PENSION SAVINGS
The Real Return

2019 Edition

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A Research Report by BETTER FINANCE

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Acronyms

AIF	Alternative Investment Fund
AMC	Annual Management Charges
AuM	Assets under Management
BE	Belgium
BG	Bulgaria
Bln	Billion
BPETR	'Barclay's Pan-European High Yield Total Return' Index
CAC 40	'Cotation Assistée en Continu 40' Index
CMU	Capital Markets Union
DAX 30	'Deutsche Aktieindex 30' Index
DB	Defined Benefit plan
DC	Defined Contribution plan
DE	Germany
DG	Directorate General of the Commission of the European Union
DK	Denmark
DWP	United Kingdom's Governmental Agency Department for Work and Pensions
EBA	European Banking Authority
EE	Estonia
EEE	Exempt-Exempt-Exempt Regime
EET	Exempt-Exempt-Tax Regime
ETF	Exchange-Traded Fund
EIOPA	European Insurance and Occupational Pensions Authority
ES	Spain
ESAs	European Supervisory Authorities
ESMA	European Securities and Markets Authority
EU	European Union
EURIBOR	Euro InterBank Offered Rate
EX	Executive Summary
FR	France
FSMA	Financial Services and Market Authority (Belgium)
FSUG	Financial Services Users Group - European Commission's Expert Group
FTSE 100	The Financial Times Stock Exchange 100 Index
FW	Foreword

GDP	Gross Domestic Product
HICP	Harmonised Indices of Consumer Prices
IBEX 35	Índice Bursátil Español 35 Index
IKZE	‘Indywidualne konto zabezpieczenia emerytalnego’ – Polish specific Individual pension savings account
IRA	United States specific Individual Retirement Account
IT	Italy
JPM	J&P Morgan Indices
KIID	Key Investor Information Document
LV	Latvia
NAV	Net Asset Value
Mln	Million
MSCI	Morgan Stanley Capital International Indices
NL	Netherlands
OECD	The Organisation for Economic Co-Operation and Development
OFT	United Kingdom’s Office for Fair Trading
PAYG	Pay-As-You-Go Principle
PIP	Italian specific ‘Individual Investment Plan’
PL	Poland
PRIIP(s)	Packaged Retail and Insurance-Based Investment Products
RO	Romania
S&P	Standard & Poor Indexes
SE	Sweden
SK	Slovakia
SME	Small and Medium-sized Enterprise
SPIVA Scorecard	Standard & Poor Dow Jones’ Indices Research Report on Active Management performances
TEE	Tax-Exempt-Exempt Regime
TCR/TER	Total Cost Ratio/ Total Expense Ratio
UCITS	Undertakings for the Collective Investment of Transferable Securities
UK	United Kingdom

Glossary of terms

Accrued benefits* – is the amount of accumulated pension benefits of a pension plan member on the basis of years of service.

Accumulated assets* – is the total value of assets accumulated in a pension fund.

Active member* – is a pension plan member who is making contributions (and/or on behalf of whom contributions are being made) and is accumulating assets.

AIF(s) – or Alternative Investment Funds are a form of collective investment funds under E.U. law that do not require authorization as a UCITS fund.[1]

Annuity* – is a form of financial contract mostly sold by life insurance companies that guarantees a fixed or variable payment of income benefit (monthly, quarterly, half-yearly, or yearly) for the life of a person(s) (the annuitant) or for a specified period of time. It is different than a life insurance contract which provides income to the beneficiary after the death of the insured. An annuity may be bought through instalments or as a single lump sum. Benefits may start immediately or at a pre-defined time in the future or at a specific age.

Annuity rate* – is the present value of a series of payments of unit value per period payable to an individual that is calculated based on factors such as the mortality of the annuitant and the possible investment returns.

Asset allocation* – is the act of investing the pension fund's assets following its investment strategy.

Asset management* – is the act of investing the pension fund's assets following its investment strategy.

Asset manager* – is(are) the individual(s) or entity(ies) endowed with the responsibility to physically invest the pension fund assets. Asset managers may also set out the investment strategy for a pension fund.

Average earnings scheme* – is a scheme where the pension benefits earned for a year depend on how much the member's earnings were for the given year.

Basic state pension* – is a non-earning related pension paid by the State to individuals with a minimum number of service years.

Basis points (bps) – represent the 100th division of 1%.

Benchmark (financial) – is a referential index for a type of security. Its aim is to show, customized for a level and geographic or sectorial focus, the general price or performance of the market for a financial instrument.

Beneficiary* – is an individual who is entitled to a benefit (including the plan member and dependants).

Benefit* – is a payment made to a pension fund member (or dependants) after retirement.

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[1] See Article 4(1) of Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010, OJ L 174, 1.7.2011, p. 1–73.

Bonds – are instruments that recognize a debt. Although they deliver the same utility as bank loans, i.e. enabling the temporary transfer of capital from one person to another, with or without a price (interest) attached, bonds can be also be issued by non-financial institutions (States, companies) and by financial non-banking institutions (asset management companies). In essence, bonds are considered more stable (the risk of default is lower) and in theory deliver a lower, but fixed, rate of profit. Nevertheless, Table EX2 of the Executive Summary shows that the aggregated European Bond Index highly overperformed the equity one.

Closed pension funds* – are the funds that support only pension plans that are limited to certain employees. (e.g. those of an employer or group of employers).

Collective investment schemes – are financial products characterised by the pooling of funds (money or asset contributions) of investors and investing the total into different assets (securities) and managed by a common asset manager. Under E.U. law collective investment schemes are regulated under 6 different legal forms: UCITS (see below), the most common for individual investors; AIFs (see above), European Venture Capital funds (EuVECA), European Long-Term Investment Funds (ELTIFs), European Social Entrepreneurship Funds (ESEF) or Money Market Funds.[2]

Contribution* – is a payment made to a pension plan by a plan sponsor or a plan member.

Contribution base* – is the reference salary used to calculate the contribution.

Contribution rate* – is the amount (typically expressed as a percentage of the contribution base) that is needed to be paid into the pension fund.

Contributory pension scheme* – is a pension scheme where both the employer and the members have to pay into the scheme.

Custodian* – is the entity responsible, as a minimum, for holding the pension fund assets and for ensuring their safekeeping.

Defered member* – is a pension plan member that no longer contributes to or accrues benefits from the plan but has not yet begun to receive retirement benefits from that plan.

Deferred pension* – is a pension arrangement in which a portion of an employee's income is paid out at a date after which that income is actually earned.

Defined benefit (DB) occupational pension plans* – are occupational plans other than defined contributions plans. DB plans generally can be classified into one of three main types, "traditional", "mixed" and "hybrid" plans. These are schemes where "the pension payment is defined as a percentage of income and employment career. The employee receives a thus pre-defined pension and does not bear the risk of longevity and the risk of investment. Defined Benefits schemes may be part of an individual employment contract or collective agreement. Pension contributions are usually paid by the employee and the employer".[3]

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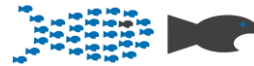
[2] See European Commission, 'Investment Funds' (28 August 2019) https://ec.europa.eu/info/business-economy-euro/growth-and-investment/investment-funds_en.

[3] Werner Eichhorst, Maarten Gerard, Michael J. Kendzia, Christine Mayrhruber, Connie Nielsen, Gerhard Runstler, Thomas Url, 'Pension Systems in the EU: Contingent Liabilities and



"Traditional" DB plan* – is a DB plan where benefits are linked through a formula to the members' wages or salaries, length of employment, or other factors.

"Hybrid" DB plan* – is a DB plan where benefits depend on a rate of return credited to contributions, where this rate of return is either specified in the plan rules, independently of the actual return on any supporting assets (e.g. fixed, indexed to a market benchmark, tied to salary or profit growth, etc.), or is calculated with reference to the actual return of any supporting assets and a minimum return guarantee specified in the plan rules.

"Mixed" DB plan* – is a DB plans that has two separate DB and DC components, but which are treated as part of the same plan.

Defined contribution (DC) occupational pension plans* – are occupational pension plans under which the plan sponsor pays fixed contributions and has no legal or constructive obligation to pay further contributions to an ongoing plan in the event of unfavorable plan experience. These are schemes where "the pension payment depends on the level of defined pension contributions, the career and the returns on investments. The employee has to bear the risk of longevity and the risk of investment. Pension contributions can be paid by the employee and/or the employer and/or the state".[4]

Dependency ratio* – are occupational pension plans under which the plan sponsor pays fixed contributions and has no legal or constructive obligation to pay further contributions to an ongoing plan in the event of unfavourable plan experience.

Early retirement* – is a situation when an individual decides to retire earlier later and draw the pension benefits earlier than their normal retirement age.

Economic dependency ratio* – is the division between the number of inactive (dependent) population and the number of active (independent or contributing) population. It ranges from 0% to 100% and it indicates how much of the inactive population's (dependent) consumption is financed from the active population's (independent) contributions.[5] In general, the inactive (dependent) population is represented by children, retired persons and persons living on social benefits.

EET system* – is a form of taxation of pension plans, whereby contributions are exempt, investment income and capital gains of the pension fund are also exempt, and benefits are taxed from personal income taxation.

Equity (or stocks/shares) – are titles of participation to a publicly listed company's economic activity. With regards to other categorizations, an equity is also a security, a financial asset or, under E.U. law, a transferable security.[6]

Assets in the Public and Private Sector' EP Directorate General for Internal Policies IP/A/ECON/ST/2010-26.

[4] Ibid.

[5] For more detail on the concept, see Elke Loichinger, Bernhard Hammer, Alexia Prskawetz, Michael Freiberger, Joze Sambt, 'Economic Dependency Ratios: Present Situation and Future Scenarios' MS13 Policy Paper on Implications of Population Ageing for Transfer Systems, Working Paper no. 74, 18th December 2014, 3.

[6] Article 4(44) of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, OJ L 173, p. 349–496 (MiFID II).

ETE system* – is a form of taxation whereby contributions are exempt, investment income and capital gains of the pension fund are taxed, and benefits are also exempt from personal income taxation.

ETF(s) – or Exchange-Traded Funds are investment funds that are sold and bought on the market as an individual security (such as shares, bonds). ETFs are structured financial products, containing a basket of underlying assets, and are increasingly more used due to the very low management fees that they entail.

Fund member* – is an individual who is either an active (working or contributing, and hence actively accumulating assets) or passive (retired, and hence receiving benefits), or deferred (holding deferred benefits) participant in a pension plan.

Funded pension plans* – are occupational or personal pension plans that accumulate dedicated assets to cover the plan's liabilities.

Funding ratio (funding level) * – is the relative value of a scheme's assets and liabilities, usually expressed as a percentage figure.

Gross rate of return* – is the rate of return of an asset or portfolio over a specified time period, prior to discounting any fees of commissions.

Gross/net replacement rate – is the ratio between the pre-retirement gross or net income and the amount of pension received by a person after retirement. The calculation methodology may differ from source to source as the average working life monthly gross or net income can used to calculate it (divided by the amount of pension) or the past 5 year's average gross income etc. (see below **OECD net replacement rate).**

Group pension funds* – are multi-employer pension funds that pool the assets of pension plans established for related employers.

Hedging and hedge funds – while hedging is a complex financial technique (most often using derivatives) to protect or reduce exposure to risky financial positions or to financial risks (for instance, currency hedging means reducing exposure to the volatility of a certain currency), a hedge fund is an investment pool that uses complex and varying investment techniques to generate profit.

Indexation* – is the method with which pension benefits are adjusted to take into account changes in the cost of living (e.g. prices and/or earnings).

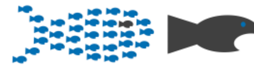
Individual pension plans* – is a pension fund that comprises the assets of a single member and his/her beneficiaries, usually in the form of an individual account.

Industry pension funds* – are funds that pool the assets of pension plans established for unrelated employers who are involved in the same trade or businesses.

Mandatory contribution* – is the level of contribution the member (or an entity on behalf of the member) is required to pay according to scheme rules.

Mandatory occupational plans* – Participation in these plans is mandatory for employers. Employers are obliged by law to participate in a pension plan. Employers must set up (and make contributions to) occupational pension plans which employees will normally be required to join. Where employers are obliged to offer an occupational pension plan, but the employees' membership is on a voluntary basis, these plans are also considered mandatory.

Mandatory personal pension plans* - are personal plans that individuals must join or which are eligible to receive mandatory pension contributions. Individuals may be required to make pension



contributions to a pension plan of their choice normally within a certain range of choices or to a specific pension plan.

Mathematical provisions (insurances) – or *mathematical reserves* or *reserves*, are the value of liquid assets set aside by an insurance company that would be needed to cover all current liabilities (payment obligations), determined using actuarial principles.

Minimum pension* – is the minimum level of pension benefits the plan pays out in all circumstances.

Mixed indexation* – is the method with which pension benefits are adjusted taking into account changes in both wages and prices.

Money market instruments – are short-term financial products or positions (contracts) that are characterized by the very high liquidity rate, such as deposits, shor-term loans, repo-agreements and so on.

MTF – multilateral trading facility, is the term used by the revised Markets in Financial Instruments Directive (MiFID II) to designate securities exchanges that are not a regulated market (such as the London Stock Exchange, for example).

Multi-employer pension funds* – are funds that pool the assets of pension plans established by various plan sponsors. There are three types of multi-employer pension funds:

a) for related employers i.e. companies that are financially connected or owned by a single holding group (group pension funds);

b) for unrelated employers who are involved in the same trade or business (industry pension funds);

c) for unrelated employers that may be in different trades or businesses (collective pension funds).

NAV – Net Asset Value, or the amount to which the market capitalisation of a financial product (for this report, pension funds' or insurance funds' holdings) or a share/unit of it arises at a given point. In general, the Net Asset Value is calculated per unit or share of a collective investment scheme using the daily closing market prices for each type of security in the portfolio.

Net rate of return* – is the rate of return of an asset or portfolio over a specified time period, after discounting any fees of commissions.

Normal retirement age* – is the age from which the individual is eligible for pension benefits.

Non-contributory pension scheme* – is a pension scheme where the members do not have to pay into scheme.

Occupational pension plans* – access to such plans is linked to an employment or professional relationship between the plan member and the entity that establishes the plan (the plan sponsor). Occupational plans may be established by employers or groups of thereof (e.g. industry associations) and labour or professional associations, jointly or separately. The plan may be administrated directly by the plan sponsor or by an independent entity (a pension fund or a financial institution acting as pension provider). In the latter case, the plan sponsor may still have oversight responsibilities over the operation of the plan.

OECD gross replacement rate - is defined as gross pension entitlement divided by gross pre-retirement earnings. It measures how effectively a pension system provides a retirement income to

replace earnings, the main source of income before retirement. This indicator is measured in percentage of pre-retirement earnings by gender.

OECD net replacement rate - is defined as the individual net pension entitlement divided by net pre-retirement earnings, taking into account personal income taxes and social security contributions paid by workers and pensioners. It measures how effectively a pension system provides a retirement income to replace earnings, the main source of income before retirement. This indicator is measured in percentage of pre-retirement earnings by gender.

Old-age dependency ratio - defined as the ratio between the total number of elderly persons when they are generally economically inactive (aged 65 and above) and the number of persons of working age.[7] It is a sub-indicator of the economic dependency ratio and focuses on a country's public (state) pension system's reliance on the economically active population's pensions (or social security) contributions. It is a useful indicator to show whether a public (Pillar I) pension scheme is under pressure (when the ratio is high, or the number of retirees and the number of workers tend to be proportionate) or relaxed (when the ratio is low, or the number of retirees and the number of workers tend to be disproportionate). For example, a low old-age dependency ratio is 20%, meaning that 5 working people contribute for one retiree's pension.

Open pension funds* – are funds that support at least one plan with no restriction on membership.

Pension assets* – are all forms of investment with a value associated to a pension plan.

Pension fund administrator* – is(are) the individual(s) ultimately responsible for the operation and oversight of the pension fud.

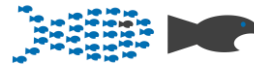
Pension fund governance* – is the operation and oversight of a pension fund. The governing body is responsible for administration, but may employ other specialists, such as actuaries, custodians, consultants, asset managers and advisers to carry out specific operational tasks or to advise the plan administration or governing body.

Pension fund managing company* – is a type of administrator in the form of a company whose exclusive activity is the administration of pension funds.

Pension funds* – the pool of assets forming an independent legal entity that are bought with the contributions to a pension plan for the exclusive purpose of financing pension plan benefits. The plan/fund members have a legal or beneficial right or some other contractual claim against the assets of the pension fund. Pension funds take the form of either a special purpose entity with legal personality (such as a trust, foundation, or corporate entity) or a legally separated fund without legal personality managed by a dedicated provider (pension fund management company) or other financial institution on behalf of the plan/fund members.

Pension insurance contracts* – are insurance contracts that specify pension plans contributions to an insurance undertaking in exchange for which the pension plan benefits will be paid when the members reach a specified retirement age or on earlier exit of members from the plan. Most countries limit the integration of pension plans only into pension funds, as the financial vehicle of the pension plan. Other countries also consider the pension insurance contract as the financial vehicle for pension plans.

[7] See Eurostat definition: http://ec.europa.eu/eurostat/web/products-datasets/product?code=tsdde511.



Pension plan* – is a legally binding contract having an explicit retirement objective (or – in order to satisfy tax-related conditions or contract provisions – the benefits can not be paid at all or without a significant penalty unless the beneficiary is older than a legally defined retirement age). This contract may be part of a broader employment contract, it may be set forth in the plan rules or documents, or it may be required by law. In addition to having an explicit retirement objective, pension plans may offer additional benefits, such as disability, sickness, and survivors' benefits.

Pension plan sponsor* – is an institution (e.g. company, industry/employment association) that designs, negotiates, and normally helps to administer an occupational pension plan for its employees or members.

Pension regulator* – is a governmental authority with competence over the regulation of pension systems.

Pension supervisor* – is a governmental authority with competence over the supervision of pension systems.

Personal pension plans* - Access to these plans does not have to be linked to an employment relationship. The plans are established and administered directly by a pension fund or a financial institution acting as pension provider without any intervention of employers. Individuals independently purchase and select material aspects of the arrangements. The employer may nonetheless make contributions to personal pension plans. Some personal plans may have restricted membership.

Private pension funds* – is a pension fund that is regulated under private sector law.

Private pension plans* – is a pension plan administered by an institution other than general government. Private pension plans may be administered directly by a private sector employer acting as the plan sponsor, a private pension fund or a private sector provider. Private pension plans may complement or substitute for public pension plans. In some countries, these may include plans for public sector workers.

Public pension plans* – are pensions funds that are regulated under public sector law.

Public pension plans* – are the social security and similar statutory programmes administered by the general government (that is central, state, and local governments, as well as other public sector bodies such as social security institutions). Public pension plans have been traditionally PAYG financed, but some OECD countries have partial funding of public pension liabilities or have replaced these plans by private pension plans.

Rate of return* – is the income earned by holding an asset over a specified period.

REIT(s) or Real Estate Investment Trust(s) is the most common acronym and terminology used to designate special purpose investment vehicles (in short, companies) set up to invest and commercialise immovable goods (real estate) or derived assets. Although the term comes from the U.S. legislation, in the E.U. there are many forms of REITs, depending on the country since the REIT regime is not harmonised at E.U. level.

Replacement ratio* – is the ratio of an individual's (or a given population's) (average) pension in a given time period and the (average) income in a given time period.

Service period* – is the length of time an individual has earned rights to a pension benefits.

Single employer pension funds* – are funds that pool the assets of pension plans established by a single sponsor.

Supervisory board* – is(are) the individual(s) responsible for monitoring the governing body of a pension entity.

System dependency ratio* – typically defined as the ratio of those receiving pension benefits to those accruing pension rights.

TEE system* – is a form of taxation of pension plans whereby contributions are taxed, investment income and capital gains of the pension fund are exempt, and benefits are also exempt from personal income taxation.

Trust* – is a legal scheme, whereby named people (termed trustees) hold property on behalf of other people (termed beneficiaries).

Trustee* – is a legal scheme, whereby named people (termed trustees) hold property on behalf of other people (termed beneficiaries).

UCITS – or Undertakings for Collective Investment in Transferable Securities, is the legal form under E.U. law for mutual investment funds that are open to pool and invest funds from any individual or institutional investor, and are subject to specific authorisation criteria, investment limits and rules. The advantage of UCITS is the general principle of home-state authorisation and mutual recognition that applies to this kind of financial products, meaning that a UCITS fund established and authorised in one E.U. Member State can be freely distributed in any other Member State without any further formalities (also called *E.U. fund passporting*).

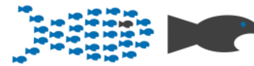
Unfunded pension plans* – are plans that are financed directly from contributions from the plan sponsor or provider and/or the plan participant. Unfunded pension plans are said to be paid on a current disbursement method (also known as the pay as you go, PAYG, method). Unfunded plans may still have associated reserves to cover immediate expenses or smooth contributions within given time periods. Most OECD countries do not allow unfunded private pension plans.

Unprotected pension plan* – is a plan (personal pension plan or occupational defined contribution pension plan) where the pension plan/fund itself or the pension provider does not offer any investment return or benefit guarantees or promises covering the whole plan/fund.

Voluntary contribution – is an extra contribution paid in addition to the mandatory contribution a member can pay to the pension fund in order to increase the future pension benefits.

Voluntary occupational pension plans - The establishment of these plans is voluntary for employers (including those in which there is automatic enrolment as part of an employment contract or where the law requires employees to join plans set up on a voluntary basis by their employers). In some countries, employers can on a voluntary basis establish occupational plans that provide benefits that replace at least partly those of the social security system. These plans are classified as voluntary, even though employers must continue sponsoring these plans in order to be exempted (at least partly) from social security contributions.

Voluntary personal pension plans* – Participation in these plans is voluntary for individuals. By law individuals are not obliged to participate in a pension plan. They are not required to make pension contributions to a pension plan. Voluntary personal plans include those plans that individuals must



join if they choose to replace part of their social security benefits with those from personal pension plans.

Wage indexation* – is the method with which pension benefits are adjusted taking into account changes in wages.

Waiting period* – is the length of time an individual must be employed by a particular employer before joining the employer's pension scheme.

Winding-up* – is the termination of a pension scheme by either providing (deferred) annuities for all members or by moving all its assets and liabilities into another scheme.

World Bank multi-pillar model – is the recommended design, developed by the World Bank in 1994, for States that had pension systems inadequately equipped to (currently and forthcoming) sustain a post-retirement income stream for future pensioners and alleviate the old-age poverty risk. Simpler, it is a set of guidelines for States to either enact, reform or gather legislation regulating the state pension and other forms of retirement provisions in a form that would allow an increased workers' participation, enhance efficiency for pension savings products and a better allocation of resources under the principle of solidarity between generations.

The standard design of a robust pension system would rely on five pillars:

a) the non-contributory scheme (pillar 0), through which persons who do not have an income or do not earn enough would have insured a minimum pension when reaching the standard retirement age;

b) the public mandatory, Pay-As-You-Go (PAYG) scheme (**Pillar I**), gathering and redistributing pension contributions from the working population to the retirees, while accumulating pension rights (entitlements) for the future retirees;

c) the mandatory funded and (recommended) privately managed scheme (**Pillar II**), where workers' contributions are directed to their own accumulation accounts in privately managed investment products;

d) the voluntary privately managed retirement products (**Pillar III**), composed of pension savings products to which subscription is universal, contributions and investments are deregulated and tax-incentivised;

e) the non-financial alternative aid scheme (pillar IV), through which the state can offer different forms of retirement support – such as housing or family support. Albeit the abovementioned, the report focuses on the "*main pillars*", i.e. Pillar I, II and III, since they are the most significant (and present everywhere) in the countries that have adopted the multi-pillar model.

Definitions with "*" are taken from OECD's Pensions Glossary - http://www.oecd.org/daf/fin/private-pensions/38356329.pdf.

Contributors

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Michaël Deinema is Chief Commercial Officer and analyst at The Pension Rating Agency (TPRA) based in Amsterdam, The Netherlands. Before joining TPRA in 2015, Michaël worked as postdoctoral researcher and lecturer at the Social and Behavioral Sciences faculty of the University of Amsterdam. He holds a PhD degree in Spatial Sciences (Economic and Social Geography). The Pension Rating Agency (TPRA) is an independent data service firm, benchmarker and rating agency for the Dutch collective pensions sector. It was founded in 2014 as a joint venture by MoneyView, a renowned research agency which focuses on financial retail products, and the econometricians of Broiler. TPRA systematically gathers, utilizes and analyzes publicly available data on Dutch pension funds and pension schemes. It produces annual reports on operating costs, investment charges, returns, cover ratios and trustee compensations which are used by Dutch pension funds, pension service providers, life insurance companies and media outlets. TPRA also publishes The Netherlands' only comprehensive and independent Quality Rating for Pension Schemes.

Laetitia Gabaut is an economist who graduated from the Toulouse School of Economics. She joined the European Savings Institute in 2010, where she is in charge of the "Overview of Savings" publication. She has been involved in European projects related to savers' behaviour and to retirement savings.

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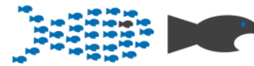

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Pension Savings: The Real Return

2019 Edition

Country Case: Italy

Sommario

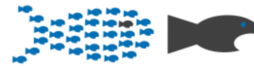
Con una spesa pubblica (in % al PIL) del 11.6%, la riforma del sistema pensionistico italiano ha determinato un solido Pillar I, in particolare il rapporto di sostituzione tra il reddito pensionistico e quello da lavoro si attesta a 93% in 2016, confermandosi uno dei più alti tra i Paesi studiati nel presente Rapporto.

Considerando inoltre la relativamente bassa partecipazione delle famiglie italiane nel mercato dei capitali, l'interesse a indirizzare il reddito disponibile verso il risparmio pensionistico o prodotti di investimetento è basso. Questa situazione si evince in primo luogo dalla percentuale di assets dei fondi pensione italiani (10% in rapporto al PIL) e in secondo luogo dalla percentuale della popolazione economicamente attiva associata agli schemi del Pillar II (17.3%) e del Pillar III (13.1%).

Per quanto riguarda i rendiementi: i fondi pensione chiusi hanno avuto una performance media dell'1% (+14% cumulativa) negli ultimi 11 anni e dello 0.7% negli utlimi 19 anni; mentre i fondi pensione aperti la performance media è stata dello 0.7% e del -0,4% con riferimento nel primo caso agli ultimi 11 e anni nel secondo agli ultimi 19 anni . I PIP (*Piani Individuali Pensionistici)* hanno avuto una performance media dello 0.9% negli ultimi 11 anni, mentre i PIP unit-linked hanno avuto un rendimento medio dello 0,4% nello stesso arco di tempo- tutti i rendimenti sono espressi al netto di inflazione, commissioni e tasse.

Summary

The Italian Pension System currently has a public expenditure of 11.6% of GDP. The Italian pension system reform in 2011 created a strong Pillar I scheme, with a pension net pre-retirement income replacement ratio of 93% in 2016, one of the highest among the country cases under review in this Report. Considering also the relatively low participation rate of Italian households in capital markets, the incentive to direct available income to the private retirement savings or investment products is low. This becomes apparent when looking at the percentage of Italian pension funds' assets, of 10% of GDP, as well as the coverage ratio for Pillar II of 17.3% and Pillar III of 13.1% of the labor force.



With regards to performances, contractual pension funds returned 1% annually on average over the past 11 years and 0.7% over the past 19 years. Open pension funds returned 0.7% annually on average over the past 11 years and -0.4% over the past 19 years, while PIP (*Piani Individuali Pensionistici*) with-profits experienced 0.9% annually on average over the past 11 years, while PIP unit-linked experienced 0.4% annually on average over the same period. All returns are expressed net of charges, taxes on benefits and inflation.

Introduction

The Italian Pension System is divided into three pillars:

- Pillar I – the public (state) pension scheme;
- Pillar II – the occupational (mandatory) pension arrangements;
- Pillar III – the individual (voluntary) pension schemes.

Pillar I – State Pension

Whilst it used to be a Defined Benefit system, the current Italian pension system is now based on a Notional Defined Contribution system. The Italian state pension system has gone through intensive reforms. The year 1995 can be seen as the threshold for moving from a defined benefits system towards a defined contribution system, the result of one of the most important law towards the restructuring of the Italian pension system: the Dini reform (law 335/1995). As a result, all workers entering the job market after 1995 have been accruing their pension entitlement according to a defined contributions method, while before 1995, pension entitlements were computed according to an earnings-related system.

The first pillar (state and mandatory) is the main pension vehicle in Italy and is made up of two tiers: the zero and first tier. The zero tier consists of a social pension ensuring a minimum level of income for the elderly. The first tier covers employed individuals and it constitutes a notional defined contribution system for all future generations.[192]

Italy spends 11.6% of its GDP on pension-benefit expenditures, while the EU level was at 9.6% in 2016, according to Eurostat. Pensions, therefore, represent a massive share of the GDP in the country. Italy faces a huge demographic challenge. The number of retirees, unemployed individuals or individuals outside of the labour force together constitute over 80% of the number of employed people (referred to as the economic dependency ratio, which is 1.25).

[192] Since the structural reform implemented by Minister Dini in 1995, the Italian pension system has been re-designed according to the Notional Defined Contribution system, in order to guarantee the stability of public finances.

In 2050, the population aged 65 years or more will represent 70% compared to the population aged 15-64, the highest percentage across developed countries - on equal footing with Japan.

Given this context, the urgency to reform the pension system was clear. In 2011, the minister of Welfare and Social Policy under the Monti Government, Elsa Fornero, put in place a huge state pension reform (law n.214) to bring the system closer to equilibrium. Under the new system, pension eligibility is based on working years rather than age. Earlier retirement is possible, but subject to penalties. The public pension system is thus sustainable, though the Italian Constitutional Court stated in April 2015 that the suppression of indexation of pensions on inflation included in the "Fornero law" was unconstitutional, a ruling that will add unforeseen costs to the first pillar, estimated at €500 millions.

Since January 1st, 2019, a new measure was implemented by the current government, known as "Quota 100". It offers the opportunity for workers aged at least 62 with 38 years of contribution to retire earlier than the normal retirement age of 67 years. This possibily will remain available for 3 years, until 2021 in order to see the economic impact, notably on the public expenditures. For the moment, the overall impact of this measure is less than predicted. From January to Jully 2019, only 154,095 individuals claim an early retirement.

The gross pension replacement rate for an Italian man who had a full career is 83%, compared to the OECD average of 53%[193]. With a substantial increase in the pension age (66.6 years for men and 65.6 years for women compared with the OECD averages of 64.3 and 63.7, respectively), in addition to a high mandatory contributions (33%), the replacement pension rate is still one of the highest in Europe (replacement rates are only higher in the Netherlands, Portugal and Turkey).

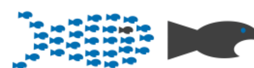
Pillar II – Occupational pensions

The second pillar is made up of collective complementary pension plans. These can be contractual occupational pension funds (managed by social partners with CBAs) or open pension funds linked to collective affiliations (managed by financial institutions).[194]

The Trattamento di Fine Rapporto (TFR) is also part of the second pillar. The TFR is a deferred indemnity. Each year the employer has to put aside (by law) part of the worker's salary which will be returned to the employee upon termination of the employment contract.

[193] OECD (2019), Gross pension replacement rates (indicator). doi: 10.1787/3d1afeb1-en (Accessed on 31 July 2019)

[194] Igor Guardiancich, 'Current Pension System: First Assessment of Reform Outcomes and Output' (2009) European Social Observatory Country Report on Italy, 2009 http://www.ose.be/files/publication/2010/country_reports_pension/OSE_2010_CRpension_Italy.pdf



Pillar III – Voluntary (individual) pension

The third pillar is made up of voluntary contributions to individual complementary pension schemes, *Individual Pension Plans* (PIP). Individuals can also make contributions to open funds in the case of individual affiliations. Given the strong component of mandatory contributions within the state pension system, both collective and individual complementary pension funds play a small role. While the savings in collective complementary pension funds are rather small, private savings are still consistent. If all pension contributions and home ownership were transformed into an annuity, the corresponding stream of generated income at retirement would be very high.

To summarise the information of the pension system set-up and to obtain a basic overview of the pension system in Italy, the table below presents key data on the multi-pillar pension system.

Introductory table. Multi-pillar pension system in Italy		
PILLAR I	**PILLAR II**	**PILLAR III**
State Pension	Private, voluntary and collective funded system	Private, voluntary and individual savings
	Legislative Decree 124/93 on complementary pension plans implemented in 1993. Reform on complementary pension (Legislative Decree 252/2005)	
National Social Security Body (INPS)	Pension accumulation companies	Insurance companies
Mandatory	Voluntary	Voluntary
Publicly managed	Privately managed pension funds	Privately managed pension funds
PAYG	Partially or fully funded	Fully Funded
Notional Defined Contribution system (NDC)	DC (Defined Contribution scheme)	
	Quick facts	
Number of old-age pensioners: 15,994,782	Funds: 328	Funds (new PIP): 70
Average old-age pension: €1,527.88	AuM: €129.8 bn.	Old et new PIP, AuM: €37.3 bn.
Monthly household average income (net): €2,500	Participants: 4.5 million	Participants in 2018: 3.4 million

Men's gross average replacement ratio (2016): 83.1%	Coverage ratio (% of labor force)[195]: 17.3%	Coverage ratio (% of labor force): 13.1%

Source: COVIP, INPS, OECD

The real net returns (before taxes) of the main retirement provision vehicles in Italy are presented below based on 6 recommended holding periods: 1 year (2018), 3 years (2016-2018), 7 years (2012-2018), 10 years (2009-2018), and since the earliest data available (19 years for pension funds, 1999-2018, and 11 years for PIP, 2008-2018).

Summary Table – Real net returns of Italian pension vehicles				
	Contractual pension funds	Open pension funds	PIP with profits	PIP unit-linked
2018	-3.6%	-3.6%	0.5%	-7.6%
2016-2018	0.02%	0.1%	1.0%	-15.7%
2012-2018	2.8%	3.4%	1.6%	3.0%
2009-2018	2.4%	3.0%	1.4%	2.7%
1999-2018	1.1%	-0.1%		
2008-2018			1.3%	-0.02%

Source: Tables IT5-IT8

Pensions Vehicles

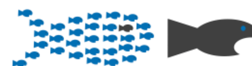
Collective and individual complementary pension funds

Complementary pension funds were introduced in 1993 and are composed of contractual funds, open funds and individual pension plans provided by life insurance companies. The main features of complementary pension plans are:

i. voluntary membership;
ii. funded;
iii. managed by banks, financial institutions and insurance companies;
iv. supervised by Commissione di Vigilanza sui Fondi Pensione (Individual Pension Funds Supervisory Commission - COVIP).

Following the signature of an agreement, all complementary pension funds are managed by an external financial institution that can only be an insurance company, a bank or a registered asset management company (Legislative Decree 252/2005). All complementary pension funds now operate on a defined contribution (DC) basis, as this is the only permitted type of pension plan. Defined benefit (DB) plans are restricted to pre-existing funds.

[195] The labor force corresponds to all working age individuals aged over 15 and all unemployed individuals. 25,971,000 individuals constitute the Italian labor force.



At the end of 2017, the total workers enrolled into collective and individual pension plans (Pillar II and III) amounted to 7.953 million[196]. Number of individuals covered by a pension plan increased by 4.9% with respect to 2016 and it represents 30.2% of the labor force. The increase in membership was driven by an increase in the number of affiliates to all catagories of schemes except pre-existing closed pension funds whose membership only rose slightly. Until 2014, the number of new members into pension plans was only increasing slowly and was driven by insurance companies and banks.

Table IT1. Number of subscribers in Complementary Pension Funds *(in thousands)*[197]

	2013	2014	2015	2016	2017	2018
Pillar II: Collective complementary pension plans						
Closed Pension Funds	1,951	1,944	2,419	2,561	2,763	2,949
Open Pension funds	985	1,057	1,150	1,230	1,343	1,429
Pre-existing Closed Pension Funds	655	645	646	620	611	613
Pillar III: Private and individual complementary pension plans						
New PIP	2,134	2,357	2,601	2,759	2,969	3,130
Old PIP	505	467	434	411	390	370
Total	**6,204**	**6,585**	**7,235**	**7,786**	**7,585**	**7,953**

Source: Covip, annual reports from 2013 to 2018[198]

In 2016, the number of closed funds members also increased following the implementation of new automatic enrolment programmes: Fondapi (SMEs), Byblos (Graphic, Editorial, Paper Manufacturers), Preverdi (construction industry), and Cooperlavoro in the cooperative sector. It should be noted, however, that these programmes only marginally increased assets managed by the pension industry, as the automatic enrolment programmes only applied to contributions made by employers and these made by employees. It is worth noting that about 200,000 individuals hold a small outstanding amount (around €100) in complementary pensions.

The vast majority of the members of the complementary pension funds (Pillar II) are employed in the private sector (about 4 million).

The budget law of 11 December 2016 allows members of complementary defined contribution pension funds, who are close to retirement age, to receive early retirement

[196] Covip, 2018 Annual Report.
[197] The total excludes the duplications due to members who simultaneously join the "new" and "old" PIPs and therefore does not correspond to the sum of the individual items shown in the table.
[198] Commissione di Vigilanza sui fondi pensione (COVIP), Annual Reports (Relazione annuale), 2013-2017.

income from of their accumulated savings in a whole or in part. (Rendita integrativa temporanea anticipata or RITA). Eligible employees are those who benefit from a similar provision in the first pillar (Anticipo finanziario a garanzia pensionistica or APE). To be eligible to RITA, an individual must:

- cease his / her professional activity;
- reach the requirements necessary to receive the old-age pension in their mandatory regime within the next five years or to be unemployed for more than 24 months;
- have contributed at least 20 complete years to the mandatory regime; or / and have completed five years in the pension scheme.

The individual determines the amount of the accrued capital to use until his / her official retirement. RITA was experimental until end of 2018. It is anticipated that this new flexibility will be an incentive to save in pension funds.

Pillar II

Contractual funds or Closed fund*ds* *(Investment portfolio at the end of 2018: €50.41 billion)*

Contractual funds are also called closed funds as only certain groups of people can join. These are professional occupational funds. Amongst employees, subscription is reserved only to those whose contracts are regulated by a collective bargaining agreement (CBA). For the self-employed, contractual agreements are usually provided by professional associations. Thus, only their members can subscribe to dedicated contractual pension funds.

Contractual pension funds are defined contribution schemes and the contribution amount is established by the fund's bylaws.[199] These funds are independent legal entities, with their own capital. Their governance is based on the principle of equal representation among employers and employees.

The Board of Directors is responsible for the investment strategies and chooses the investment manager, as well as the depositary bank and the designated entity dealing with administration. The fund must report on an annual basis, at least. Given the long-term characteristic of funds, managers' mandates are usually five years, or even longer for certain types of assets.

In some sector of activity, employees are automatically enrolled to a pension fund and then level of employer contributions is determined by agreement. For example, employees in the

[199] Paci S., P. Contaldo, C. Fiorentino, G. Nocera, L. Spotorno, F. Vallacqua, 'Carefin Report: Pension Funds in Italy' (2010) Bocconi University.

automobile sector and the highway sector are automatically affiliated to a pension fund since 2016.

Open funds *(Investment portfolio at the end of 2018: €19.6 billion).*

In contrast to closed funds, membership is not restricted to certain groups. An open fund is not a legal entity. They can be established for collective or individual members, or both.

Like contractual funds, open funds are defined contribution funds. Alike closed funds, a depositary bank is required, and administration costs can be outsourced.

At the end of 2018, assets managed by open funds amounted €19.6 billion.

The TFR, Severance Payment

During his/her whole career, an employee perceives severance payments, which are paid upon work termination. The severance payments are collected in a specific vehicle for pension asset accumulation, also known as *Trattamento di Fine Rapporto* (TFR). The TFR is computed on an annual basis and is equal to 6.91% of employee's annual remuneration. The TFR rate of return was 1.9% in 2018. It is mandatorily saved and returned upon termination of employment (such as retirement, the most common form).

The TFR can also be partially drawn on (70%) before the employee ends his / her professional activity, but only under very special need-based circumstances, including health problems, first-house purchases and parental leave. Moreover, the stability law of 2015 enabled employees in the private sector to receive their severance payments in advance with a State guarantee on bank loans to companies.

The TFR represents a huge savings pot and its management underwent heavy changes from January 2007 onwards. Since 2007, each worker can opt to accumulate their TFR by joining a complementary pension fund. If a worker does not make such a decision, tacit consent applies for the TFR to be transferred to a collective contractual pension fund when it exists for specific sectors.

This change represented a small cultural revolution in the Italian pension structure, where pensions had previously been provided by the public sector, with no active role by workers in choosing how much to invest. Workers have mandatorily contributed a conspicuous amount of their income, through the first pillar State system, with no involvement in where to invest their savings. With the TFR law, workers are now offered the possibility to choose to join any complementary pension fund[200] among contractual pension funds, open pension funds or even PIPs (Individual Pension Plans). When opting for PIPs, workers can decide the

[200] Cannata and Settimo, 2007

amount they contribute, a new element in the Italian framework, with no discretion in terms of pension contributions.

If an employee decides to opt-out from complementary pension funds and belongs to a company with more than 50 employees, his / her accumulated amount of severance payments is transferred to INPS (National Institute for Social Security), which manages the severance payment according to the law. For an employee who works in firms with less than 50 employees and who does not opt for complementary pension funds, his / her TFR remains in the firms he / she works in and represents a debt for the company.

Third Pillar

PIP, individual pension funds *(Investment portfolio at the end of 2018: € 30.7 billion)*

They are subscribed on an individual basis only, as insurance contracts in the legal framework of complementary pension funds. Within PIPs policies, two types of insurance contracts are offered: with-profits or unit-linked. A combination of the two type of contracts is possible with a more flexible risk-profile.

The with-profits policies guarantee a minimum rate of return (guaranteed and consolidated in the company's accounts) which is added to a quota related to the financial performance. The unit-linked policies do not have a guarantee. Their performance depends on the value of the units in which contributions are invested.

Public employees

The coverage of public employees by specific retirement products is very limited, as the law introducing pension funds excluded them. Contractual pension funds are only possible for individuals working in National Education (Espero), in the National Health and in a regional or local authority (Perseo and Sirio). These contractual pension funds were implemented in 1993.

There are pension funds implemented before 1993 that are semi-autonomous in their management and can collect money directly from subscribers without intermediaries. These pension funds are more numerous than those implemented in 1993.

Asset allocation of complementary pension plans

Looking at the portfolio composition of the complementary pension system as a whole, low-risk assets constituted the majority of holdings. In 2018, Sovereign bonds were still the main investment and their share in total portfolio remained steady at 41.7% (against 41.5% in 2017). The share of direct holdings of equities decreased from 17.7% in 2017 to 16.4% in 2018. According to COVIP calculations, considering equities held through investment funds, the equity exposure decreased to 23.4% in 2018 (against 25.3% in 2017).

Table IT2. Asset allocation of complementary pension funds (end-2018)	
Sovereign bonds	41.7%
Other debt securitiess	17.1%
Equities	16.4%
Mutual funds	13.8%
Real estate	1.2%
Alternatives	2.3%
Cash and Deposits	7.5%
Total	100%

Source: COVIP Annual Report 2018[201]

Law no.703, that regulates pension funds' asset allocation, has been approved at the end of 2014. It allows more flexibility, moving from a quantitative approach to a principle-based one. However, short selling remains prohibited and funds should allocate a minimum of 70% to listed products.

Charges

COVIP calculates a synthetic indicator of cost for a member who contributes €2,500 every year with a theoretical annual return of 4%. The calculation methodology of the indicator was revised by COVIP in order to eliminate distortions between the categories of funds. Since 2014, the tax rates on investment revenues depend on the underlying assets of the funds. Since March 2015, the cost indicator is no longer calculated net but gross of the tax paid by pension funds on their revenues.

The average cost indicator remained stable in 2018.

However, there is a great variation in complementary pension funds costs. In closed pension funds, the indicator cost is 1% for two years of participation, while it drops to 0.3% after 35 years of participation. With respect to PIP, it drops from 3.9% to 1.8%. It has to be noted that small differences in these costs will result in effects of considerable magnitude. Ceteris paribus, PIP (open funds) will have a final return of 23% (17%) lower than that corresponding to closed pension funds.

The cost indicator decreases with the time of membership, with initial fix costs being progressively amortised.

There are significant differences between each category of funds, depending on the distribution channels of the products and the fees paid to distributors. Economies of scale lead lower costs for closed funds while no such impact can be observed on new PIP and open funds, according to a review of individual figures by COVIP.

[201] COVIP Annual Report, 2019.

Table IT3. Average costs at the end of 2018 (in %) *				
	2 years	5 years	10 years	35 years
Closed Funds	1.07	0.57	0.39	0.26
Min	*0.47*	*0.3*	*0.18*	*0.08*
Max	*3.04*	*1.35*	*0.81*	*0.48*
Open Funds	2.37	1.58	1.37	1.24
Min	*0.55*	*0.55*	*0.55*	*0.55*
Max	*5.14*	*3.42*	*2.82*	*2.38*
New PIP	3.87	2.67	2.21	1.83
Min	*1.04*	*0.85*	*0.58*	*0.38*
Max	*6.44*	*4.82*	*4.07*	*3.44*

Source: COVIP Relazione annuale 2017[202]

** Simple arithmetic averages within each category. Costs differ depending on the number of contribution years*

Taxation

The regime of taxation chosen by Italy is essentially an ETT (exemption, taxation, taxation), corresponding to the following three stages: contribution, accumulation and payment.

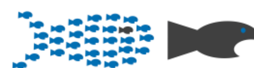
In the first phase, employee contributions to private pension funds benefit from a favourable tax treatment. An employee can deduct his / her contibutions from his / her taxable income up to a ceiling of € 5,164.57 per year. Employer contributions are considered as employment income and are thus subject to tax and social security contributions.

Until 2014, in the second phase a tax rate of 11.5% was applied on the accrued capital gains paid by complementary pension funds. From 1 January 2015, this tax rate increased to 20%, except for accrued capital gains generated by investments in Government Bonds which are taxed at a rate of 12.5%. The difference in taxation rates of bonds and shares is an incentive to change the asset allocation towards the former, a trend that is likely to lower the returns of pension products in the future. The budget law of 31 December 2016 foresaw that assets invested in European shares or European investment funds (up to 5% of the fund's total assets) were exempted from income tax.

In order to avoid double taxation, benefits are taxed only on the corresponding shares that were not taxed during the accumulation phase. Contributions that were not deducted, and thus already taxed, won't be taxed again.

In the third phase the corresponding benefits are taxed at a rate varing from 9% to 15% depending on the length of membership in the private pension funds. Income received before retirement age in the framework of the RITA scheme is taxed at 15%, reduced by 0.3% for each year over the fifteenth year of participation in supplementary pension schemes,

[202] Covip, 2019 Annual Report.



with a maximum reduction limit of six percentage points. If years of enrolment in the supplementary pension scheme are prior to 2007, those years can be considered up to a maximum of 15 years.

The tax rate of pension benefits that come from TFR varies between 9% and 15%, depending on the length of enrolment in the complementary pension funds.

Pensions Returns

The following table (IT4) provides returns broken down by type of complementary private pension funds. Returns are calculated net of taxes paid by the pension funds on investment revenues.

Returns of all categories of complementary private pension funds fell sharply since 2015 as a consequence of historically low interest rates paid on bonds. In 2018, all categories of funds, except new PIP with-profits and separate management, experienced negative returns, due to low interest rates on bonds, in addition to losses on Stock Markets.

Table IT4. Nominal returns net of charges and taxes on investment revenues by type of private pension funds

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Contractual pension funds	7.5	3.8	2.1	-6.3	8.5	3	0.1	8.2	5.4	7.3	2.7	2.7	2.6	-2.5
Guaranteed	-	-		3.1	4.6	0.2	-0.5	7.7	3.1	4.6	1.9	0.8	0.8	-1.1
Bonds Only	2.1	2.6	2.2	1.6	2.9	0.4	1.7	3	1.2	1.2	0.5	0.2	-0.2	-0.6
Bonds Mixed	6.9	2.7	2.1	-3.9	8.1	3.6	1.1	8.1	5	8.1	2.7	3.2	2.6	-2.4
Balanced	7.9	5.6	2.4	-9.4	10.4	3.6	-0.6	9.2	6.6	8.5	3.2	3.2	3.1	-2.8
Equity	14.9	8.2	1.3	-25	16.1	6.2	-3	11.4	12.8	9.8	5	4.4	5.9	-5.3
Open pension funds	11.5	2.4	-0.4	-14	11.3	4.2	-2.4	9.1	8.1	7.5	3	2.2	3.3	-4.5
Guaranteed	2.9	1	1.9	1.9	4.8	0.7	-0.3	6.6	2	4.3	0.9	0.7	0.6	-1.8
Pure Bonds	3.3	-0.2	1.6	4.9	4	1	1	6.4	0.8	6.9	0.9	1.3	-0.3	-0.8
Mixed	6.4	1	0.3	-2.2	6.7	2.6	0.4	8	3.6	8	2.2	1.4	0.4	-1.8
Balanced	11.4	2.4	-0.3	-14.2	12.6	4.7	-2.3	10	8.3	8.7	3.7	2.7	3.7	-4.8
Equity	16.2	3.7	-1.6	-28	17.7	7.2	-5.3	10.8	16	8.7	4.2	3.2	7.2	-8
New PIP: with-profits and separate management				3.1	3.1	3.2	3.2	3.3	3.2	2.9	2.5	2.1	1.9	1.7
New PIP: unit-linked				-22	14.5	4.7	-5.2	7.9	10.9	6.8	3.2	3.6	2.2	-6.5
Bonds				2.4	3.7	0.6	0.8	4.9	-0.3	3.3	0.6	0.4	-0.7	-1.4
Balanced				-8.3	7.8	2.5	-3.5	6.4	5.8	8.2	1.9	1.5	2.3	-5.9
Stocks				-32	20.6	6.7	-7.9	9.6	17.2	7.1	4.5	6	3.2	-8.9

Source: COVIP Annual Report, 2019

Contractual pension funds

Table IT5 reports the net returns for closed pension funds. Column (2) reflects nominal returns before charges. The synthetic cost indicator for a 35-year subscriber is added to column (3), as reported by COVIP. Until 2014, the cost indicator was calculated net of taxes on investment revenues ("imposta sostitutiva") but the latter was not disclosed in COVIP statistics. Thus, we added 11.5% (the tax rate on investment returns until 2014) to the cost indicator of the positive nominal return before charges. From 2015, as the cost indicator was calculated gross of these taxes, a correction is no longer needed.

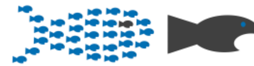
Column (3) records the nominal returns after charges and before taxes on investment revenues calculated by COVIP (see table IT4).

Column (4) is equal to column (3) minus the Inflation Rate (as CPI index variation in percentage).

We calculate both the average annual rate of investment returns on the whole period 2000 - 2018 and on the period 2008 – 2018 because the legislative framework of pension funds was overhauled in 2007. The average annual real net return after taxation, equal to column (4), once 15% of the return, has been taken out of the nominal return after charges. The tax rate can be reduced by 0.3% for each year after 15 years of contributions, for a maximum of 6 percentage points of reduction in taxation of the benefit.

Between the end of 2000 and the end of 2018, the annual average real return of contractual funds after deduction of charges, taxes and inflation was 0.69%. On a more recent period 2008-2018, the return increased to 0.98%.

Table IT5.1. Annual rates of investment returns of contractual pension funds (in %)			
Year	Nominal return	Nominal Return, after charges	Real Return, net of inflation and charges, before taxes on benefits
2000	3.9	3.6	0.8
2001	3.7	3.4	1.1
2002	-3.2	-3.4	-6.2
2003	5.3	5.0	2.4
2004	4.9	4.6	2.2
2005	7.8	7.5	5.3
2006	4.1	3.8	1.6
2007	2.4	2.1	-0.7
2008	-6.0	-6.3	-8.5
2009	8.7	8.5	7.3
2010	3.2	3.0	0.9
2011	0.3	0.1	-3.5



2012	8.4	8.2	5.5
2013	5.6	5.4	4.8
2014	7.5	7.3	7.3
2015	3.0	2.7	2.6
2016	3.0	2.7	2.2
2017	2.9	2.6	1.6
2018	-2.2	-2.5	-3.6
Average 2000-2018	**3.3**	**3.0**	**1.1**
Average 2008-2018	**3.0**	**2.8**	**1.4**

Source: COVIP Annual Report, 2019; BETTER FINANCE own computations

Table IT5.2. Contractual pension funds' average annual rate of returns (in %)		
	2000-2018	2008-2018
Real Return, net of inflation, charges and taxes on benefits	0.69	0.98

Source: BETTER FINANCE calculations based on COVIP,[203] Eurostat[204]

Open pension funds

The same methodology as for contractual pension funds is used to calculate the returns of open funds. The only difference lies in the synthetic cost indicator that is different. Between the end of 2000 and the end of 2018, the annual average real return of open funds after deduction of charge, taxes and inflation was negative at -0.36%. The annual average return was positive at 0.76% over the period 2008-2018.

Table IT6.1 Open pension funds annual rate of returns (in %)			
Year	Nominal return	Nominal Return, after charges	Real Return, net of inflation and charges, before taxes
2000	4.2	3.0	0.3
2001	-4.7	-5.6	-7.7
2002	-12.3	-13.1	-15.6
2003	6.9	5.7	3.1
2004	5.5	4.3	1.9
2005	12.7	11.5	9.3
2006	3.5	2.4	0.3

[203] COVIP, Annual Reports from 2000 to 2018
[204] Eurostat Harmonised Index of Consumer Prices (HICP) Annual Index Average Rate of Change (2015=100, prc_hicp_aind), http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=prc_hicp_aind.

2007	0.7	-0.4	-3.1
2008	-13.0	-14.0	-16.0
2009	12.5	11.3	10.1
2010	5.4	4.2	2.1
2011	-1.3	-2.4	-5.9
2012	10.3	9.1	6.4
2013	9.3	8.1	7.5
2014	8.7	7.5	7.5
2015	4.3	3.0	2.9
2016	3.4	2.2	1.7
2017	4.6	3.3	2.3
2018	-1.3	-2.5	-3.6
Average 2000-2018	**2.9**	**1.7**	**-0.1**
Average 2008-2018	**3.7**	**2.5**	**1.1**

Source: COVIP Annual Report, 2019; BETTER FINANCE own computations

Table IT6.2. Open pension funds' average annual rate of investment returns (in %)

	2000-2018	2008-2018
Real Return, net of inflation, charges and taxes on benefits	-0.36	0.71

Source: BETTER FINANCE calculations based on COVIP,[205] Eurostat[206]

Individual Pension Plans

Individual Pension Plans (PIP) have the highest costs on the pension product market in Italy. The charges applied to PIPs were 1.8% for long-term subscribers in 2018.

The performance of the PIPs depends on the type of contracts. With-profits policies have a comparable performance to contractual pension funds, while unit-linked PIPs have a lower average return on the market comparable to open pension funds.

However, performances are highly volatile, potentially associated with the relatively short timeframe considered, in fact corresponding to the financial crisis years. Moreover, given the shorter timeframe, the high variability could lead to misleading conclusions. In 2018, the returns of unit-linked PIPs decreased once again and was even negative at -7.6%.

[205] Covip (n 9) Table 1.23.
[206] Eurostat HICP (n 15).

Table IT7. PIP with-profits: annual rate of returns (in %)			
Year	Nominal return	Nominal Return, after charges	Real Return, net of inflation and charges, before taxes
2008	4.7	3.1	0.7
2009	4.7	3.1	2.0
2010	4.8	3.2	1.1
2011	4.8	3.2	-0.5
2012	4.8	3.2	0.6
2013	4.8	3.2	2.6
2014	4.5	2.9	2.9
2015	4.4	2.5	2.4
2016	4.0	2.1	1.6
2017	3.8	1.9	0.9
2018	**3.6**	**1.7**	0.5
Annual average 2008-2018	**4.4**	**2.7**	**1.3**

Source: COVIP Annual Report, 2019; BETTER FINANCE own computations

Table IT7.2 PIP with-profits: annual average rate of returns (in %)	
	2008-2018
Real Return, net of inflation, charges and taxes on benefits	0.9

Source: BETTER FINANCE own computation

The return computations for individual pension plans (unit-linked) are presented in Table IT8 below.

Table IT8.1 PIP unit-linked: annual rate of returns (in %)			
Year	Nominal return	Nominal Return, after charges	Real Return, net of inflation and charges, before taxes
2008	-20.7	-21.9	-24.5
2009	16.2	14.5	13.6
2010	6.3	4.7	3.1
2011	-3.8	-5.2	-7.9
2012	9.5	7.9	4.5
2013	12.6	10.9	9.6
2014	8.4	6.8	6.6
2015	5.1	3.2	3.1
2016	5.5	3.6	3.7
2017	4.1	2.2	0.9
Average 2008-2017	**3.8**	**2.2**	**0.7**

Table IT8.2 PIP Unit-Linked: Average annual rate of investment returns (in %)	
	2008-2017
Real Return, net of inflation, charges and taxes on benefits	0.4

Source for Tables IT7.1, IT7.2, and IT8.1 and IT8.2: BETTER FINANCE calculations based on COVIP,[207] Eurostat.[208]

Conclusion

The Italian Pension System has a strong State component, which is likely to displace complementary pension funds. The mandatory contribution rate amounts to 33%. As the system is pre-funded, contributions to the pension system will translate one to one to future pension incomes. In this scenario the second and third pillar are likely to only develop slowly.

Even if the number of employees enrolled in private pension funds increased, it remained quite low. 7.953 million individuals are enrolled in private pension funds, representing 30.2% of the labor force. Experiences from the automatic enrolment implemented by labour agreements in 2015 and 2016 did not fundamentally change the framework, as employers' contributions were still low, and few employees voluntarily contributed to the new schemes. In addition, women and young people are under-represented in pension funds. The government has to play a role in encouraging all profile among employees to save for the retirement in pension funds.

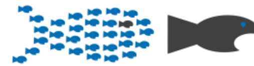
The complementary pension funds can be of three types: contractual occupational pension funds (managed by Social Partners), open funds managed by financial institutions and Individual Pension Plans (PIP), split into with-profits and unit-linked policies.

Over the period 2000-2018, we calculated the return rate associated to open funds and contractual pension funds. We calculated returns over the 2008-2018 period for all types of pension funds available in Italy. Over the eleven-year period, all types of pension funds experienced positive annual average real return, except PIP funds with unit-linked contracts. Contractual pension funds experienced the highest annual average real return (+0.98%), PIP unit-linked policies experienced the lowest one (-0.2%).

Since 2000, contractual pension funds recorded a positive annual average return (+0.69%), while open pension funds recorded a negative one of -0.36%.

Private pension funds in Italy offer low real returns after inflation and taxation, even negative for open pension funds on a long period (19 years). Sovereign bonds remained the most important assets on average (42% in 2018) in the asset allocation of private pension funds.

[207] Covip (n 9), Table 1.23.
[208] Eurostat HICP (n 15).



The private pension funds have to elaborate other investement strategies which could provide higher returns to pensioners.

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