Will You Afford to Retire?

The Real Return on Long-Term and Pension Savings

2024 Edition

BETTER FINANCE

The European Federation of Investors and Financial Services Users

Fédération Européenne des Épargnants et Usagers des Services Financiers

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The Real Return of Long-term and Pension Savings

2024 Edition — Slovakia

A research report by BETTER FINANCE

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Executive Summary

Was 2023 the year when European retail investors finally obtain the "fairer deal" that the outgoing European Commissioner Mairead McGuiness wished for them (McGuinness, 2023)? As far as long-term and pension products are concerned, this report presents mixed results. While European capital markets performed strongly in 2023, helping many pension funds and life insurance companies to rebound after a calamitous 2022, we find that many of the products we analyse failed to pass on the benefits of this renewed performance to pension savers. One or even two years of past performance, however, do not tell us much about the long-term performance of saving products. What matters for individuals who invest part of their income into those products is how much income they will be able draw from them in the distant future, in particular for retirement purposes. The objective of this report therefore is to provide readers with a long-term perspective on performance that aligns with the extended investment horizon. We analyse the costs and performance of a broad range of products across various holding periods, spanning up to 24 years. Over this longer period good years supposedly make up for bad ones. Nevertheless, we observe that many of the product categories do not offer sufficient nominal returns in the long run to compensate for inflation, even with the moderate inflation rates of the of the 2000s and 2010s. This weak performance then results in a loss of purchasing power for many European savers and investors.

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

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

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

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

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

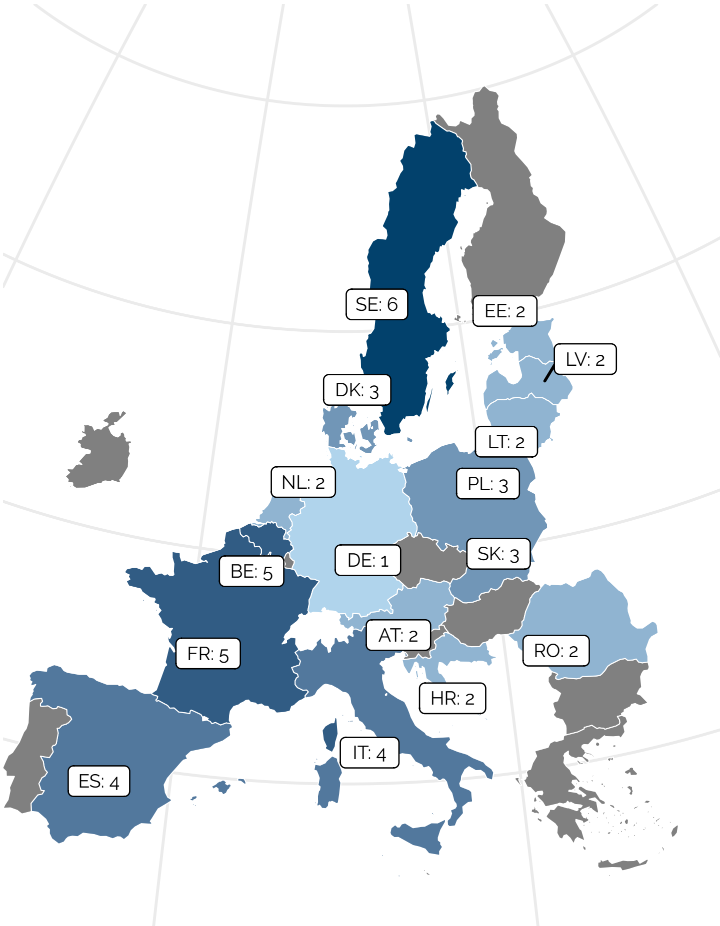
This research report by BETTER FINANCE covers 16 of the 27 European Union (EU) Member States. In each of these countries the team of contributors analyses the costs and performance of up to 6 product categories. Our goal is to calculate, based on publicly available data about these product categories, the *real net return* that long-term and pension savers may expect to obtain from their investments, going back as far as the year 2000. When we refer to real net return, we are indicating the rate of return on an investment after deducting all costs and charges levied by the product provider. This calculation also accounts for inflation, which reduces the purchasing power of both the invested capital and returns. The map in Figure XS.1 shows the countries included in this study, and the total number of product categories analysed in each country.

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

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

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

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

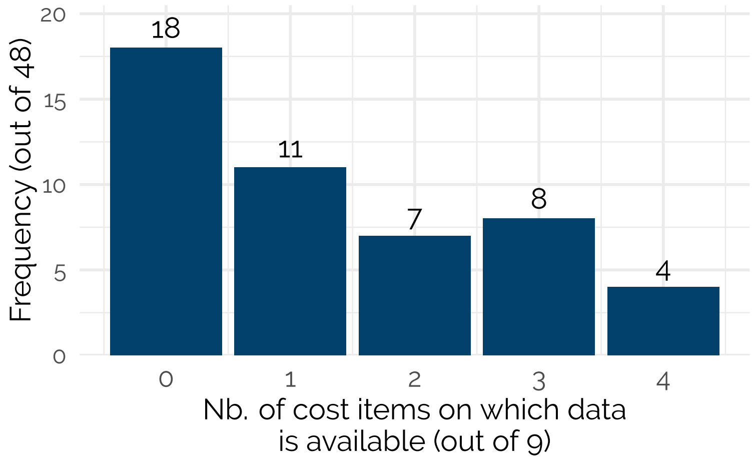


Besides performance data, information on costs is very often patchy and displayed in a way that makes it impossible for investors to compare cost levels across product providers, and for our contributors to aggregate this information at the level of product categories. The reader can appreciate this reality in Figure XS.2: for none of the 48 product categories included in our study could our contributors find data for more than 4 out of the 9 cost items defined in our methodology. Additionally, for more than a third of the product categories in our study, there is simply no cost information available.

For the 18 product categories for which no cost data is available, the lack of information on costs and charges prevents us from evaluating the average effect of charges on investors' returns. Consequently, we are forced to start our analysis with disclosed nominal *net* returns, whereas providers' marketing communications usually communicate on the basis of nominal *gross* returns.

Given the challenges in obtaining fundamental data on the average costs and performance of long-term and pension savings products, which capture a large share

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



of the wealth of European households, we advocate for EU and national authorities to urgently enact and implement the proposed rules on product oversight, governance, and information to investors, as outlined in the recent Retail Investment Strategy (RIS) proposals made by the European Commission (see our policy recommendations on Page xiii). Costs and performance disclosures are key to properly assess the functioning of the European market for pension savings products.

While opacity on cost and charges presents a challenge for many of the product categories we study, it is only fair to acknowledge the few cases in which industry and supervisors made significant efforts to define and implement coherent reporting frameworks, such as that of the Dutch pension funds or the Italian *Commissione di Vigilanza sui Fondi Pensione* (COVIP)'s annual report on pension funds and *Piani Individuali Pensionistici* (PIP).

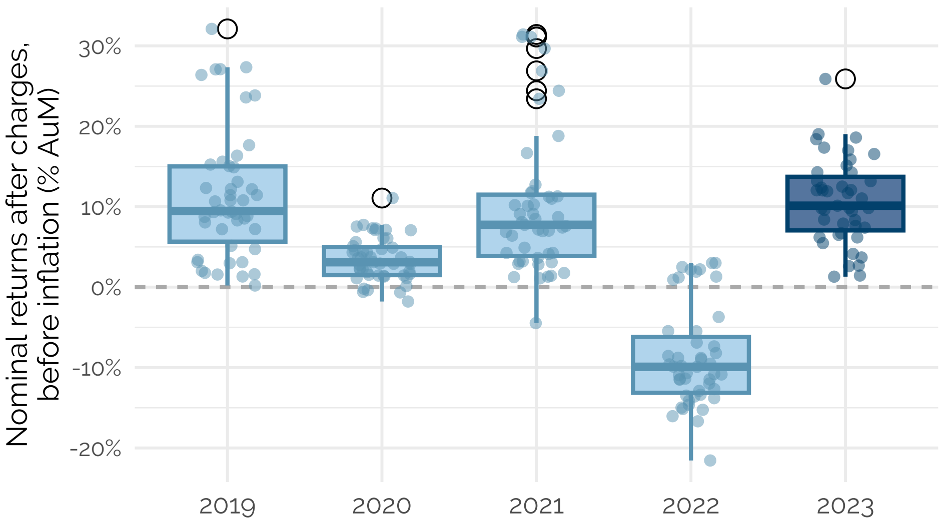
2023: Recovering from the slump

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

These good results reflect the good performance of, in particular, equity markets between January and December 2023, which recovered strongly after the slump of 2022. Figure XS.4 shows the performance of European capital markets. Using two pan-European market indices as proxies—one for equities and one for bonds, we calculate the cumulative return of a hypothetical portfolio composed of European equity and bonds in equal proportion, with annual rebalancing. The cumulated return, in nominal terms, of this portfolio dropped by 44.8 percentage points between

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

Figure XS.3 – **Average 1-year return rates of analysed product categories (2019–2023)**



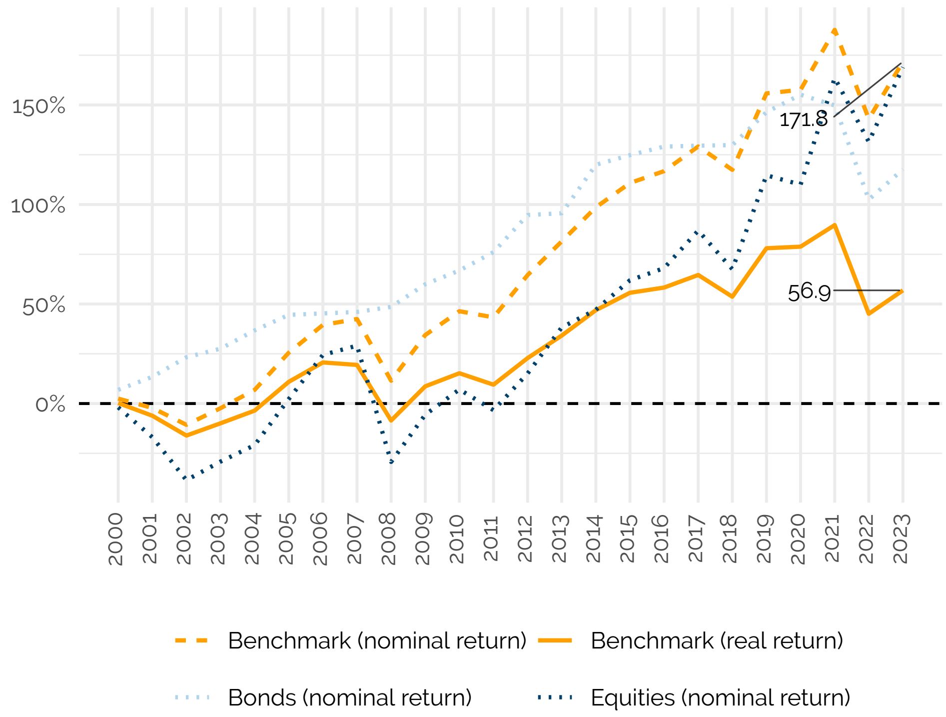
Data: NCAs and sectoral associations (see Country Cases); *Calculations:* BETTER FINANC

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

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

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

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



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

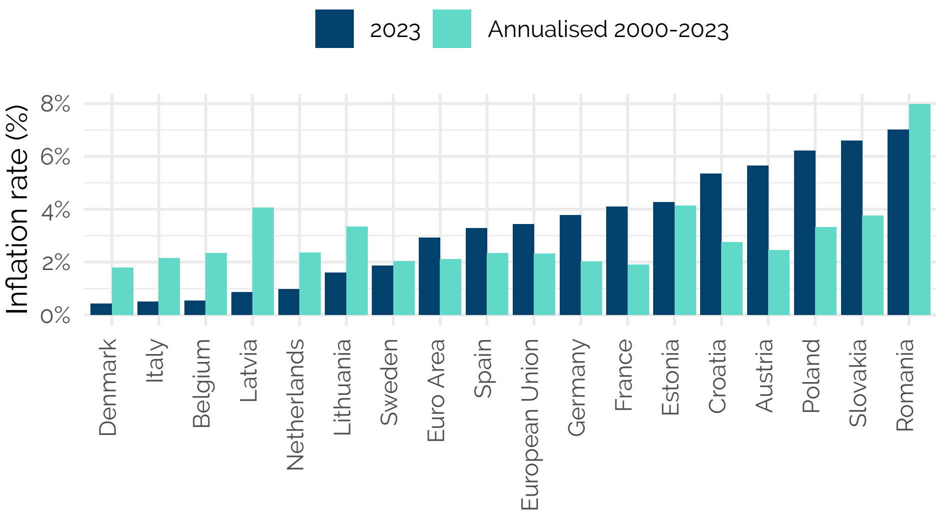
We wish to highlight the good performance of the first PEPP to be included in our study: with a nominal return before charges and inflation standing at +15% and charges amounting to 0.72% of assets under management (AuM), the Slovak PEPP yielded a net return of +14.3% in nominal terms and 7.2% in real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

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

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

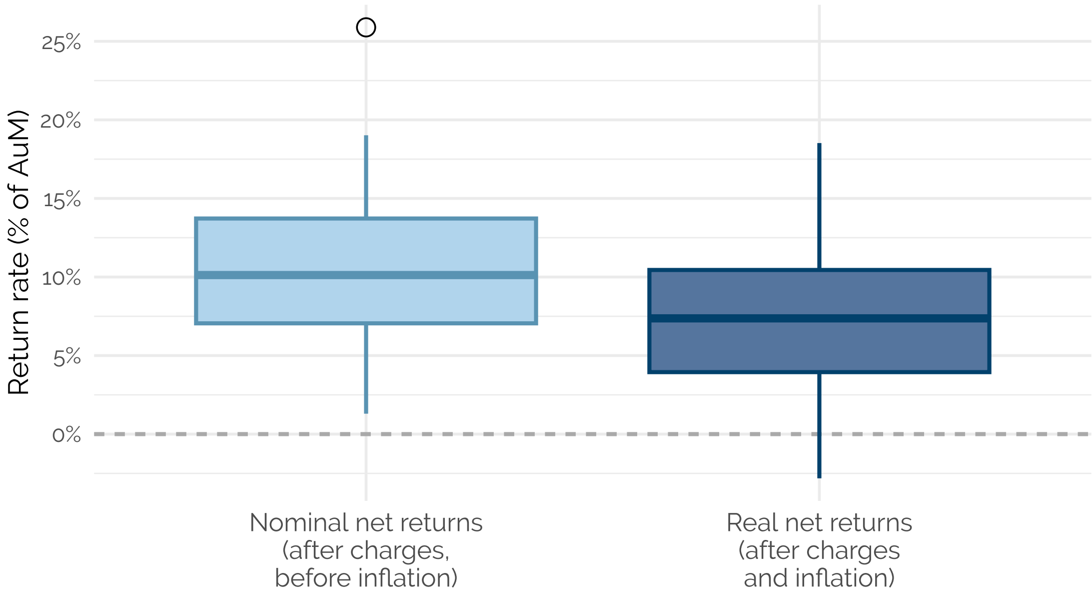
In the meantime, we urge Member State governments to offer the PEPP the same treatment, as regards taxation, subsidies and transferability of accrued pension benefits, that existing national personal pension products enjoy (see our policy recommendation on this topic on Page xvii).

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



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

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

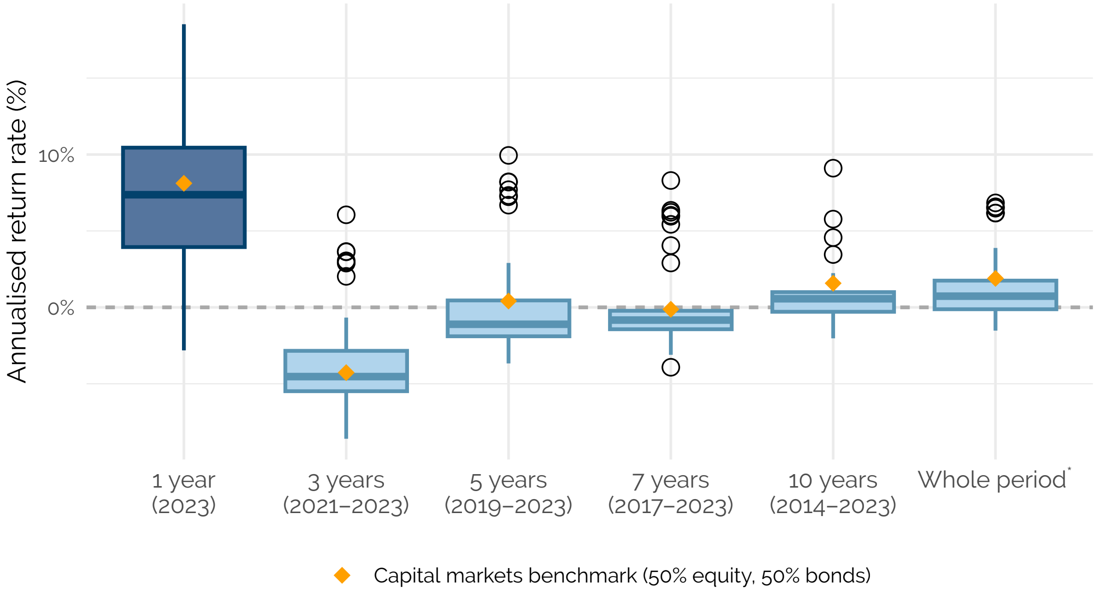


Calculations: BETTER FINANCE

The long-term view on long-term savings

Naturally, one should not assess the performance of long-term and pension savings products based on the results obtained in one bad year but rather take a long-term view. That is why our ambition in this report is to gather data about costs and performance for a period of up to 24 years (2000–2023).

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



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

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

Market volatility, whether upwards or downwards, is cancelled out over longer periods (the standard devaition falls from 4.9 p.p. for 1 year to 2 p.p. for 10 years, see Table XS.1), allowing us to more accurately assess the returns offered by the various product categories. Over 10 years and over whole reporting periods (up to 24 years), we see that the most of the interquartile range (the boxes in Figure XS.7) lies in positive territory. This may seem reassuring, until one notes that over 7 years, 10 years and whole periods, the annualised real performance of our capital markets benchmark (50% equity–50% bonds, rebalanced annually), shown with a yellow diamond in the figure, lies in the top quartile of the returns of product categories (above the upper bound of the box), meaning that 75% of the product categories fail to beat the benchmark.

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

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

Calculations: BETTER FINANCE

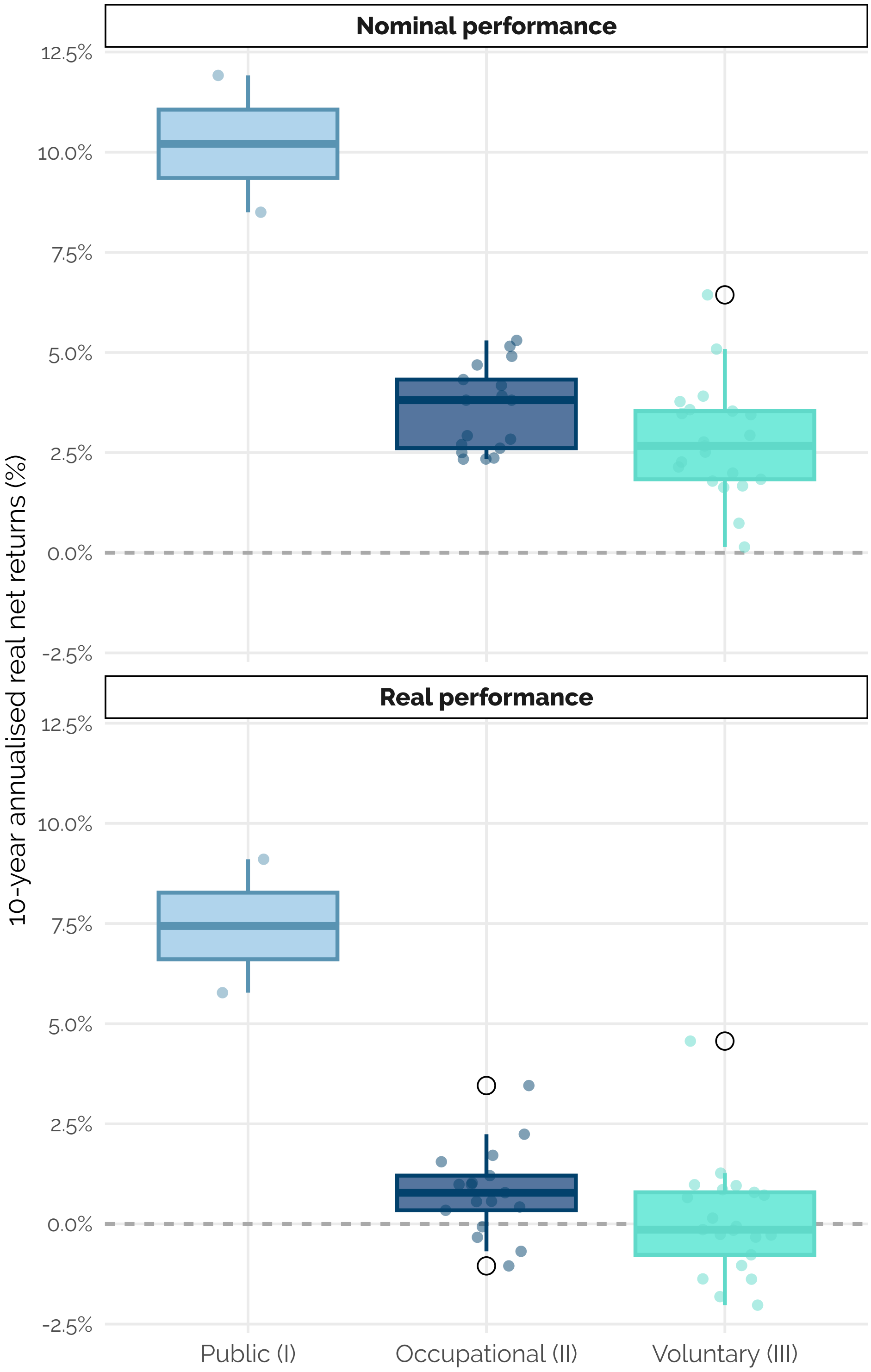
* Whole period varies across products (up to 24 years).

Observing the distribution of performance levels across pension system pillars, we also note that occupational pension schemes in Pillar II generally outperform voluntary products within Pillar III. Figure XS.8 illustrates the distribution of 10-year performance per pillar.

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

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

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



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

Policy recommendations

Policy recommendation 1 — Supervisory reporting and statistics

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

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

Harmonised frameworks for reporting from product providers to NCAs and pension scheme participants already exist for various of the product categories we analyse in this report. These commendable efforts should be assessed through a peer-review process to be organised by the European supervisory agencies (ESAs) in order to identify best practices, but also discard misleading disclosure practices that prevent retail investors to obtain a clear picture of the cost and performance of the products on offer. As part of these efforts to better report on the costs and performance of retail investment products, BETTER FINANCE calls on the ESAs to keep improving their annual costs and performance reports. Currently, the data and coverage of these reports are incomplete and based on commercial databases or surveys. The European Securities Markets Authority (ESMA), the EIOPA and—in the future—the European Banking Authority (EBA) should be able to rely on regular reporting of supervisory data from NCAs, which themselves should have the necessary powers to require regular reporting of data on the costs and performance of saving and investment products in their respective areas of competence.

Going further, the EU legislator should draw inspiration from these examples and incorporate into EU law - specifically, theMiFID and IDD legislation for Pillar III products, currently under review as part of the Retail Investment Strategy (RIS), or the next revision of the IORP II directive on occupational pensions - requirements for NCAs to adequately report figures on a quarterly or monthly basis. This should include the constant updating and public reporting of AuM and net AuM, unit value, asset allocation, as well as the number of participants for all supervised vehicles in the area of long-term and pension savings.

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

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

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

BETTER FINANCE has consistently opposed this system, and strongly supported the European Commission's proposal to partially ban so-called "inducements" as part of the RIS. We believe that the inducements-based distribution system hurts retail investors through higher charges, the illusion of "free" investment advice and a selection bias in distributors' recommendations, all of which result in lower returns and inadequate retirement income for European citizens (BETTER FINANCE, 2023b, pp. 4–13). The financial industry failure to acknowledge the problem and its intense lobbying efforts to maintain a damaging status quo resulted in the utterly disappointing provisional positions of the Council and, especially, the European Parliament (BETTER FINANCE et al., 2024), which should not be expected to improve outcomes for consumers in any meaningful way. Nevertheless, ignoring the problem will hardly make it disappear, and so we urge all involved policy-makers, supervisors, but also willing representatives of the indsutry, to keep working towards the generalisation of high-quality bias-free financial advice that EU citizens can rely for their retail investments.

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

Policy recommendation 3 — Information to (prospective) investors

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

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

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

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

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

While we are generally disappointed with the current state of the legislative negotiations on the EU's RIS, we urge the co-legislators to adopt these proposals on disclosures. For more information about our recommendations regarding information to investors and prospective investors, see BETTER FINANCE (2023b, pp. 17–22).

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

Finally, we urge EU and member state authorities to step up efforts towards the implementation of comprehensive individual pension tracking systems, following the recommendation of the High-Level Forum on the Future of the Capital Markets Union (HLF CMU). These constitute crucial empowering tools, enabling individuals to keep track of their accumulated pension rights across employers and across borders.

Policy recommendation 4 — Sustainability

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

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

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

EU policy-makers should also address the short-termism of the financial industry by reinforcing the consistent linkage between sustainability and long-term value creation. It must be clearly emphasised that exemplarity with regard to investor protection rules first and ensuring decent returns for individual investors is compatible with investing in a way that respects environment and society. To this end, clear and intelligible ESG disclosures should be combined with financial disclosures, preferably integrated into one document providing savers and investors with a holistic picture of the products they buy.

Finally, EU and national policymakers should require sustainability and ESG knowledge and training for board members in long-term and pension savings vehicles, as well as for financial advisors and sales personnel distributing such products. Regarding the latter, BETTER FINANCE supports the European Parliament's proposal, within the framework of the RIS to impose on financial advisors and sales personnel a yearly training requirement on sustainable investing (see BETTER FINANCE, 2023b, pp. 12–13).

Policy recommendation 5 — Asset allocation

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

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

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

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

Policy recommendation 6 — Taxation

Stop penalising taxation of long-term and pension products.

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

Policy recommendation 7 — Pan-European Pension Product (PEPP)

Create a friendly environment for the PEPP

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

- As noted by EIOPA:

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

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

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

BETTER FINANCE urges policy-makers not to give in to industry pressures to delete the 1% fee cap for the Basic PEPP. Instead,

- Member States should amend their respective legislations to ensure that PEPP receives the same treatment as any other personal pension product marketed in their jurisdiction.

- EU and Member State authorities must further explore the suggestions put forward by EIOPA in its recent paper to expand the target market for PEPP with a view to offer potential PEPP providers the perspective of greater economies of scale.

Policy recommendation 8 — Auto-enrolment

Introduce auto-enrolment in occupational pensions.

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

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

Policy recommendation 9 — Suspensions

Allow savers to defer contributions to pensions without penalties.

Savers should be allowed to suspend payments into a pension savings or life insurance plan without incurring a penalty. In an era characterised by uncertainty, it can never be assumed that an individual will always have an income sufficient to cover their immediate needs as well as pay their premium or set contribution towards their pension plan.

When an individual, for whatever reason, cannot, for a short period of time, contribute to their pension product, they should not be faced with the choice between foregoing their pension plan or paying a penalty. Instead, they should be able to suspend payments and resume as soon as they have a new income stream.

Policy recommendation 10 — Insurance guarantee schemes

Urgently establish harmonised insurance guarantee schemes in the EU.

EU citizens are partially covered against the default of product manufacturers through

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

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

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Country Case 13

Slovakia

Zhrnutie

Slovenský dôchodkový systém je typickým modelom Svetovej banky založenom na viac-pilierovom (troj-pilierovom) systéme s individuálnymi (osobnými) účtami sporiteľov. V roku 2019 došlo výrazným zmenám v I. pilieri, ktoré boli motivované politickým populizmom pred voľbami. Do dôchodkového systému bol ústavným zákonom zapracovaný dvojpilierový systém a zároveň strop dôchodkového veku. V roku 2021 boli očakávané výrazné reformné zmeny v I. pilieri, ktoré by mali zvýšiť finančnú stabilitu I. piliera a vyriešiť problémy v nastavení súkromných dôchodkových schém. V roku 2022 prebehla zásadná reforma I. piliera (naviazanie dôchodkového veku na strednú dĺžku dožitia) aj II. piliera, kde sa zaviedol automatický vstup, predvolená investičná stratégia, zmena výplatnej fázy, zníženie poplatkov aj zníženie poplatkov v III. pilieri.

Summary The Slovak pension system is a typical World Bank model based on a multi-pillar (three-pillar) system with individual (personal) pension accounts. In 2023, the essential steps of the 2022 reform were applied, in particular the mandatory entry into the Pillar II, the application of the default investment strategy in Pillar II, new rules for early retirement after 40 years of service, reduction of fees in both Pillar II and Pillar III. Conversely, changes to the payout phase in Pillar II have been postponed until 2025. In 2023, for the first time, a PEPP product appears on the market, which competes with III. Pillar under unequal conditions of support for employers' contributions.

Introduction: The Slovakian pension system

- The year 2023 brought implementation of major pension reform from 2022 influencing all pension pillars;
- The reform removed retirement age ceiling and tied the retirement age back to the life expectancy;
- For Pillar II, starting May 2022, participation in Pillar II became mandatory for all new workers younger than 40 years with the opt-out options;
- Starting July 2023, application of predefined saving strategy took place with automatic portfolio rebalance for non-active savers in Pillar II with re-allocation of savings into the passively managed index pension funds (100% until the age of 50 years and then adopting the glide path of 4% annually from index funds into bond pension funds);
- after the government changes in October 2023, the contribution rate toward Pillar II was permanently decreased to 4% of insurable income starting January 2024;
- For Pillar III, the reform has decreased the fees to the level competitive to the PEPP products (1% of AuM);
- The year 2023 brought the introduction of first PEPP products to the market.

Table SK.1 – Long-term and pension savings vehicles analysed in Slovakia

Product	Pillar	Reporting period	
		Earliest data	*Latest data*
Pension funds	Occupational (II)	2005	2023
Supplementary pension funds	Voluntary (III)	2009	2023
Pan-European Personal Pension	Voluntary (III)	2023	2023

- The pension reform adopted in 2022 as part of the Recovery and Resilience Plan (Component 18) has had some positive features on the overall financial stability of Pillar I. However, further measures on the financial stability of the pay-as-you-go (PAYG) scheme are necessary.
- There should be a significant increase in the state support for private pension schemes in order to increase the pension savings ratio which is one of the lowest among the EU countries and spurs the financial problems for the generation retiring in the next 20 years.
- The year 2022 brought the first PEPP products to the Slovak pension market that have the features allowing them to effectively compete the III. pillar pension products. However, tax laws favour the Pillar III products and thus reduce the competitiveness of PEPP products on the market.

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

	Pension funds	Supplementary pension funds	Pan-European Personal Pension
1 year (2023)	5.1%	5.0%	7.2%
3 years (2021–2023)	-5.6%	-6.7%	—
5 years (2019–2023)	-2.3%	-2.8%	—
7 years (2017–2023)	-2.1%	-2.6%	—
10 years (2014–2023)	-0.7%	-1.4%	—
Whole period	-0.9%	-0.9%	—

Data: National Bank of Slovakia, Eurostat; *Calculations:* BETTER FINANCE.

Pension system in Slovakia: An overview

The Slovak old-age pension system is based on the multi-pillar approach, which consists of three main pillars:

- Pillar I – State pension organized as a mandatory PAYG scheme;
- Pillar II – Funded pension organized as voluntary funded defined contribution (DC)-based scheme; and
- Pillar III – Supplementary pension organized as a voluntary individual pension DC-based scheme.

Pillar I — State pensions

The Slovakian pension reform started in 1996 with the introduction of Pillar III, which at that time (and until 2009) was organized as voluntary pension pillar offering life insurance contracts and as an occupational pillar as well. Since July 2009, the system was changed to funded saving schemes and voluntary Pillar III pension funds are offered to the savers (members). The organization of Pillar III started to become more personal with the financial support of employers.

The World Bank's approach has been fully implemented by introducing Pillar II at the beginning of 2005, and, from a terminological point of view, it should be called the "Pillar I-bis", as individual retirement accounts are funded via partial redirection of social security contributions on individual pension savings accounts. For a person who works a full career (42 years) and retires in 2023, the main income stream derives from the PAYG (Pillar I) pension scheme. On average, the individual replacement ratio of such a person could reach 47% of their gross salary. If the person would have participated since 1996 in Pillar III and contributed on average 3% of their salary into a Pillar III pension scheme, having also entered Pillar II (1bis pillar) in 2005, their income stream during retirement would have been slightly different and their replacement ratio would have been a little higher than 60%. However, still more than 90% of the retirement income stream is provided via the PAYG scheme (Pillar I), around 5% from Pillar II (1bis pillar) and 5% from Pillar III.

Pillar I is a state organized PAYG pension scheme, managed by the State Social Insurance Company. Pensions are funded on an ongoing basis and benefits are calculated based on the number of insured years and paid contributions. The PAYG principle of financing is supplemented by the redistribution principle, where the lowest income groups receive higher replacement ratios and higher income groups (due to the solidarity mechanisms) receive lower replacement ratios.

Pillar I is closely connected to the economic activity and income of the citizens. This pillar is financed by contributions of economically active individuals, amounting to 18% of their base income (gross salary) under the condition, that an individual is not participating in Pillar II). These contributions are directed to the Social Insurance Company, which distributes the allowance to the beneficiaries (current pensioners).

An individual is entitled to an old-age pension after the statutory retirement age is reached. There are two options for early retirement: 40 years of insurance period or 2 year before retirement age. In both cases, the minimum level of pension (1,6 $\times$ living minimum) should be reached.

Pension insurance is mandatory; statutory insurance and participation in this scheme is a legal obligation for all eligible persons. However, the Act on Social Insurance also enables voluntary pension insurance participation.

Pillar I is a typical PAYG point scheme (defined benefit – DB) with a certain income solidarity element. The old-age pension of the insured person depends on three parameters:

1. The insurance period, that is, the number of insured years with active contribution;
2. The average personal wage point (APWP), determined as the ratio of the sum of personal wage points calculated for each calendar year of the reference period and the period of pension insurance in the relevant period; and
3. The value of the pension point, that is, the monetary value of one personal wage point. The pension value is adjusted on 1 of January each year through indexation, which is determined as the ratio of the average wage calculated in the third quarter of the previous calendar year and the average wage calculated in the third quarter of the calendar year two years preceding the calendar year on which the pension value is calculated. The value is automatically revalued on an annual basis with the objective to mimic the increase in the average salary in Slovakia.

Statutory retirement age is 63 years and 2 months in 2023, valid for both men and women. For women, the retirement age might be lowered depending on the number of raised children. For each raised child the retirement age is lowered by 6 months up to three children. For the birth years 1968 and younger, a new pension reform in 2022 re-introduced the retirement age tied to the life expectancy.

To illustrate the calculation of an old-age pension, let us assume an individual who reached the statutory retirement age of 63 years in 2022 and has following characteristics:

1. Number of insured years (N) = 42 (full working career);
2. APWP = 1 (for the entire working career, an individual has been earning on average 100% of average salary in Slovakia);
3. value of pension unit (VPU) = EUR 16.4764 (for persons retiring in the year 2023).

The old-age pension is then calculated using the following formula: N $\times$ APWP $\times$ VPU. Therefore, considering the above-mentioned individual parameters of a person claiming old-age pension, he/she will be entitled to a monthly pension equal to: 42 $\times$ 1 $\times$ EUR 16.4764 $=$ EUR 692. If an individual has earned on average 100% of an average salary during their entire working career and the average salary in 2023 was EUR 1430, then the gross individual replacement ratio of such an individual would be: EUR 692 / EUR 1430 $=$ 48.39%.

Pillar II - Funded pensions

The Slovak Pillar II was established as a DC pension saving scheme in 2005. The principle of funded pension is based on the accumulation of savings during employment and investing savings in financial markets via special purpose vehicles—pension funds, which are managed and administrated by Pension Assets Management Companies (PAMCs), licensed by the National Bank of Slovakia.

During the period from September 2012 until May 2022, the enrolment was voluntary and eligible for persons up to 35 years of age. Since May 2022, the automatic enrolment with opt-out option is applied for all workers under the 40 years entering the labour market for the first time. In general, pension fund members (Pillar II savers) are free to choose pension funds provided by the same PAMC. Each saver has an individual retirement account (IRA). Their contributions (savings) are redirected from the Social Insurance Company to the chosen supplementary pension assets management company (Supplementary Pension Assets Management Company (SPAMC)) on their IRA at a rate of 5.5% of gross salary in 2023. In December 2023, the contribution rate has been permanently cut down to 4% of gross salary starting 2024.

With the possibility to save in one or two pension funds at the same time, it is completely up to a saver how much of their own savings would be invested in one pension fund or another. They can invest, for example, 70% in a bond guaranteed pension fund and another part (30%) in an index non-guaranteed pension fund. There is no fee or charge to change their allocation ratio or switch pension funds managed by the same PAMC—even on a daily basis. Switching providers (PAMCs) for free is possible for savers if the change is made after one year, otherwise a fee of EUR 16 is applied.

Pillar III - Supplementary pensions

The Supplementary pension is a voluntary funded DC-based pension saving scheme in which the funds of the participants are administered by SPAMCs. The SPAMCs are private joint stock companies established under the Slovak law and able to only provide services tied to the management of supplementary pension funds. SPAMCs and their supplementary pension funds are supervised and regulated by the National Bank of Slovakia.

The purpose of supplementary pension saving is to allow participants to obtain supplementary pension income in old-age and the whole Pillar is mostly oriented towards employers and their employees. However, the coverage ratio is rather low (31% in 2023).

Both employers and employees can contribute to the individual retirement account with no limits. The following benefits are paid from the supplementary pension saving upon the completion of the saving period:

- supplementary old-age pension in the form of lifelong or temporary supplementary annuity;
- supplementary pension in the form of programmed withdrawal;
- lump-sum settlement;
- redundancy pay.

Table SK.3 – Overview of the Slovakian pension system

Social Insurance Company	National Bank of Slovakia		
Pillar I	**Pillar II**	**Pillar III**	PEPP
State pension	Funded pension	Voluntary pension	
Mandatory	Mandatory	Voluntary	Voluntary
State management	Pension Assets Management Companies (PAMCs)	Supplementary Pension Assets Management Companies (SPAMCs)	PEPP provider
PAYG		Funded	
Defined benefit (DB) Point scheme	Individual personal pension accounts	DC Individual personal pension accounts	Individual PEPP account
Retirement Age: 63 years and tied to the increase in life expectancy; Early retirement possible after 40 years of service or 2 years before retirement age; Contributions: 18% (if participating only in Pillar I) or 12.5% (if participating in Pillar I and Pillar II)	Withdrawal allowed if Pillar I pension is granted; Witdrawal options: phased withdrawal for the first half of life expectancy + single annuity for the second half (since 2025); lump-sum if the Pillar I pension is higher than average pension; Contributions: 5.5% in 2022 - 2024; 5.75% in 2025 - 2026; 6% afterwards (derived from the paid social insurance contributions)	Individual as well as employer can contribute with no limits (indirect fiscal support provided for the individual as well as employer); Withdrawal options: lifetime annuity; phased withdrawal for minimum of 10 years; lump-sum if the value of savings is less than 4-times the average wage; combination of phased withdrawal and annuity	Individual as well as employer can contribute with no limits (indirect fiscal support provided only for the individual); Withdrawal options: phased withdrawal for minimum of 5 years; lump-sum at the age of statutory retirement age + 5 years
Quick facts			
Number of old-age pensioners: 1.118 mil. Coverage (active population): 2.74 mil.	Administrators: 5	Administrators: 4	Administrators: 1
Average old-age pension: EUR 606	Funds: 16	Funds: 21	PEPP products: 2
Average salary (gross): EUR 1 430	AuM EUR 13.997 bln.	AuM EUR 3.519 bln.	AuM: EUR 0.1 bln.
Average replacement ratio: 42.38%	Participants: 1.838 mln.	Participants: 0.99 mln.	Participants= 0.025 mln.

Source: Social Insurance Company, 2024, https://www.socpoist.sk/sp-transparentne/statistiky; Data for Pillars II and III: employment.gov.sk.

The year 2023 was a year of major pension reform implementation. The reform adopted in 2022 has brought major changes in Pillar I with support of the funded pension schemes — Pillar II and Pillar III. The summary of key reform changes in the Slovak pension system from 2022 included:

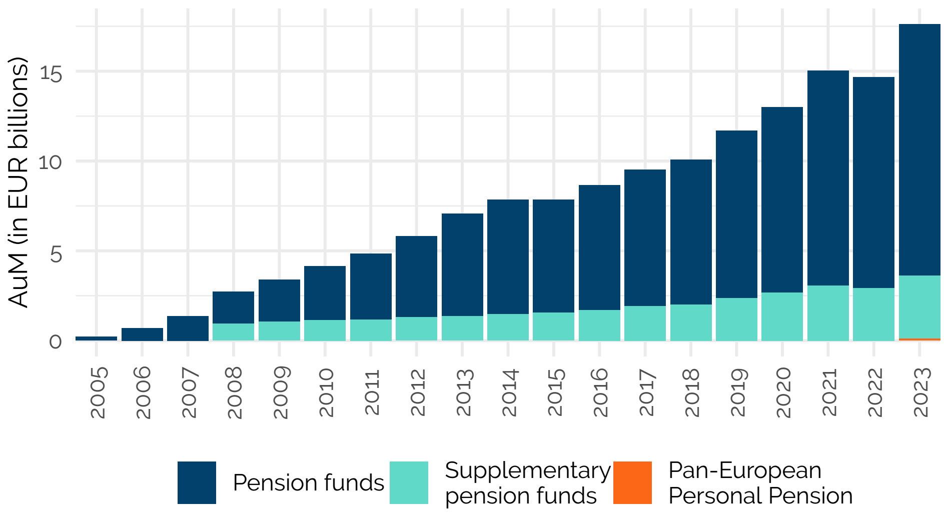
1. Pillar I. (state pensions)
   - Flexible statutory retirement age tied to life expectancy (longer working career) for people born after 1967;
   - Early retirement (2 years before statutory retirement age or after 40 working years regardless the age) = risk of losing employees (lowered fine for early retirement 3,6% annually) effective since January 2023;
   - Reduced pension point increase (0,95 × average wage increase) = lower replacement rates in future, effective since January 2023;
   - Introduction of parental bonus (1,5% of child's wage, maximum 1,2 × average wage) effective since January 2023;
2. Pillar II. (funded DC scheme)
   - Decreased fees (removing the performance fee 10% of new highs and 0,4% p.a. of accumulated savings + 1,25% of new contributions), effective since January 2023;
   - Predefined saving strategy (life-cycle strategy with glide path starting at 50 years, 4% annually equity share decrease), effective since May 2023;
   - Automatic enrolment for the new workers entering labour market, effective since May 2023;
   - Major changes in payout phase (programmed withdrawal for the first half of life expectancy and annuity for the remaining life expectancy)—one-off withdrawal possible for above average earners, effective since January 2025;
3. Pillar III. and PEPP (voluntary occupational and personal pensions)
   - Introduction of PEPP legislature in 2022 (tax benefits for employee contributions similar to the III. pillar, no tax benefits for employer's contributions, more relaxed payout phase compared to the III. pillar, 5 years of programmed withdrawal or up to statutory age + 5 years) with first PEPP products starting from 2023;
   - Decreased fees for III. pillar (max 1% p.a. of accumulated savings), effective since January 2023.

Long-term and pension savings vehicles in Slovakia

There are five providers—PAMCs—operating on the Pillar II (funded pension) market. According to the AuM measure, the two biggest providers, Allianz and UNIQA, represent nearly 52.86% of the market in 2023 (down from 55.16% in 2022).

There are four providers—SPAMCs—operating on the Pillar III market. According to Assets under management, the two biggest, NN and DDS Tatra banky, represent nearly 70.98% of the whole market.

Figure SK.1 – **AuM of Slovakian long-term and pension savings vehicles**



Data: National Bank of Slovakia; *Calculations:* BETTER FINANCE.

It should be noted that the majority of pension savings are accumulated in Pillar II pension funds that is financed via redirected mandatory pension insurance contributions. Additional voluntary contributions towards Pillar III pension funds are driven mainly by employers' contributions and not individual contributions of savers.

Second pillar: Pension funds

The Pillar II market is fairly concentrated. Each saver can choose one out of six currently existing providers (PAMCs) on the Slovak market. The PAMCs are private joint-stock companies with a minimum capital requirement of EUR 10 million and established in the territory of the Slovak Republic. Their exclusive business is the creation and administration of pension funds. As a further condition, they must attain at least 50000 members within a period of 18 months from the establishment of the pension fund.

According to the applicable law (the Act on Old-Age Saving), each PAMC is obligated to operate at least two pension funds. We can divide these pension funds into two main groups:

1. Bond guaranteed pension fund (Guaranteed scheme);
2. Index non-guaranteed pension fund (Non-guaranteed scheme) applying passive investment management style that replaced actively managed equity non-guaranteed pension funds starting 2023.

Each PAMC is free to choose (mostly based on their business model) whether it operates additional pension funds, which are optional. These legislative changes entered into force on April 30, 2013. Before that date, each PAMC had to operate three (respectively four) obligatory pension funds:

1. Bond (Conservative) pension fund (since March 2005);
2. Mixed (Balanced) pension fund (since March 2005);
3. Equity (Growth) pension fund (since March 2005);
4. Index pension fund (since April 2012).

After the legislative changes became effective since major pension reform in 2022, index pension funds with passive investment strategy became the key pension vehicle for all savers younger than 50 years. Changes in the fee policy (strictly regulated) forced providers to change the investment strategy of pension funds towards being passively managed using mostly exchange-traded funds (ETFs) as main financial instruments.

PAMCs are subject to a variety of regulations. The Old-age Pension Savings Act defines the range of allowed investment instruments and sets maximum limits for portfolio allocations (quantitative limits). Investment procedures and valuation of investments (daily at market prices) are also regulated. Thus, each category of pension funds has their own investment strategy, as well as general or special quantitative limits and operating conditions. PAMCs and managed pension funds are supervised by the National Bank of Slovakia.

The year 2019 brought an introduction of Pension Benefit Statement with pension benefits projections also into the II. pillar. The providers are obliged to send the pension benefit statements to all savers since January 2021.

The reform of the pay-out phase, introduced in 2022 and effective from 2025, stipulates the following pay-out phase rules:

1. Half of the savings have to be used to buy programmed withdrawals lasting half of the life expectancy of the retiring person;
2. The second half of the savings is invested using the predefined investment strategy and used to buy the single nominal annuity once the retired person survives to the age expected in the first point.
3. Programmed withdrawal (phased withdrawal) with no limitations if the retired persons benefits are higher than the average pension benefits;

4. Perpetuity (withdrawal of only annual returns).

Products 1, 2 and 3 are provided by insurance companies, products 4 and 5 by PAMCs.

Market structure of providers and pension funds shows the almost equal market share of 3 players.

Table SK.4 – Pension Assets Management Companies market shares (Pillar II)

PAMC	Assets under management (in € million)	Market share based on AuM
Allianz – Slovenska	3 880.1121	27.72%
UNIQA (AXA before 2021)	3 518.7209	25.14%
Kooperativa (DSS Postovej banky unitl 2023)	645.3894	4.61%
NN (ING before 2015)	3 197.5767	22.85%
VUB - Generali	2 754.7740	19.68%
TOTAL	*13 996.5731*	*100.00%*

Data: oranzovaobalka.sk, 2024 (data as of December 31, 2023.

Table SK.5 presents the market share of Pillar II pension funds according to their dominant investment strategy and asset allocation. The dominant part of savings is allocated into bond pension funds that invest conservatively. However, the allocation has started to change from bond pension funds towards index pension funds due to the implementation of 2022 pension reform applying predefined saving strategy.

Table SK.5 – Pillar II market share by group of pension funds

Scheme	Type of voluntary pension fund	Assets under management (in millions €)	Market share based on AuM
Guaranteed PFs	Bond guaranteed pension funds (5) - obligatory	6 337.1420	45.28%
Nonguaranteed PFs	Mixed nonguaranteed pension funds (2) - optional	179.5706	1.28%
	Equity nonguaranteed pension funds (2) - optional	2 487.9174	17.78%
	Index nonguaranteed pension funds (7) - obligatory	4 991.9430	35.67%
TOTAL	*16 Pension funds*	*13 996.5731*	*100.00%*

Data: oranzovaobalka.sk, 2024 (data as of December 31, 2023.

The reform in 2022 introduced the predefined investment strategy for all non-active savers who made no active choice during May 2013 and January 2023. Starting July

2023, the portfolio of these savers should be gradually re-allocated to the index pension funds (100% until the age of 50 years and then adopting the glide path of 4% annually from index funds into bond pension funds). The 2022 reform stipulates that the pension provider has to align the saver´s portfolio with the predefined saving strategy within 2 years (until the end of 2025). The increase in AuM was caused mainly by the stabilization of the market and higher returns of Index pension funds. We see increased number of savers, who mix two funds on their individual retirement savings accounts, one of which is the index pension fund.

Asset allocation of Pillar II pension funds is regulated by law (Act on Old-Age Saving), laying down the general quantitative investment limits on all pension funds — for example:

- max. 3% of AuM into one financial instrument (does not apply on bond investments or in case of passively managed pension funds);
- max. 10% of AuM into one UCITS fund;
- max. 15% of the whole pension fund portfolio into one issuer (does not apply on bond investments or in case of passive managed pension funds);
- bond investments must have investment grade rating (does not apply in case of passively managed pension funds).

Pillar II savers can choose from two main types of obligatory and two types of optional voluntary pension funds.

Obligatory — Bond guaranteed pension funds are actively managed pension funds and are obliged to invest 100% of the assets into bonds, money market instruments, deposits, investment funds in which assets must be invested in the above securities and deposits and other similar assets. Bond guaranteed pension funds are not allowed to invest in equities and real estate, nor respective investment funds. This conservative strategy focuses on bonds, and its objective is the preservation of capital and moderate growth primarily on shorter horizons. Bond guaranteed pension funds are obliged to hedge at least 95% of the whole portfolio against currency exposure. That means that if the pension fund allocates the assets into the financial instruments that are denominated in a currency other than Euro, fund managers must open the position (usually swaps or other hedging instrument) that fixes the value of such investment in Euro.

Obligatory — Index non-guaranteed pension funds, introduced in April 2012, are the only passively managed pension funds in Slovak pillar II. There are no general nor specific quantitative limits, because of the nature of investing. Slovak Index non-guaranteed pension funds track respective stock market benchmarks (such as MSCI World, EuroSTOXX 50, MSCI ACWI, MSCI Euro).

Third pillar: Supplementary pension funds

Currently, there are four providers (SPAMCs) operating on the market, which could be considered concentrated. Each SPAMC is obliged by law to operate at least one contributory and one "pay-out" supplementary pension fund. The legislation does not determine specific types of contributory pension funds; however, we can divide all existing contributory pension funds according to the portfolio structure into three main groups:

- Conservative supplementary pension funds (no equity investments);
- Balanced supplementary pension funds (small portions of equity investments);
- Growth supplementary pension funds (highest portions of equity investments).

Company "NN" and later on "AXA (UNIQA since January 2021)" have launched the first passively managed equity fund within the Pillar III. Most of the competitors followed this move in 2022 and introduced passively managed index (equity) pension funds as well. There are no specific investment restrictions regarding asset classes in supplementary pension funds, but there are some general quantitative limits to restrict the concentration risk of the fund.

DDS Tatra banky has introduced target date funds (TDFs) in 2015, with the aim to provide age specific investment strategy for its members saving for retirement.

Table SK.6 – Supplementary Pension Assets Management Companies market shares (Pillar III)

Supplementary Pension Company	Assets under management (in millions €)	Market share based on AuM
DDS Tatra banky	964.60	32.95%
UNIQA (AXA before 2021)	445.16	15.21%
NN	1 113.20	38.03%
STABILITA	404.46	13.82%
TOTAL	*2 927.42*	*100.00%*

Data: oranzovaobalka.sk, 2023 (data as of December 31, 2022.

For supplementary pension funds, there are no special investment restrictions regarding asset classes, but there are some general quantitative limits, i.e. no more than:

- max. 5% of AuM in one financial instrument;
- max. 30% of AuM in securities and money market financial instruments from one issuer (does not apply to instruments issued by the EU Member States);
- max. 35% of AuM in securities and money market financial instruments issued by the EU Member State, the EU, ECB, International Monetary Fund (IMF) or World bank;
- max. 20% of AuM in one standard mutual fund (-compliant);

- max. 10% of AuM in one alternative investment fund (AIF);
- max. 40% of AuM in mutual funds.

Table SK.7 – Supplementary vehicles' market share by group of pension funds

Type	Supplementary pension vehicles	Assets under management (in millions €)	Market share based on AuM
Contributory	Conservative supplementary pension funds (4)	840.8641	28.09%
	Balanced supplementary pension funds (2)	1 018.7700	34.04%
	Growth supplementary pension funds (9)	1 017.1700	33.99%
PAY-OUT	Pay-out supplementary pension funds (4)	116.1700	3.88%
TOTAL	*19 Pension funds*	*2 927.4100*	*100.00%*

Data: oranzovaobalka.sk, 2023 (data as of December 31, 2022.

In general, the Pillar III scheme covers less than 31% of economically active population, while only 70% of them actively contribute to the scheme. At the same, most of the retirement savings are directed into balanced supplementary pension funds, which apply rather conservative investment strategy with limited long-term investments.

Charges

Pension products for both pillars have seen continual decrease in costs and charges over the period of their existence. However, it is obvious that both pillars do have different fee structures that reflects the features of the pillars and duties of the asset managers and administrators.

The year 2023 has brought no significant changes in fee structure for Pillar II products. Main changes were applied in 2022 when two fees has been abandoned (entry fee as well as performance fee) and the administration fee has been slightly increased. Pillar III products have also seen some changes in fee policy as the law required the providers to continually decrease the asset management fee towards the 1% cap within 4 years.

Charges of pension funds (Pillar II)

Charges are highly regulated and capped in the Pillar II scheme by the Old-Age Pension Saving Act. In 2023, PAMCs can apply only one type of fee:

- Management fee (as percentage of in respective pension fund);

However, the law allows to charge additional charges that cover the costs incurred, namely:

- Depository fee (as percentage of in the respective pension fund); and
- Other charges (mostly trading charges).

It must be mentioned that on top of these charges, each saver in Slovak Pillar II also has to pay an Administration fee to the Social Insurance Company that administers the central collection system, central information, and offering system for annuities. The Social Insurance Company collects the social security contributions and transfers part of savers' contributions to their personal pension account managed by the PAMC.

Table SK.8 compares applied charges for Pillar II pension funds and the evolution of fee policy over the analysed period.

Table SK.8 – Costs and charges of Slovakian pension funds (% of assets unless otherwise specified)

Year	Entry fees*	Admin. and mgt. fees	Other ongoing fees	Performance fees‡
2005	1.50%	0.80%	0.04%	5.60%
2006	1.50%	0.80%	0.04%	5.60%
2007	1.50%	0.80%	0.04%	5.60%
2008	1.50%	0.80%	0.04%	5.60%
2009	1.50%	0.80%	0.04%	5.60%
2010	1.50%	0.80%	0.04%	5.60%
2011	1.50%	0.80%	0.04%	5.60%
2012	1.50%	0.80%	0.04%	5.60%
2013	1.25%	0.30%	0.04%	10.00%
2014	1.25%	0.30%	0.04%	10.00%
2015	1.25%	0.30%	0.04%	10.00%
2016	1.25%	0.30%	0.04%	10.00%
2017	1.25%	0.30%	0.04%	10.00%
2018	1.25%	0.30%	0.04%	10.00%
2019	1.25%	0.30%	0.04%	10.00%
2020	1.25%	0.30%	0.04%	10.00%
2021	1.25%	0.30%	0.04%	10.00%
2022	1.25%	0.30%	0.04%	10.00%
2023	0.00%	0.45%	0.04%	0.00%

Data: Pension Asset Management Companies; *Calculations:* BF.
* % of contributions ‡ % of overperformance

Charges of supplementary pension funds (Pillar III)

Charges in Pillar III are capped by law. Supplementary Pension Fund Management Companies are (since January 1, 2014) allowed to apply the following types of charges:

- Management fee, as percentage of AuM in a respective supplementary pension fund;
- Performance fee, as percentage of new highs reached in performance of a respective supplementary pension fund — High Water Mark (HWM);,
- Depository fee (as percentage of AuM in a respective pension fund);
- Other charges (Switching fee).

Table SK.9 compares charges applied in the Pillar III.

Table SK.9 – Costs and charges of Slovakian supplementary pension funds (% of assets unless otherwise specified)

Year	Admin. and mgt. fees	Other ongoing fees	Performance fees‡
2009	2.50%	0.04%	10.00%
2010	2.50%	0.04%	10.00%
2011	2.50%	0.04%	10.00%
2012	2.50%	0.04%	11.00%
2013	2.40%	0.04%	12.00%
2014	2.30%	0.04%	13.00%
2015	1.80%	0.04%	10.00%
2016	1.70%	0.04%	10.00%
2017	1.60%	0.04%	10.00%
2018	1.50%	0.04%	10.00%
2019	1.40%	0.04%	10.00%
2020	1.30%	0.04%	10.00%
2021	1.20%	0.04%	10.00%
2022	1.20%	0.04%	10.00%
2023	1.15%	0.04%	10.00%

Data: Own research based on Supplementary pension saving Act; *Calculations:* BF; *Note:* data as of December 31, 2022.
‡ % of overperformance

It should be noted that the pension reform in 2022 has changed the fee structure and reduced the overall cost ratio starting the year 2023.

Taxation

The Act on Income Tax recognizes two different of income tax rates in Slovakia that apply to pension saving schemes.

Personal income tax rate has been set at 19% since 2005. Since 2013, there is higher tax rate of 25% for higher earners, whose monthly income in 2023 was higher than EUR 3 453.79 (around 8% of working population in 2023).

Corporate income tax rate for 2023 was 21%.

Table SK.10 – Taxation of pension savings in Slovakia

Product	Phase			Regime
	Contributions	*Investment returns*	*Payouts*	
Pension funds	Exempted	Exempted	Exempted	EEE
Supplementary pension funds	Exempted	Exempted	Taxed	EET
Pan-European Personal Pension	Taxed	Exempted	Taxed	TET

Source: Own elaboration, 2024.

Pillar II

Pillar II should be viewed as a 1bis pension pillar that is basically a derivative of the basic old-age security scheme, as a part (5.25% in 2023) of the overall (18%) old-age social insurance contributions are diverted from a PAYG pillar into funded DC scheme. Understanding this principle, Pillar II taxation is similar to the PAYG pillar, meaning that an "EEE" taxation regime is applied.

Taxation of contributions

Contributions paid to Pillar II are tax deductible. However, a saver can add voluntary contributions on top of the 5.25% contributions redirected from PAYG pillar. Since 2017, voluntary contributions on top of redirected social insurance contributions are subject to the personal income tax (19%) as well as social and health insurance. Thus, the "T" regime applies for voluntary contributions.

Taxation of the Fund

Fund returns are not subject to Slovak income taxes at the fund level.

Taxation of pay-out phase income

Income generated via purchased pillar II pay-out phase products (annuity, perpetuity, programmed withdrawal) are not subject to personal income tax. In case of heritage, the amount the successor receives as inherited (accumulated) savings is not subject to personal income tax.

Thus, we can say that for Pillar II the "EEE" taxation regime applies in general. However, for voluntary contributions, the "TEE" regime applies.

Pillar III

Taxation of Pillar III differs from the Pillar II taxation approach significantly. There are different taxation treatments of contributions as well as different treatments of the pay-out phase. It is rather difficult to generalize the regime. However, the "EET" regime can be used with several exceptions and specifications.

Taxation of contributions

When considering the taxation treatment of contributions, a slightly different regime is used for savers' (employees') contributions and a different regime for employer's contributions.

Generally, both contributions are income-tax deductible; however, for employees (savers) there is a ceiling of EUR 180 per year. This means that the monthly contributions to the Pillar III supplementary pension fund up to EUR 15 are income tax base deductible. Above this amount, the contributions made to the individual saving account are subject to personal income tax. Considering that the average salary (EUR 1 430 in 2023), employee contributions up to 1.05% of the gross average salary can be deducted from the personal income tax base.

Employer contributions are treated in a slightly different way. Contributions are tied to the monthly salary of employees. Employer's contributions up to 6% of monthly salary are treated as tax expenses. Therefore, employers are motivated to contribute on behalf of employees up to this tax favourable ceiling. Taking into account the average salary in Slovakia, contributions up to EUR 85.80 per employee per month are considered as tax expenses for contributing employers in 2023. Taking into account the poor supplementary pension funds' performance and the relatively high level of charges, favourable tax treatment of employer's contributions are the key drivers for the participants. At the same time, this favourable treatment of employer's contributions paid on behalf of its employees exclusively in the Pillar III scheme creates an administrative monopoly in form of preferred supplementary retirement product in Slovakia.

Taxation of the Fund returns

Fund returns are exempt from income taxes at the fund level.

Taxation of pay-out phase

There are three different types of products used for the Pillar III pay-out phase (according to the Act on Supplementary Pension Saving):

1. Lump-sum — paid out through SPAMC at maximum of 50% of accumulated savings;
2. Annuities — paid out through insurance company in form of a single annuity;
3. Phased (Programmed) withdrawal — paid out through SPAMC for at least 5 years.

There are 3 general conditions, where at least one should be met when entering the pay-out phase in order to achieve more favourable tax treatment of income stream from Pillar III savings. They concern the member's age, the entitlement for state retirement pension benefits or the entitlement for early state retirement pension benefits.

When considering the tax treatment of the pay-out phase income stream from the saver's point of view, there is a possible way to adjust the personal income tax base. The Act on Income Tax stipulates that the deduction from income tax base will be applied to the income stream from Pillar III benefits and life insurance contracts. Personal income tax base shall be lowered by the paid contributions (Pillar III) or paid premiums (life insurance contract). The Act on Income Tax also defines the income tax base adjustments in case of paid monthly benefits according to the following formulas:

- In the case of temporary annuity, the income tax base is calculated as positive balance between sum of already received benefits and sum of paid contributions;
- In the case of single annuity, the income tax base is calculated as paid monthly benefits and total paid contributions (or premium) divided by the number of remaining years calculated as life expectancy and the age of the taxpayer (beneficiary) at the moment of the first paid benefit.

Therefore, we can conclude that the income tax treatment of pay-out phase is, in fact, a deferred taxation of investment returns applied not to the supplementary pension fund, but directly to the saver during the pay-out phase. In general, we can say, that the tax regime for Pillar III is "EET".

Performance of Slovakian long-term and pension savings

Real net returns of Slovakian long-term and pension savings

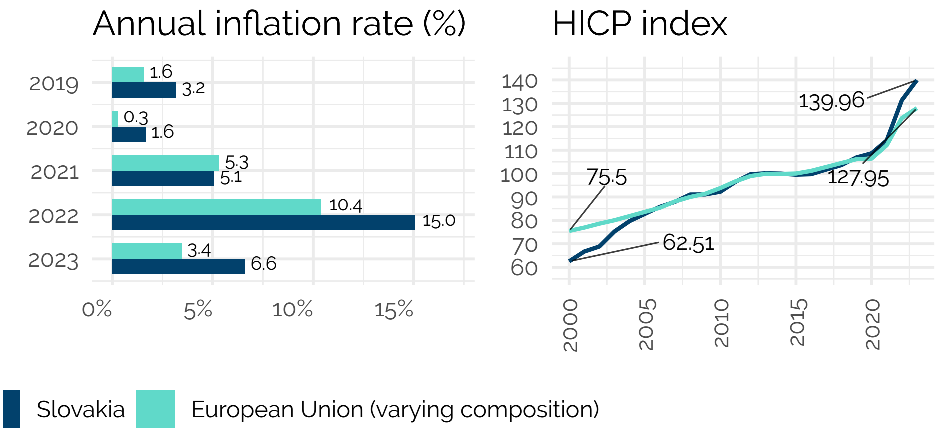
The year 2023 brought overall positive returns on both equity and bond markets for both pension pillars across all types of pension funds. Higher positive returns were recorded for equity based funds. On the other hand, higher inflation negatively influenced the performance of all pension funds.

The performance (returns and respective volatility) differs in all types of pension funds. This is caused by the portfolio structure and different investment strategies. Bond guaranteed pension funds do not invest in equity investments. Mixed non-guaranteed pension funds invest a small portion in equity investments (currently less than 40% of AuM on average) and equity non-guaranteed pension funds invest higher portion in equity investments (currently more than 50% of AuM on average). Optional Index non-guaranteed pension funds possess the highest level of equity investments (nearly 100% of AuM), because their fully passive investment strategy focusing on the replication of benchmark (various equity market index) performance. The following figure presents the performance of Pillar II Pension Funds over various holding periods.

Figure SK.2 – Inflation in Slovakia

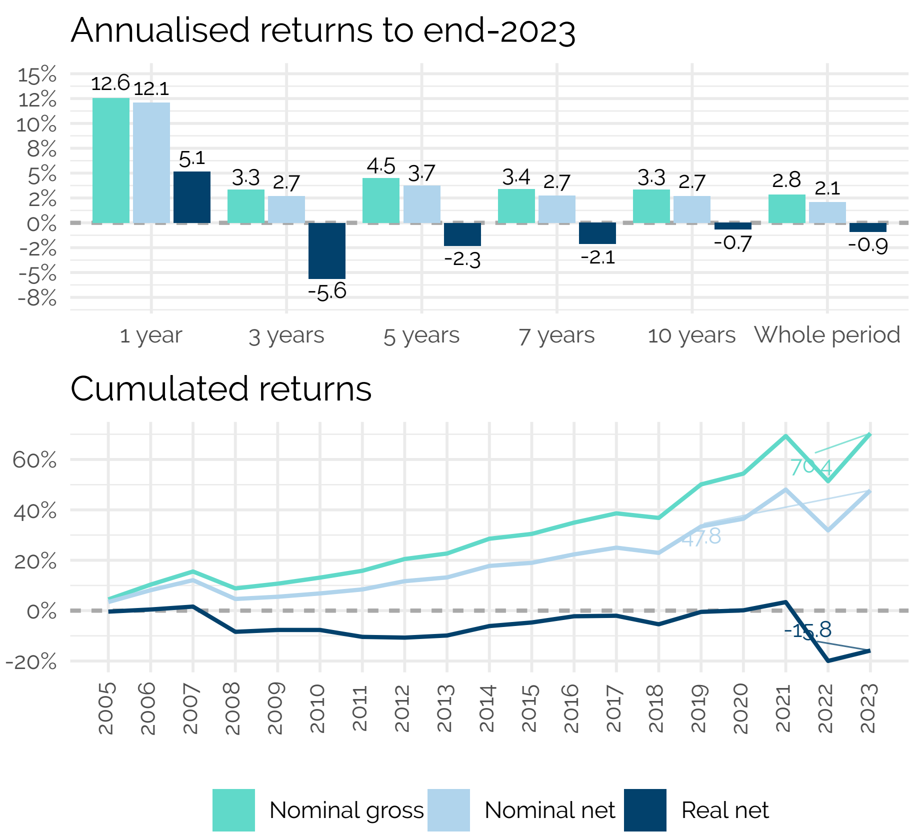
Period 2000–2023

	Annualised	**Cumulated**
Slovakia	3.8%	142.7%
European Union (varying composition)	2.3%	73.2%



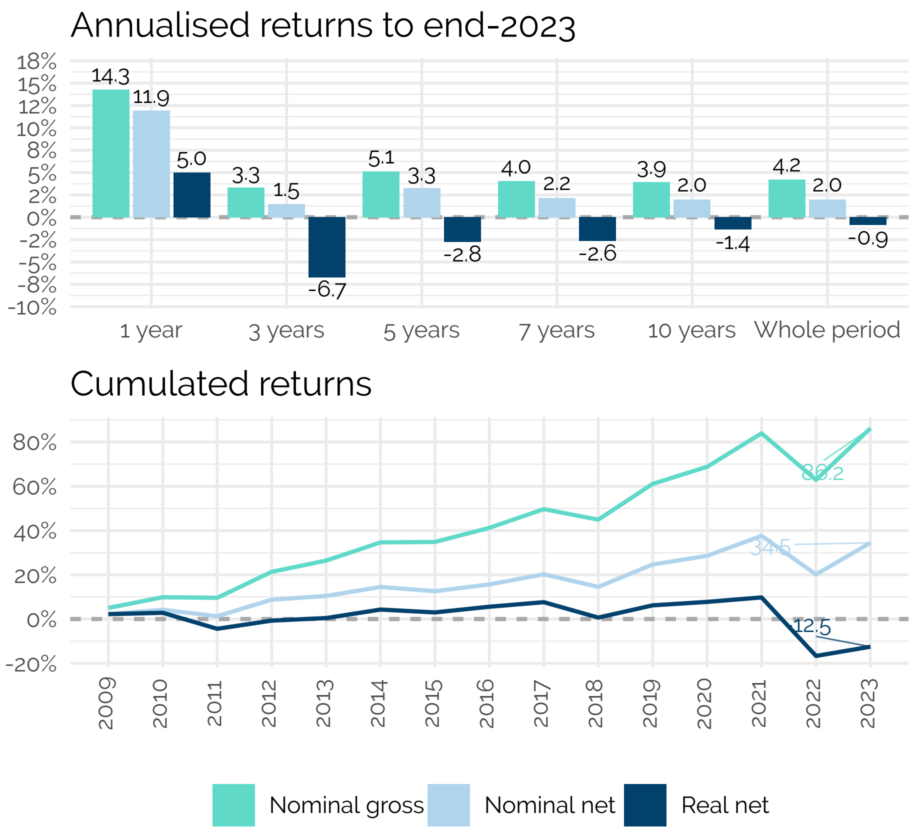
Data: Eurostat, HICP monthly index (2015 = 100); *Calculations:* BETTER FINANCE

Figure SK.3 – **Returns of Slovakian IORPs (before tax, % of AuM)**



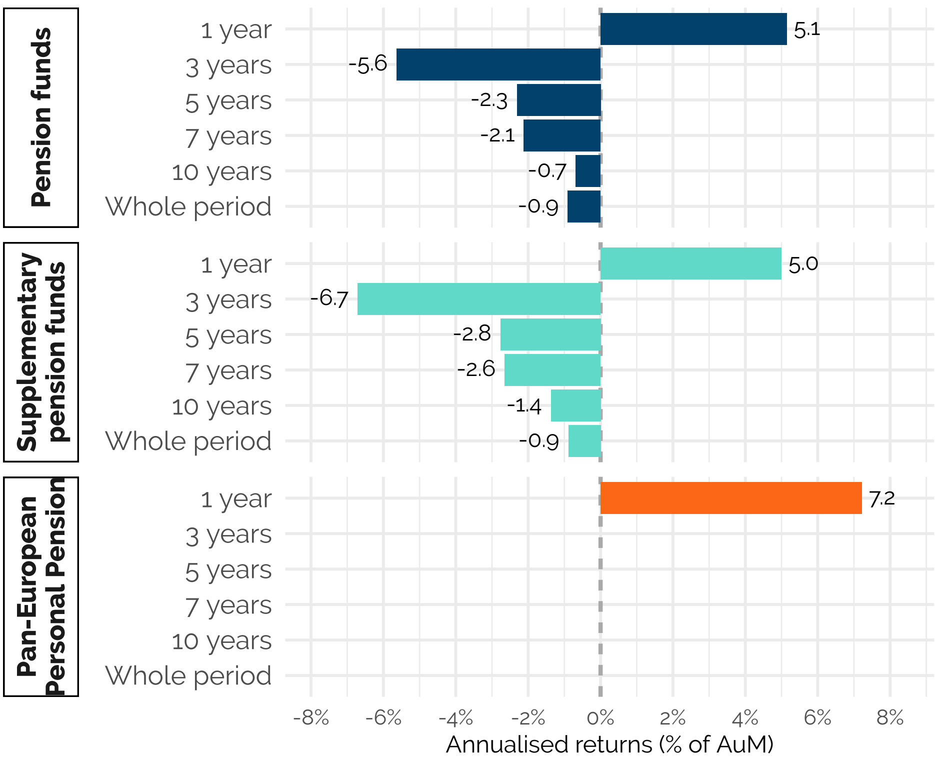
Data: National Bank of Slovakia, Pension Asset Management Companies, Eurostat; *Calculations:* BETTER FINANCE, holding periods to end-2023.

Figure SK.4 – **Returns of Slovakian pension savings products (before tax, % of AuM)**



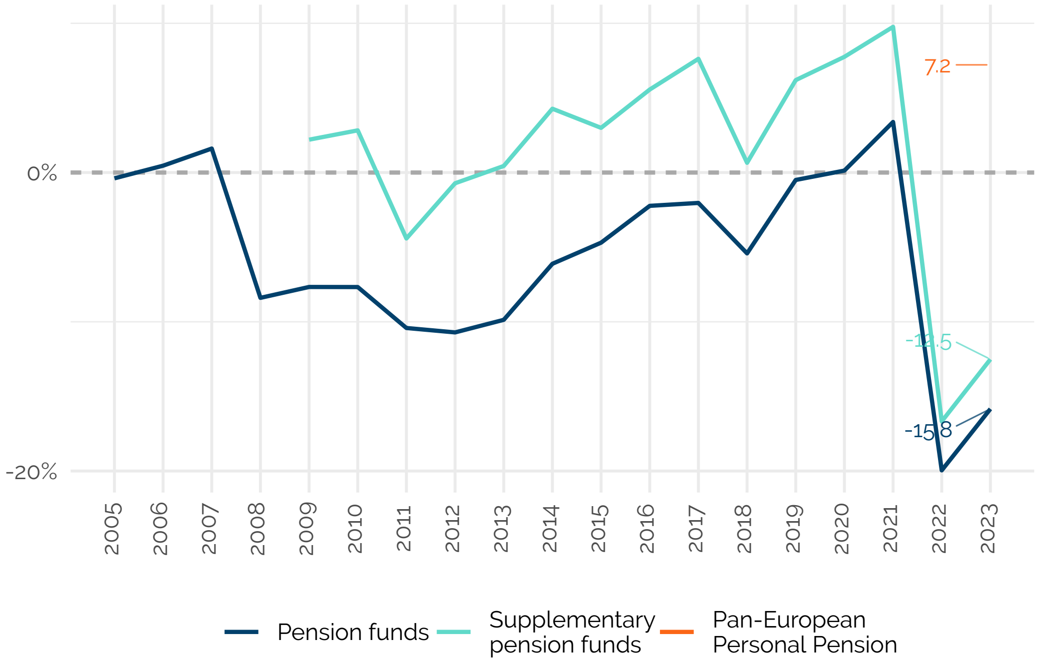
Data: National Bank of Slovakia, Supplementary Pension Asset Management Companie
Eurostat; *Calculations:* BETTER FINANCE, holding periods to end-2023.

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



Data: National Bank of Slovakia, Pension Asset Management Companies, Supplementary Asset Management Companies, PEPP providers, Eurostat; *Calculations:* BETTER FINANC to end-2023.

Figure SK.6 – **Cumulated returns of Slovakian long-term and pension savings vehicles (2000–2023, before tax, % of AuM)**



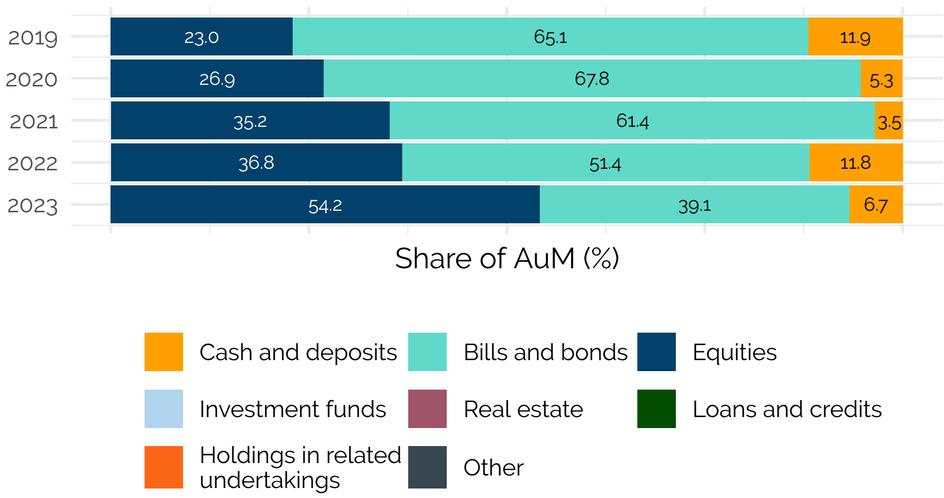
Data: National Bank of Slovakia, Pension Asset Management Companies, Supplementary Pension Asset Management Companies, PEPP providers, Eurostat; *Calculations:* BETTER FINANCE.

Do Slovakian savings products beat capital markets?

Before comparing the performance of savings products against relevant market benchmarks, portfolio structure of pension products should be understood.

For pillar II pension funds, most of the savings have been invested into money market instruments and later in bond investments due to the legislative ruling and started to invest more into equities starting 2015 (see Figure SK.8). Portfolio structure changes has started in 2023 by applying predefined saving strategy allocating all savings into passively managed index pension funds until the age of 50.

Figure SK.7 – Global allocation of Slovakian pension funds' assets



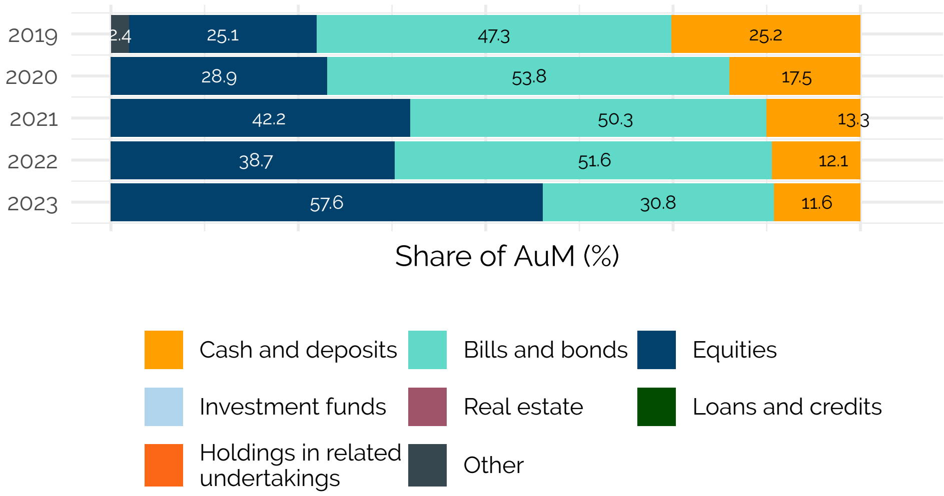
Data: Pension Asset Management Companies; *Calculations:* BETTER FINANCE.

Pillar III products have allocated savings into the equities and bonds, so the performance of the vehicles has been more volatile compared to the Pillar II pension funds. The portfolio structure of Pillar III Supplementary Pension funds is presented below.

In order to compare the performance, we set the weight for two key classes (equities and bonds) based on the respective portfolio structures of pension vehicles in both pillars (see Table SK.11).

The new PEPP products introduced in 2023 came on the market with clear, transparent and efficient passive management style delivering high performance combined with low fees well below 1% of AuM. However, unfair tax regime and inability to switch from Pillar III products towards PEPP products limit the increased value-for-money for savers.

Figure SK.8 – **Global allocation of Slovakian pension funds' assets**



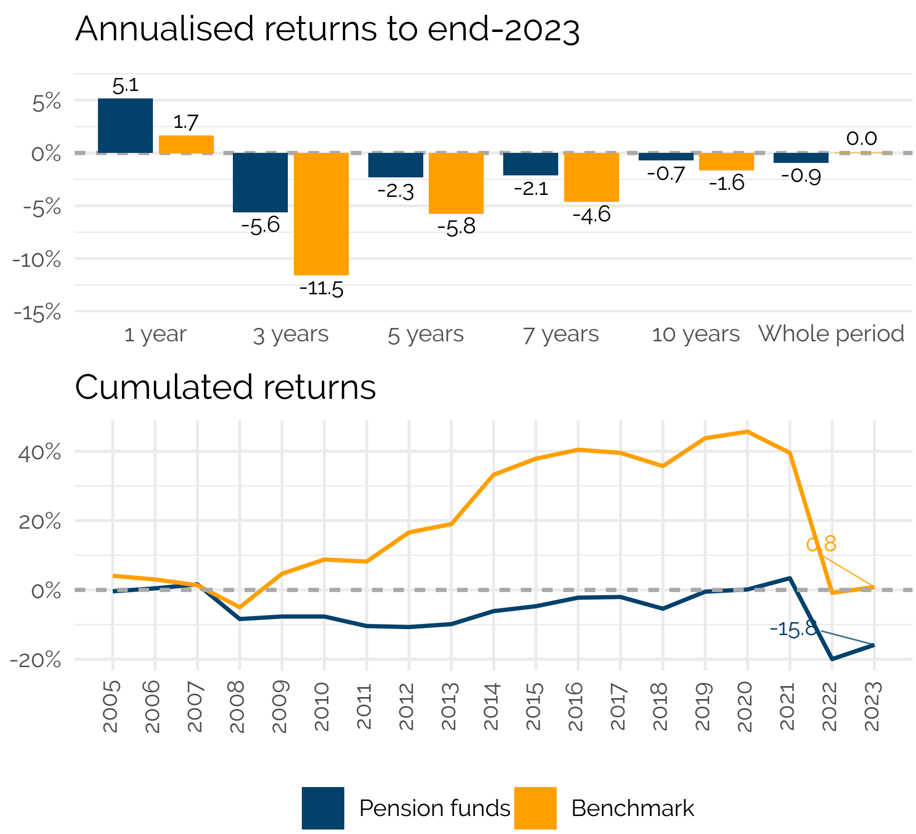
Data: Supplementary Pension Asset Management Companies; *Calculations:* BETTER FIN

Table SK.11 – **Capital market benchmarks to assess the performance of Slovakian pension vehicles**

Product	Equity index	Bonds index	Allocation
Pension funds	STOXX All Europe Total Market	Barclays Pan-European Aggregate Index	10.0%–90.0%
Supplementary pension funds	STOXX All Europe Total Market	Barclays Pan-European Aggregate Index	25.0%–75.0%
Pan-European Personal Pension	STOXX All Europe Total Market	Barclays Pan-European Aggregate Index	50.0%–50.0%

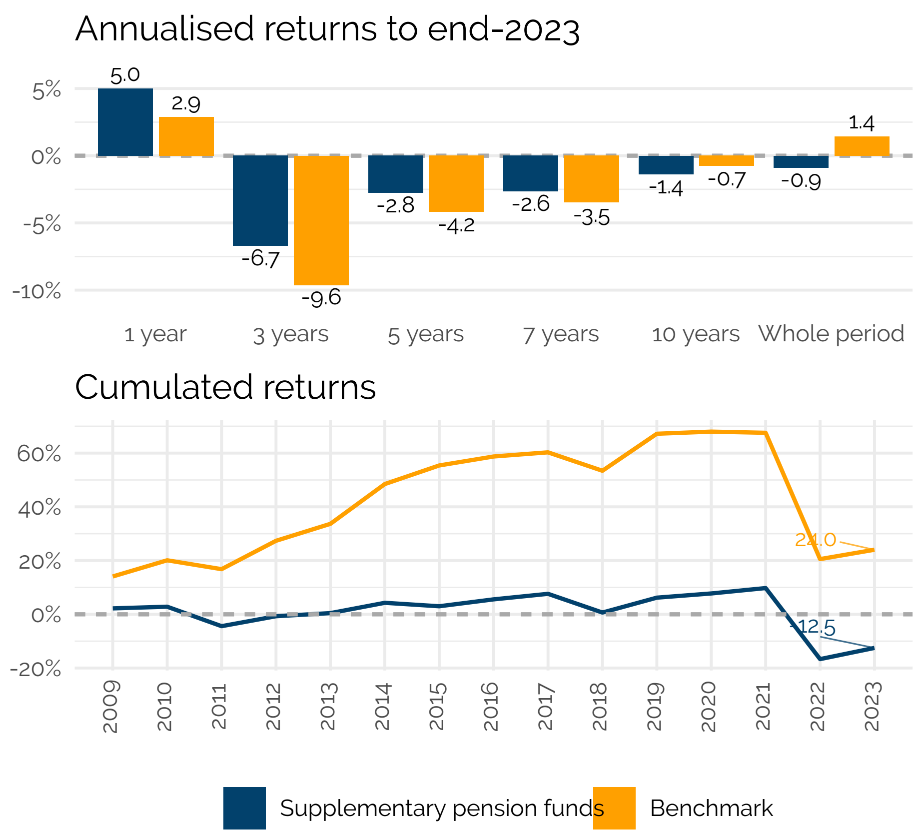
Note: Benchmark porfolios are rebalanced annually.

Figure SK.9 – Real performance of Slovakian Pillar II pension funds vs. capital markets (returns before tax, after inflation, % of AuM)



Data: National Bank of Slovakia, Pension Asset Management Companies, Eurostat; *Calculations:* BETTER FINANCE, holding periods to end-2023.

Figure SK.10 – **Real performance of Slovakian Pillar II pension funds vs. capital markets (returns before tax, after inflation, % of AuM)**



Data: National Bank of Slovakia, Supplementary Pension Asset Management Companie Eurostat; *Calculations:* BETTER FINANCE, holding periods to end-2023.

Conclusions

The Slovak multi-pillar pension system is not quite favourable for savers. Pillar II still suffers from constant changes and significant political risk therefore not only arises from diverging political opinions on the pension system. The new phenomena in Slovak pension system is the pension populism, where political parties reverted stabilization features and decreased the financial stability and trustworthiness of the PAYG scheme. The year 2022 brought major reform changes in Slovak pension pillar. However, it combines recommended positive changes (retirement age tied to the life expectancy, lowering fees for pension funds, introduction of predefined investment strategy) with the populistic features (new parental bonus, new early retirement rules, low state support for private savings). The new government in late 2023 decreased permanently the contributions towards the Pillar II scheme to 4% of contribution base, which will have significant detrimental impact on young savers due the fiscal imbalance of Pillar I on long-term.

The unprofessional move of transferring savers' assets from equity-based pension funds into bond ones in 2013 had detrimental effect on savings, which could lead to low pension pots and further political pressures on decreasing importance of private pension savings in Slovakia. The reform in 2022 with the introduction of predefined investment strategy for all inactive savers could improve the situation and expected pension benefits in future.

Pillar III pension vehicles are generally poorly performing, costly and without significant tax benefits for employees' contributions; Pillar III would never survive competition from Pillar II pension funds and typical investment funds. The debate on finding an appropriate regime for the Pillar III scheme is still ongoing, while there are several different views on how to make Pillar III more favourable for savers.

PEPP products introduced in 2023 suffers from uneven conditions compared to Pillar III products, however they have brought significantly lower level of fees.

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