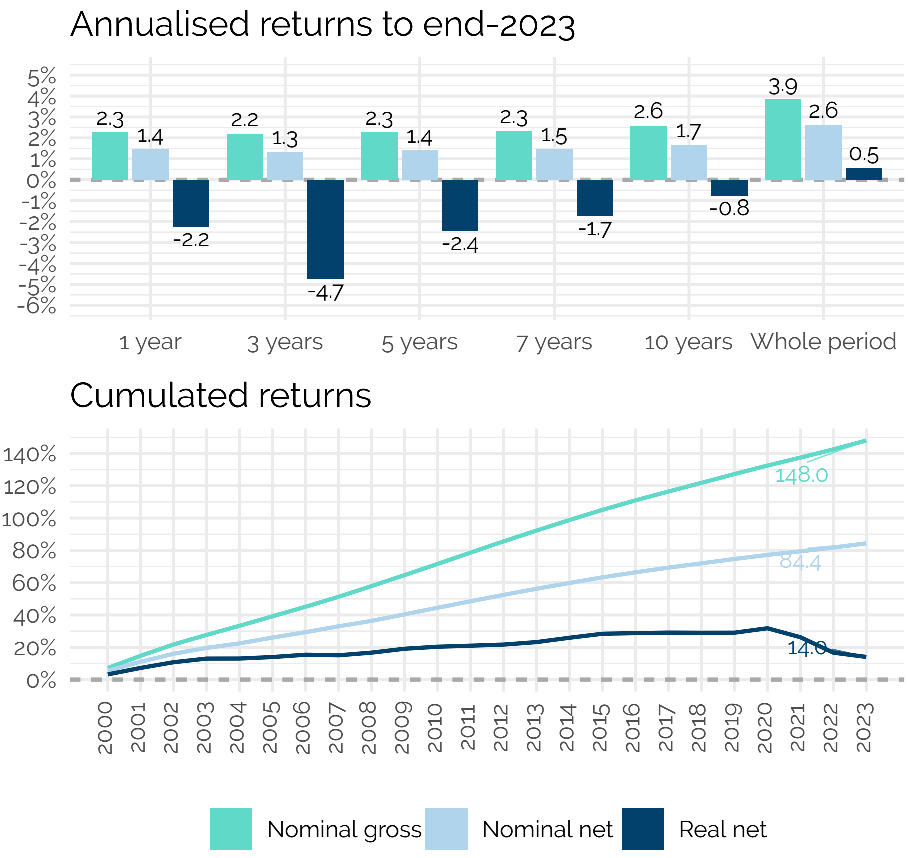


Data: Eurostat, HICP monthly index (2015 = 100); *Calculations:* BETTER FINANCE

Regarding life insurances and pensions, the opposing effects of inflation and rising interest rates on assets are clear: with regard to fixed-income securities, "hidden reserves" may diminish or even reach negative market values, while new investments will yield higher returns but only in the very long run. This perspective was clearly outlined by Frank Grund, the BaFin Executive Director for Insurances, in a public speech in November 2022 (BaFin, 2022a). However, by December 2022, it became obvious that some of the major life insurers reversed their approach and began increasing the bonuses for their products for the first time since the early 2010s (Assekurata Ratings, 2022, 2024; VersicherungsJournal Deutschland, 2022).

Looking at the annual performance of the life insurances displayed in Figure DE.4, it is

Figure DE.4 – Returns of German life insurance contracts (before tax, % of AuM)



Data: Gesamtverband der Versicherer (GDV), Eurostat; *Calculations:* BETTER FINANCE, h

clear that charges alone have consistently reduced the nominal return by a quarter to a third over the last twenty years. This fact can only be described as having a severe detrimental impact on the policyholders' stakes. It supports the conclusions already outlined in the chapter on charges, especially distribution charges, above.

Additionally, in contrast to former periods of inflation (for ex. in the 1970s), there is now an ongoing strongly negative difference between the level of inflation in Germany and the level of the ECB Key Interest Rate, even though the latter has been raised up to 4,5% in September 2023. Some economists refer to this situation as "financial repression" (on this topic, see, e.g., BETTER FINANCE, 2022). Fortunately this overall picture has considerably improved since mainly due to the decreasing inflation and stabilized, even somewhat reduced key interest rates.

As a consequence, as long as fixed-income securities remain a major part of the asset allocation for life insurers and pension funds, there is a substantial risk of a substantial loss of purchasing power for policyholders over the long term, even though some life insurers have made minor increases in bonuses. This long-term erosion of purchasing power will persist, even if inflation does not remain at its current very high levels.

The negative effects of inflation may be mitigated for certain beneficiaries of occupational pensions provided by *Pensionskassen* and *Pensionsfonds*. Some of these pensions scheme include a clause that obliges sponsors to increase their contributions in response to the ongoing inflation rate. Unfortunately, BaFin does not publish any figures regarding the number of IORPs that offer this contractual clause.

Do German savings products beat capital markets?

Figure DE.5 shows the comparison of the performance of life insurers with a balanced benchmark portfolio, the composition of which is presented in Table DE.15. Since capital guarantees during the accumulation phase play a dominant role in the German life-insurance market, we have selected a benchmark portfolio comprising 30% equities and 70% bonds.

Table DE.15 – Capital market benchmarks to assess the performance of German pension vehicles

Product	Equity index	Bonds index	Allocation
Life insurances	STOXX All Europe Total Market	Barclays Pan-European Aggregate Index	30.0%–70.0%

Note: Benchmark porfolios are rebalanced annually.

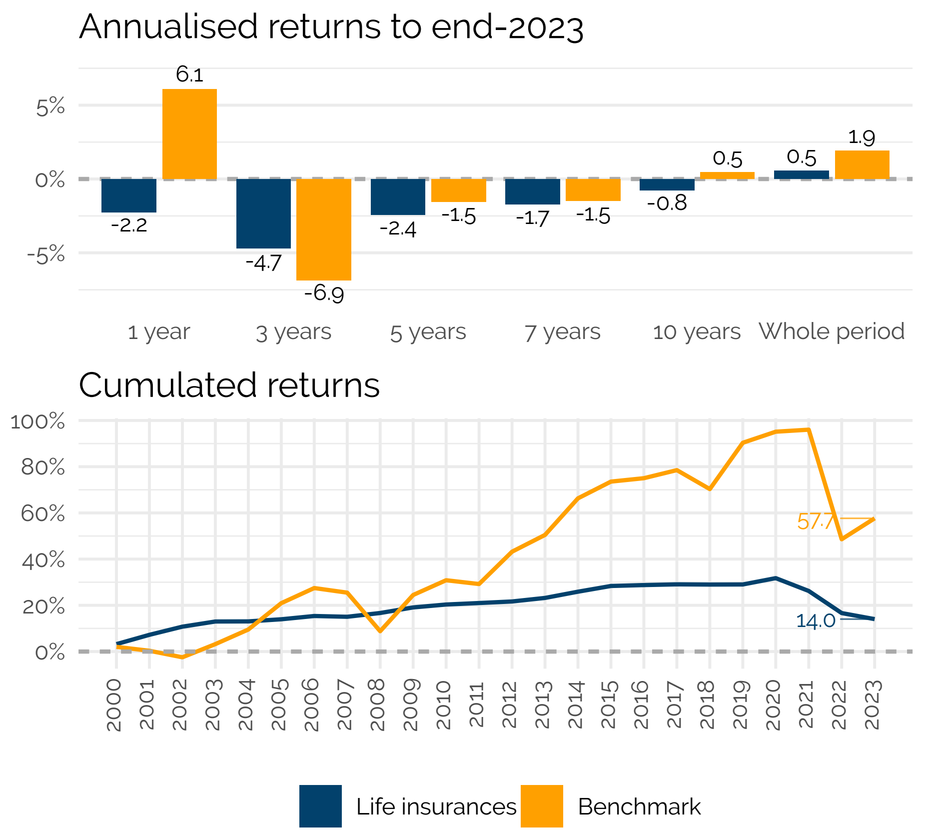
If this portion is changed by increasing the proportion of equities, the results are less favourable for the life insurers due to the higher "risk benefit" of the benchmark:

- 30/70: Cumulated returns of the benchmark 2000-2022: 48.60% (i.e., 7.36 pp below the 50/50 benchmark), 31.94 pp above the cumulated returns of life insurance contracts.
- 40/60: Cumulated returns of the benchmark 2000-2022: 52.89% (i.e., 3.07 pp below the 50/50 benchmark), 36.24 pp above returns of life insurance contracts.
- 50/50: Cumulated returns of the benchmark 2000-2022: 55.96%, 39.31 pp above the cumulated returns of life insurance contracts.

When assessing the return comparison, it's important to consider not only guarantees but also other specific insurance factors. We will outline some fundamental aspects such as life insurance as a "complex" product in itself, the emerging trade-off between "guarantees" and "security", and the necessary combination of the accumulation phase and decumulation phase for payouts.

When stating that life insurances are "complex" products in themselves, this implies that the "complexity" is not only linked to the mechanisms of the investment part of the premium but also with the "insurance wrapper" (EIOPA, 2022, pp. 90–106). In

Figure DE.5 – **Performance of German life insurance contracts against a capital market benchmark (returns before tax, after inflation, % of AuM)**



Data: Gesamtverband der Versicherer (GDV), Eurostat, Eurostat; *Calculations:* BETTER FIN
end-2023.

terms of costs that reduce the investment component of the total gross premium, it is essential to consider not only distribution and administration costs, but also biometric costs (for example, whether death risk is included or not).

The death risk can be covered both during the accumulation phase and the decumulation phase, whereas coverage for the risk of longevity is relevant only for the decumulation phase. We will come back on this second point later.

It is important to emphasise that any comparison of returns for life insurances can only be related to the investment part of the premium, not to the gross premium paid by the policyholder.[13] Therefore the transparent disclosure of the investment part of the gross premium by life insurers constitutes one of the fundamental "classical" demands by German consumer protectors (*Prämientrennung*—differentiation

[13]For more details on biometric risk coverage, cf. BaFin website on life-insurances: https://www.bafin.de/EN/Verbraucher/Versicherung/Produkte/LebenRente/leben_rente_sterbegeld_node_en.html.

of gross premium into three parts: investment part, distribution and administration costs, and costs of biometric risk coverage).

The issue of a potential conflict between the "guaranteed interest rate" (*Garantiezins*) included in a life insurance contract and the general promise of "security", especially during the accumulation phase, only emerged during the "low for long" interest rate phase. As long as the "guaranteed interest rates" were between 4% (in 2000) and 2,25% (in 2010) in the first decade after 2000, and the total benefits (*Gesamtverzinsung* including capital guarantees and bonuses) averaged around 7% in 2000 and 4% in 2010, life insurance could be considered as a "security" against the turbulences of global capital markets (especially during the two global financial crises in 2000/01 and in 2008/09).

However, this perception changed dramatically during the "low for long" interest rate phase throughout the 2010s, when the authorised maximum "guaranteed interest rate" dropped to 0,9% in 2017 and further to only 0,25% in 2022 (and the average total benefits of life insurers to 2,23% in 2020, see DAV, 2023; Walz, 2020). Following to a recommendation of the Association of German Actuaries (DAV) the Federal Ministry of Finance decided in April 2024 that this interest rate shall again be increased up to 1% from January 2025 on (see GDV, 2024b).

As already outlined in the previous chapter the consequences were clear: life insurers as well as policyholders broadly said "good-bye" to guarantees and accepted the fundamental change to products with more or less strongly reduced guarantees during to accumulation phase. It was shown by actuarial studies that reduced guarantees could help to increase at least nominal returns , even though the real results were and are still rather modest…

Even though it is a statistically proven general factor that life-expectancy and in consequence longevity are increasing slowly but constantly, in Germany there is the particular constellation that neither the average life-expectancy of the total population nor even the mortality tables of the association of actuaries are legally binding for the payouts of annuities, but only the particular calculation of longevity based on the actual annuity portfolio of each life insurer. This judicial condition explains why life-insurers make intense public relation work with regard to a possible underestimation of life-expectancy by the "average" policyholders (GDV, 2023).

Right now German policyholders cannot do much more than having "thrust" in the ongoing work of the supervisory authorities and their control of the actuarial calculations of longevity by each life-insurer separately (including the legal obligation to transfer any possible gains due to an over-calculation of biometric risks—be it death or longevity—back to the policyholders).

Admitted that a pure real return observation might not be sufficient for the total evaluation of the "suitability" especially of a pension product due to the longevity aspect, it should have become evident that German life insurers have a lot of legal discretion for "adjusting" the returns and benefits of their products by using factors like administration and distribution costs, reduced guarantees, longevity, etc. The situation becomes even more complex when taking into account the "turn-around" of key interest rates (*Zinswende*) in the Eurozone since 2021/22.

Conclusions

Like policyholders and insurers in other EU member states, German policyholders and insurers were also confronted with a phenomenon from mid-2022 onwards that they hadn't experienced for 14 years: within a little more than one year key interest rates set by the ECB rose from 0,0% in July 2022 to 4,5% in September 2023 (with only a tiny reduction back to 4.25% in June 2024). From March 2016 to July 2022, this key interest rate was fixed at 0,0% ("low for long" period), and only in July 2008, the rate had reached 4,25% before, after which a gradual but constant decline began. The crucial question now is whether this increase in the key interest rate will lead to a revival of the classical life insurance with strong guarantees or not. Of course, it is much too early for any definitive answer, nevertheless some assessments can be made.

- Life-insurers: most of them are increasing their bonuses but have not yet raised the "guaranteed interest rate" (only possible with authorization of BaFin). Given the ongoing high volatility in stock and real estate markets on the one hand and the Solvency II rules on the other, it does not seem very likely that they will make a significant shift in their distribution practices. So, as product providers, they will surely continue to focus on products with hybrid or reduced guarantees.

- Policyholders: The transition for German policyholders from full guarantees to hybrid or reduced guarantees represented a profound "learning process" that reshaped long-held attitudes. As a result, it's less likely that they will undergo another major change, especially considering that the younger generation, on average, is more inclined to act as retail investors using digital tools

- NCA, BaFin: it appears to be too early to make any announcements regarding a possible "turn-around" of the "guaranteed interest rate" authorised for life-insurers, because former "hidden reserves" have now turned into "hidden losses". However, there is at least some relief in the form of refunds from the obligatory "additional capital reserve" (*Zinszusatzreserve*) introduced in 2011 to secure the long-term payment obligations of the life insurers which started in 2023. Additionally, BaFin is closely monitoring whether the total number of early cancellations is rising due to the competition from new saving offers by banks, but as of now, this does not seem to be the case on a significant scale (with the exception of one-off contribution products).

As a result, as of 2023/2024, the only assessments that can be made are that the "turn-around" of the key interest rates (*Zinswende*) has not (yet) led to a noticable resurgence of classical life insurance contracts with full "minimum guarantees". At the same time it is much too early to give a definite assessment, whether the ongoing mitigation of the "financial repression" caused by high inflation rates was actually effective or not.

Life insurers (like banks) are not increasing the interest rates for their savings products in the line with the rise in key interest rates (and even if they did, this would not be enough to stop the long-term loss of purchasing power). So long-term "real" protection against inflation does not seem to be in place—a bitter truth just for German consumers.

Taking into consideration the inevitable conflict between long-term loss of purchasing power primarily associated with insurance-based pension products like annuities on one hand, and the desire and necessity for coverage of the biometric risk of longevity by many consumers on the other hand, there appears to be only one reasonable compromise: depending on the risk awareness or "risk appetite" policyholders should allocate only a proportionate part of their total retirement savings into an annuity (either deferred or immediate) and invest the larger part in various other financial products such as bank saving plans, investment funds, shares, bonds, etc. By doing so, the best solution should consist of a diversified portfolio of financial products designed to strike a balance between "free" asset allocation and long-term retirement provision that aligns with the individual's risk tolerance. A long-standing principle of consumer protection in Germany related to retirement provision has always been the clear separation of the "saving process" (by capital accumulation) and of the "risk coverage" (by insurance).

This kind of solution requires "best advice", which can only be developed and implemented for each individual case by genuinely "independent" financial advisors. The enforcement of "independent advice" for both retail investors and policyholders is part of the proposal outlined in the EU Commission's Retail Investment Package of May 24, 2023 (European Commission, 2023). From the perspective of German consumers, this initiative should be strongly supported.

In particular, "independent" advice needs full pre-contractual and ongoing information on costs, performance scenarios, and real returns. In the occupational pensions' sector this can only partly be achieved, since, for example, distribution costs of "direction insurances" and "competitive" IORPs are only disclosed at the product level, with no average figures available. The NCA should take the necessary steps to provide this data separately. Nevertheless, it is obvious that the final real return of any "implementation type" of occupational pension largely depends on the actual contributions from the sponsor company, which can vary widely.

With regard to third pillar private pensions—state subsidised or not—publicly available data indicates that two major factors influence the final real return of these products: costs, especially distribution costs, during the accumulation phase, and biometric costs of longevity during the decumulation phase.

Given the current situation, where no additional legal amendments are expected at least until the forthcoming implementation of the EU Retail Investor Package of May 2023, German consumers have little choice but to rely on the NCA, BaFin. BaFin has announced its intention to strengthen its supervision of the conduct of business by life-insurers. In May 2023, BaFin (2023) published an "Information Sheet" (*Merkblatt*) aimed at enhancing the supervision of the "appropriate benefit for clients", which must be secured mainly by enforcing the product approval process already stipulated by the Insurance Distribution Directive (IDD). Particularly relevant are the precise determination of target markets, realistic performance scenarios, disclosure of returns in nominal and real figures (the latter after accounting for costs and inflation), prohibition of possible conflicts of interest due to inducements, and BaFin's focus on distributors with particularly high commissions.

In fact, it can be said that nearly all the relevant factors that could have a significantly detrimental impact on the real return of private life and annuity insurances ("value for money") are included in this supervisory approach. Additionally, we emphasize the importance of controlling annuity factors and their correlation with the assumed life expectancy, which should not deviate significantly from general statistics. Consequently, it is up to the BaFin itself to prove to the German consumers that it will effectively implement its own supervisory objectives and should not be considered as a "toothless tiger" in the long run.[14] An exciting story that will be followed as closely as possible...

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[14] In August 2024 BaFin published the results of a research on "value for money" of unit-linked products mainly criticizing not sufficiently precise definitions of target markets, high costs and early cancellation cases (BaFin, 2024b).

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