PENSION SAVINGS
The Real Return

2019 Edition

BF BETTER FINANCE

The European Federation of Investors and Financial Services Users
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Pension Savings: The Real Return
2019 Edition

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.

[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]

[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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Alessandra Manis is Research Assistant at BETTER FINANCE and holds a master's degree in law, obtained from the University of Cagliari in Italy. She completed her studies with an in-depth look at "Consumer Protection in the sale of Financial Instruments". She was admitted to the Italian Bar and has prior professional experience in the field of banking, insurance and consumer law. She worked as a junior associate in a boutique law firm boutique specialized in banking and insurance law, carrying out both contentious and non-contentious activities.

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Pension Savings: The Real Return

2019 Edition

Country Case: Romania

Rezumat

Populaţia României emigrează, scade şi îmbătrâneşte într-un ritm accelerat, ceea ce pune presiune semnificativă asupra sistemului de pensii publice.

Deşi contribuţiile la fondurile de pensii ocupaţionale sunt obligatorii (Pilonul II), fără a distinge forma de angajare (salariaţi sau liber-profesionisti), cetăţenii români trebuie motivaţi să investească mai mult în planuri voluntare de pensie (Pilonul III).

Evoluţia randamentelor reale ale planurilor de pensii din România a înregistrat o evoluţie pozitivă până la sfârşitul anului 2017, moment din care tendinţa s-a inversat, ceea ce este de natură să genereze preocupări asupra capacităţii administratorilor de a menţine performanţele pozitive ale primilor 10 ani de funcţionare ai sistemului de pensii administrat privat din Romania.

Compunerea portofoliilor ambelor tipuri de scheme administrate privat este aproape identică şi, prin urmare, generează randamente brute similare. Cu toate acestea, randamentul net al Pilonului III este influenţat în mod semnificativ de structura comisioanelor substanţial mai mari (aproape de 4 ori mai mari) şi astfel, pe termen lung, va genera randamente mai mici decât cele aferente Pilonului II. Per total, randamentele produselor de pensie din Pilonul II şi Pilonul III au ramas pozitive şi deasupra nivelului inflaţiei.

O preocupare majoră o ridică şi posibilitatea adoptării unei decizii politice de renunţare la Pilonul II. Deja a fost adoptată o reglementare care permite participanţilor la Pilonul II să opteze pentru trecerea la Pilonul I, fără a fi însă explicate şi consecinţele acestei decizii pe termen mediu şi lung asupra patrimoniului participantului.

Asociaţia Utilizatorilor Români de Servicii Financiare (AURSF), membră BETTER FINANCE, a atras în permanenţă atenţia asupra riscurilor pe care le presupune o asemenea decizie. În plus, AURSF a criticat vehement decizia autorităţilor de a reduce contribuţiile virate în contul participanţilor de la 5,1% la 3,75%. De asemenea, AURSF consideră că trebuie identificate măsuri care să încurajeze opţiunea asumată a participanţilor pentru unul dintre fondurile administrate privat (în prezent, numărul celor care optează este extrem de redus, participanţii fiind distribuiţi printr-un mecanism aleatoriu)

Summary

Romania's population is rapidly decreasing, aging, and migrating, which puts considerable pressure on the State pension system.

Although occupational pensions are mandatory regardless of the work form (employees and self-employed), the Romanian households must be incentivised more to save in voluntary pension plans (Pillar III).

The evolution of the real returns of private pension schemes in Romania recorded a solid performance until 2017, but started the trend changed in 2018, which may generate concerns regarding the ability of pension managers to keep up with these positive performance of the first 10 years since the establishment of the private pension system in Romania.

Both schemes (occupational and private) have almost identical portfolio structures and thus generate similar gross returns. However, Pillar III net performance is significantly influenced by the high fee structure (almost 4-times higher) and will, in the long-run, deliver lower returns than Pillar II peers. Overall, the real return of pension funds in Pillar II as well as Pillar III are still positive and above the inflation.

A major concern is posed by the possible adoption of a political decision to "give up" Pillar II. A regulation allowing Pillar II participants to withdraw and move to Pillar I has already been adopted, but without explaining beforehand the medium- and long-term consequences of such a decision on the participant's savings.

The Romanian Financial Services Users' Association (AURSF), member of BETTER FINANCE, has constantly drawn attention to the risks entailed by such a decision. Moreover, AURSF has firmly criticised the public authorities' decision to reduce the contribution transfer rate to Pillar II from 5.1% to 3.75%. In addition, AURSF considers that measures incentivising an active choice of savers with regards to a mandatory privately administered funds must be found (currently, the number of those making an active choice is considerably low, the rest being randomly allocated).

Introduction

The Romanian old-age pension system is based on the World Bank's multi-pillar model, which consists of three main pillars:

- Pillar I – State pension organized as a mandatory Pay-As-You-Go (PAYG) scheme;
- Pillar II – Organised as a mandatory, funded and defined contribution pension scheme,
- Pillar III – A supplementary pension scheme, based on the principle of voluntary participation with the defined-contribution characteristic.

Romania's multi-pillar pension reform began in 2007, when Pillar III was added into the pension system (collecting the first contributions) and became voluntary for all persons earning any type of income. Pillar II was put into place in 2008 (collecting the first contributions) and became mandatory for all employees aged under 35.

Table RO1. Pensions system in Romania		
National House of Public Pensions	Private Pension System Supervisory Commission	
PILLAR I	**PILLAR II**	**PILLAR III**
State Pension	**Funded pension**	**Voluntary pension**
Law no. 263/2010 on the unitary public pension system	Law no. 411/2004 on the privately managed pension funds, republished, including subsequent amendments and additions	Law no.204/2006 on the voluntary pensions, including subsequent amendments and additions
Mandatory	Mandatory	Voluntary
Publicly managed	Privately managed pension funds	
PAYG	Funded	
DB (Defined Benefit scheme)	DC (Defined Contribution scheme)	
	Individual personal pension accounts	
The possibility of early and partially early retirement, contingent upon the fulfillment of the age conditions and the contribution stage provided by the law and the accumulated points.	Withdrawal from the system is only allowed through retirement.	The participant can, at any time, suspend or stop the contribution payment (they remain members in the system until retirement).
Quick facts		
Number of old-age pensioners: 4.7 mil.	Administrators: 7	Administrators: 8
Number of insured: 6.01 mil.	Funds: 7	Funds: 10
Average old-age pension: €241	Custodians: 3	Custodians: 3
Average salary (gross): €853	Brokers: 14	Brokers: 21
Net replacement ratio (state pension): 28.32%	AuM: €10.21 bln	AuM: €0.43 bln
	Participants: 7.27 mil.	Participants: 0.47 mil.
Average pension replacement ratio (men/women): 51%		

Source: Own elaboration based on CNPP, ASF and INSSE data, 2019; Notes: Exchange rate RON/EUR = 4.6635; data on average old-age pension and gross salary and data on the number of old-age pensioner are as of December 2018; data on number of participants and assets under management as of December 2018

The overall coverage of Pillar II, measured as a ratio between the number of participants and the economically active population, was almost entire working population in 2018, while Pillar III covered only 6% of the economically active population. Thus, we can expect than future pension income stream will be influenced mostly by Pillar II pensions, while Pillar III will generate an insignificant part of individuals income during retirement.

Summary Return Table – Nominal and real returns in Romania				
	Pillar II		Pillar III	
	Nominal	Real	Nominal	Real
1 year	1.06%	-1.96%	-0.66%	-3.68%
3 years	3.02%	1.16%	2.05%	0.19%
7 years	6.18%	4.55%	5.29%	3.61%
10 years	7.83%	5.14%	6.46%	3.73%
Whole reporting period	7.70%	4.64%	5.67%	2.27%

Source: BETTER FINANCE own composition

Pillar I – State Pensions

The first pillar of the Romanian pension system is organized on the Pay-as-You-Go (PAYG) principle of redistribution, being funded on an ongoing basis and functioning on the defined-benefit rule.

The state (through the National House of Public Pensions, a public institution constituted for this purpose in particular[220]) collects the social pension contribution from the contributors[221] and immediately pays the pensions to the current retirees.[222] State pension in Romania is also based on the principle of solidarity between generations and gives the right to pension entitlement upon retirement age, following a minimum contribution period (15 years), as provided by law.

This compulsory system is closely connected to the economic activity and income of citizens. It is 88%[223] financed from social security contributions made by both employers and by employees, while generally consuming the biggest part (or entirety) of the social security budget.

Social security contributions are paid to the State's social security budget at a rate of 20.8% of payroll for employers and 10.5% of income (gross earnings) for employees. It should be noted that since 1 October 2014, the employer's contribution ratio has been reduced to

[220] In Romanian, „Casa Naţională de Pensii Publice", hereinafter CNPP, as per Article 4.2 read in conjunction with Article 52 (Chapter IV, Section I) of Law no. 263/2010: http://legislatie.just.ro/Public/DetaliiDocument/124530.
[221] According to the principle of contributivity, as per Article 2.c) of Law no. 263/2010.
[222] According to the principle of redistribution provided in Article 2.e) of Law no. 263/2010.
[223] In 2017, 75% of the budget was constituted from social security contributions and 25% from the consolidated state budget – see Annex no. 1/03 to Law no.7/2017 concerning the social security budget for 2017; in 2018, 88% of the budget was financed from contributions and 12% from the consolidated state budget – see Annex no. 1/03 of Law no. 3/2018 concerning the social security budget for 2018.

15.8%. This pillar is financed by contributions of economically active individuals. These contributions are directed to the CNPP, which distributes the benefit to current pensioners (system beneficiaries).

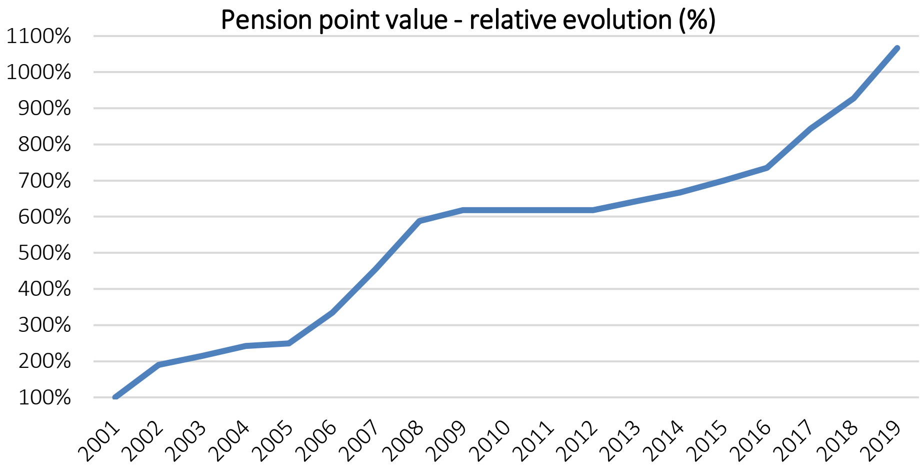
The pensions are calculated using a formula to an algorithm based on the mean salary score (which is calculated by comparing an individual's own salary to the average monthly salary), the correction coefficient, the full vesting period (35 years), and on pension points, which are expressed as a nominal value.

Therefore, the pension entitlement is calculated when the employee claims it and uses the values determined for that date (once), using the following formula:

Pension allowance =

Mean Salary Score x Correction Coefficient x Value of the Pension Point.

The most important variable is given by the value of the pension point, which continues to grow for the 18th year in a row.



Source: BETTER FINANCE own composition based on CNPP data

The main retirement income stream is generated by Pillar I and, on average, representing 28% of the mean annual salary during the economically active period of the retiree in December 2018, while the net replacement rate generated by Pillar I was 51%.[224] However, gross replacement ration continues to decline.

[224] See OECD, 'Pensions at a Glance 2017: OECD and G20 Indicators' (OECD Library, 2017), page 106, https://www.oecd-ilibrary.org/docserver/pension_glance-2017-en.pdf?expires=1533208010&id=id&accname=guest&checksum=D723E9620BBEC45B10FD

According to Romania's legislation, starting on 1 January 2011, the standard retirement age is 63 years for women and 65 years for men. These levels will be gradually reached as follow:

- between January 2011 and January 2015, the standard age for the pensioning of women will grow from 59 years to 60 years and for men from 62 years to 65 years;
- at the end of 2015 period retirement age will gradually increase only for women from 60 years to 63 years until 2030.

Early retirement - According to Law no. 263/2010 regarding the public pension schemes (in force since 1 January 2011) claiming early pension is possible as of a maximum 5 years before the standard retirement age, provided the worker has at least eight or more contribution years. The deduction made on early pension payment is fixed at 0.75% for each month (9% per year), which might bring a maximum deduction of 45% from the standard pension. The deduction is applied until the standard age limit is reached.

Pillar II – Funded pensions

Romania's mandatory private pensions system (Pillar II) is based on the World Bank's multi-pillar model. It is a fully funded scheme, with mandatory participation and distinct and private management of funds based on personal accounts and on the defined contribution (DC) philosophy with minimum return guarantees. The minimum return guarantee means that participants will receive at least the sum of contributions, net of fees, at retirement. Each fund has to comply, during the accumulation phase, with a minimum return mechanism that is set quarterly by national regulation and based on average market performance of all funds. Pillar II represents the privately managed mandatory pensions funds or schemes.

The beginning of Pillar II in Romania is connected with three important dates:

- January – July 2007 (Authorizing the administrators),
- 17 September 2007 – 17 January 2008 (Choosing pension fund by participants),
- 20 May 2008 (Collecting the first contributions to Pillar II).

Pillar II has been mandatory since its inception for all employees paying social security contributions under the age of 35 and voluntary (optional) for employees aged 35 to 45.[225]

Contribution collection is centralized by CNPP (The National House of Public Pensions), which collects and directs the contributions towards the mandatory pension funds.

956DCF9A420A, data accessible here https://data.oecd.org/pension/net-pension-replacement-rates.htm.

[225] Article 30 of Law no. 411/2004 regarding the privately managed pension funds.

A participant contributes during his active life and will get a pension when reaching the retirement age of 65 for men and 63 for women. The starting level of contribution was at 2% of the participant's total gross salary and it should go up by 0.5 percentage points a year, to reach 6% of total gross revenues in 2017. However, these values were never reached and the value for 2017 was 5.1 p.p. and in 2018 it was lowered to 3.75 p.p. The contribution level is fixed, with no possibility to contribute less or more based on individual preferences.

The contributions to a pension fund are recorded in individual personal pension account. The savings are invested by the pension fund administrator, according to the rules and quantitative limits generally set by the law regulating Pillar II vehicles.[226] Participants can choose only one pension fund.[227]

Mandatory pension funds are managed by their administrators - Pension Management Companies (PMCs). Each PMC can manage only one mandatory pension fund. Mandatory pension funds operations are similar to the investment funds. PMC must obtain several licenses from Romania's pension market regulatory and supervisory body, which is the Financial Supervisory Authority (in Romanian, *Autoritatea de Supraveghere Financiară*, '**ASF**').

The ASF is in charge of control, regulation, supervision and information about private pensions as an independent administrative authority and legal entity under the control of the Romanian Parliament.

Withdrawal from the system is only allowed at the standard retirement age of participants in the private pension system.

Pillar III – Voluntary private pension

Romania's voluntary private pensions system Pillar III is also based on the World Bank's multi-pillar model. It is also a fully funded system, based on personal accounts and on the defined contribution (DC) philosophy. Pillar III represents privately managed supplementary, voluntary pensions.

The beginning of Pillar III in Romania is connected with two important dates:

- October 2006 – May 2007 (Authorizing the administrators),
- May 2007 (Collecting the first contributions to third Pillar).

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[226] Article 23 defines the guiding principles and rules of conduct the fund administrator must follow, Article 25 defines the quantitative limits on asset allocations and Article 28(1) lists the ineligible investments (Law no. 411/2004).
[227] Article 31 of Law no. 411/2004.

Participation is open to everybody earning an income, either employees or the self-employed. Contributions are generally made through the employers in case of employees. In case of self-employed, the contributions are sent directly on the accounts managed by pension management companies. The contributions are made by the employee, with the possibility for employers to contribute a share.

Voluntary pension funds as a special purpose vehicle are managed by their administrators - Pension Management Companies (PMCs), Life Insurance Companies (LICs) or Asset Management Companies (AMCs). Each administrator is obliged to establish and operate at least one voluntary pension fund. However, in contrast to Pillar II, administrators can manage as many funds as they wish. A voluntary pension fund operates on a similar basis as investment fund. Pension fund administrators must get several licenses from Romania's Financial Supervisory Authority.

Participants to such a fund contribute during their active life and will get a pension at the age of 60 (both woman and men) if he had accumulated at least 90 contributions. The contribution is limited up to 15% of the participant's total gross income. The contribution level is flexible - it can be decided upon, changed, and even interrupted and resumed.

Pension Vehicles

Pillar II – Funded pensions

As indicated above, each PMC specifically authorized to provide Pillar II savings products in Romania is allowed to manage only one mandatory pension fund. At the introduction of the Pillar II, the total number of authorized administrators (funds) was 18. Consolidation started as early as 2009 and 2010. Currently (end of 2018), there are 7 administrators offering 7 pension funds. The two biggest mandatory pension funds (AZT and NN) serve almost 50% (according to number of participants) or 57% (according to AuM) of the market.

Each PMC is authorized and supervised by ASF. One of the most important conditions imposed on PMC is to attract at least 50,000 participants. ASF withdraws the fund's authorization if the number of participants drops below 50,000 for a quarter.

The structure of savers, assets under management and market share of respective mandatory pension fund (PMC) is presented in a table below.

Table RO2. Pension Management Companies market share in Romania (Pillar II)				
Mandatory Pension Fund (PMC)	Assets under management *(in €)*	Market share based on AuM	Number of participants	Market share based on participants
ARIPI	872,006,331	8.54%	735,499	10.03%
METROPOLITAN LIFE*	1,455,238,334	14.26%	1,012,614	13.97%
AZT VIITORUL TAU	2,213,403,148	21.68%	1,560,583	21.76%
BCR	670,202,145	6.57%	635,769	8.58%
BRD	371,617,775	3.64%	417,361	5.46%
NN	3,638,872,702	35.65%	1,986,101	27.79%
VITAL	985,762,262	9.66%	902,372	12.40%
TOTAL	**10,207,102,698**	**100.00%**	**7,042,179**	**100.00%**

Source: Own calculations based on ASF data, 2019 (data as of 31 December 2018)

Mandatory pension funds' investment strategy is very strictly regulated. The law imposes percentage limits for different asset classes.

Mandatory pension funds can invest:

- up to 20% in money market instruments;
- up to 70% in State bonds of Romania, the EU or EEA;
- up to 30% in bonds and other transferable securities issued by the local public administrations in Romania, the EU or EEA, traded on a regulated market in RO, EU or EEA;
- up to 50% in securities traded on a regulated market in Romania. the EU or EEA;
- up to 15% in bonds issued by third-party states, traded on a regulated market in Romania, the EU or EEA;
- up to 10% in bonds and other transferable securities issued by the local public administration in third-party states, traded on a regulated market in Romania. the EU or EEA;
- up to 15% in bonds issued by the World Bank. the European Bank for Reconstruction and Development and the European Investment Bank, traded on a regulated market in Romania, the EU or EEA;
- up to 5% in bonds issued by Non-governmental Foreign Bodies, traded on a regulated market in Romania, the EU or EEA;
- up to 5% in units issued by Undertakings for Collective Investment in Transferable Securities – UCITS, including ETF in Romania, the EU or EEA;
- up to 3% in ETC`s and equity securities issued by non UCITS set up as closed investment funds, traded on a regulated market in Romania, the EU or EEA;
- up to 10% in private equity - only for voluntary pension funds.

There is no explicitly defined general quantitative limit on equity investments.

Aside from the quantitative restrictions by asset class, fund managers have quantitative limits by type of issuer:

- 10% of the total number of shares issued by one issuer;
- 10% of the preferential shares issued by one issuer;
- 25% of the equity securities issued by an UCITS, ETF, non UCITS closed investment fund or ETC;
- 10% of an issuer's bonds, with the exception of the state bonds.

Mandatory pension funds can invest all their assets abroad. There are no explicit restrictions regarding investments made abroad.

Pension funds can have one of three possible risk profiles, which are calculated on a daily basis according to a formula established by ASF regulations:

- low risk (risk level up to and including 10%),
- medium risk (risk level between 10%, exclusively, and 25%, inclusively),
- high risk (risk level between 25%, exclusively, and 50%, inclusively).

Pillar III – Voluntary private pensions

The Romanian Pillar III allows each administrator (PMC, LIC or AMC) to manage as many voluntary pension funds as they prefer. At its inception, there were only four providers and six voluntary pension funds. Currently (at the end of 2018), there was 8 providers offering 10 voluntary pension funds. Only two administrators (NN and AZT) are currently offering more than one voluntary pension fund.

Each administrator in Pillar III (PMC, LIC or AMC) is authorized by ASF and must get several licenses from ASF. ASF withdraws the fund's authorization if the number of participants drops below 100 for a quarter.

Voluntary pension funds are also constituted by civil contract and authorized by ASF. Accounting of the voluntary pension fund is separated from the administrator.

Investment rules in the voluntary private pension pillar are the same as in the mandatory pillar (see quantitative and restriction limits for different asset classes in the text above), with less strict limits on private equity (5%) and commodities (5%).

The structure of savers, assets under management and market share of respective voluntary pension fund is presented in a table below.

Table RO3. Voluntary pension funds market share in Romania (Pillar III)					
Risk profile	Voluntary pension fund	Assets under management (in €)	Market share based on AuM	Number of members	Market share based on participants
High	FPF AZT VIVACE	18,141,450	4.75%	20,386	4.57%
	FPF NN ACTIV	42,569,365	11.14%	43,299	9.71%
Medium	FPF AZT MODERATO	45,632,260	11.94%	38,381	8.60%
	FPF BCR PLUS	68,404,744	17.90%	130,347	29.22%
	FPF BRD MEDIO	20,509,346	5.37%	23,994	5.38%
	FPF NN OPTIM	153,038,922	40.04%	159,438	35.74%
	FPF PENSIA MEA	12,973,791	3.39%	9,839	2.21%
	FPF RAIFFEISEN ACUMULARE	15,713,989	4.11%	11,442	2.56%
	FPF STABIL	3,768,964	0.99%	5,185	1.16%
	FPF AEGON ESENTIAL	1,468,050	0.38%	3,82	0.86%
	TOTAL	**382,220,880**	**100.00%**	**446,131**	**100.00%**

Source: Own calculations based on ASF data, 2019 (data as of 31 December 2018)

Charges

Pillar II – Funded pensions

According to the Mandatory Pensions Law, the fund manager's income resulted from the administration of privately administrated pension funds are composed of:

- management fees and commissions;
- transfer penalties (covered from personal assets, in case of moving to another fund/PFC earlier than in 2 years – between 3.5% and 5%);
- tariffs for additional information services, in particular:
    - Depositary commission (depository fee);
    - Transaction costs (trading fees);
    - Bank commissions (banking fees);
    - Fund auditing taxes (pension fund auditing fees).

The administration fee is established by:

a) deducting an amount from the contributions paid, but not higher than 2.5%, before the conversion of contributions into fund units (Management commission);
b) deducting a percentage from the total net assets of the fund, but not higher than 0.05% per month (up to 0.6% per year) established by the pension scheme's prospectus (Management fee).

The transfer penalty represents the amount paid by the participant in the event of a transfer to another administrator, occurring within two years of the subscription date to the private pension fund, with the maximum ceiling of this penalty being established by ASF and set at maximum 5% of assets (Norm CSSPP 12/2009 for Pillar II and Norm 14/2006 for Pillar III).

The fund also pays for the annual auditing fee (Fund auditing taxes) and the rest of the fund's expenses (custody, depositary, transaction/trading expenses) must be supported by the pension company (the administrator).

The next table compares effective charges of mandatory pension funds in Pillar II over time (calculated via total and net NAV).

Table RO4. Effective annual charges in mandatory pension funds (Pillar II) in %

Mandatory pension fund	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
ARIPI	1.23	0.86	0.75	0.68	0.63	0.62	0.62	0.63	0.61	0.58	0.63
METROPOLITAN LIFE	0.54	0.70	0.65	0.61	0.62	0.60	0.59	0.60	0.58	0.56	0.61
AZT VIITORUL TAU	0.56	0.69	0.66	0.60	0.61	0.61	0.60	0.60	0.58	0.56	0.61
BCR	1.69	0.93	0.75	0.64	0.63	0.62	0.63	0.61	0.58	0.56	0.62
BRD	2.04	1.11	0.87	0.75	0.70	0.62	0.62	0.64	0.60	0.56	0.61
NN	0.55	0.62	0.61	0.58	0.62	0.60	0.60	0.60	0.58	0.56	0.61
VITAL	0.00	0.58	0.79	0.70	0.65	0.64	0.61	0.61	0.58	0.56	0.61
EUREKO	*0.36*	*0.12*	*0.84*	*0.60*	*0.60*	*0.60*					
PENSIA VIVA	*0.12*	*0.60*	*0.60*	*0.60*	*0.60*						
BANCPOST	*8.04*										
KD	*5.88*	*0.60*									
OMNIFORTE	*2.04*										
OTP	*14.6*	*6.00*									
PRIMA PENSIE	*8.88*	*6.72*									
TOTAL	**0.77**	**0.70**	**0.66**	**0.61**	**0.62**	**0.61**	**0.60**	**0.60**	**0.58**	**0.56**	**0.61**

Source: Own calculations based on CSSPP data, 2019 (data as of December 2018)

Pillar III – Voluntary private pensions

According to the Voluntary Pensions Law,[228] the administrator shall charge a fee from participants and beneficiaries for the management of a pension fund.

- The levels of fees shall be established in the pension scheme prospectus and shall be the same for all participants and beneficiaries;
- Participants shall be notified of any change to the fees at least 6 months before it is applied.

[228] Law number 204/2006 concerning voluntary pensions

The administrator's revenue will come from:

- management commission (up to 5% from the contributions) and management fee (up to 0.2% monthly from total gross assets in pension fund);
- transfer penalties (covered from personal assets, in case of moving to another fund/PFC earlier than in 2 years – 5%);
- fees for services requested by participants:
  - Depositary commission (depository fee);
  - Transaction costs (trading fees);
  - Bank commissions (banking fees);
  - Fund auditing taxes (pension fund auditing fees).

Management fees are made up of:

a) deduction of a percentage from contributions paid by participants; this percentage cannot be higher than 5% and must be made before contributions are converted into fund units (Management commission);

b) deduction of a negotiated percentage from the net assets of the voluntary pension fund; this percentage cannot be higher than 0.2% per month and shall be mentioned in the pension scheme prospectus (Management fee).

A transfer penalty is applicable (paid by the participant) in the event of a transfer to another fund within two years of having joined the previous fund; its upper limit is established by Commission norms. The next table compares effective charges of voluntary pension funds in pillar III over time (calculated via total and net NAV).

Table RO5. Effective annual charges of voluntary pension funds (Pillar III) in %

Voluntary pension fund	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
AZT VIVACE	1.05	1.47	2.83	2.83	2.52	2.06	2.00	1.91	1.84	1.74	1.67	1.79
NN ACTIV	0.04	1.64	1.85	2.38	2.19	2.34	2.14	2.09	2.17	2.10	1.95	2.11
AZT MODERATO	0.99	1.83	2.16	1.86	1.66	1.41	1.33	1.28	1.24	1.18	1.13	1.21
BCR PLUS	5.61	2.38	2.28	2.77	2.44	2.40	2.23	2.27	2.16	2.03	1.97	2.16
BRD MEDIO	0.00	0.00	0.85	1.90	1.56	2.86	2.18	2.14	2.20	2.11	1.91	2.18
*CONCORDIA MODERAT**	0.00	*0.00*	*1.47*	*1.47*	*1.43*	*1.46*	0.00	0.00	*0.00*	*0.00*	*0.00*	*0.00*
*EUREKO CONFORT**	0.00	0.00	*0.05*	*0.00*	*0.18*	*0.06*	*0.14*	*0.07*	*0.00*	*0.00*	*0.00*	*0.00*
NN OPTIM	0.09	1.58	1.68	2.09	1.97	2.05	1.99	1.97	2.00	1.94	1.85	2.00
PENSIA MEA	3.22	3.17	2.85	2.66	2.66	2.70	2.66	2.66	2.64	2.43	2.37	2.56
RAIFFEISEN ACUMULARE	0.00	0.15	2.93	2.40	2.23	2.15	2.43	2.26	2.47	2.16	2.06	2.19

STABIL	0.00	0.00	2.26	1.61	1.50	1.65	1.63	3.16	3.71	3.37	2.80	2.99
AEGON ESENTIAL	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	1.87	3.15	2.99	3.12
*BRD PRIMO**	0.00	0.00	*0.83*	*1.57*	0.00	0.00	0.00	0.00	*0.00*	*0.00*	*0.00*	*0.00*
*OTP STRATEG**	*N/A*	*19.10*	*3.80*	*2.91*	0.00	0.00	0.00	0.00	*0.00*	*0.00*	*0.00*	*0.00*
TOTAL	4.72	1.91	2.12	2.30	2.09	2.10	1.99	1.99	2.01	1.92	1.83	1.99

Source: Own calculations based on CSSP data, 2019 (data as of December 2018)

* Closed

The year 2018 brought smaller increase in effective annual charges, and the Pillar III confirmed that the Pillar III pension funds remain expensive pension vehicles.

Taxation

Pillar II – Funded pensions

Romania applies an EET system for the taxation of future mandatory accounts. Employee contributions are tax-deductible and investment income on the level of the pension fund is tax-exempt. Pension benefits paid out during retirement will be subject to a personal income tax (10% tax rate) above a certain level (€460 in 2018). The social security contributions have been removed as of 2018 and are supported completely from the consolidated state budget.

Pillar III – Voluntary private pensions

The amount of contributions to voluntary pension funds is fiscally deductible from each subscriber's gross monthly wage or any other assimilated revenue if the total amount is not greater than the equivalent in RON of €400 in a fiscal year. The same rule applies to the employer, meaning that the employer can deduct the amount paid to the employee's voluntary pension account up to €400 annually.

The investment returns achieved by the third pillar fund are tax exempt until the moment of payments toward subscribers' start. The pension benefits paid from Pillar III are subject to personal income tax, thus representing an 'EET' regime.

Pension Returns

Pillar II – Funded pensions

Seven asset managers offer seven mandatory pension funds in Romania. Performance analysis reveals similarities in their investment strategy, implying similarity in the pension funds' portfolio structure.

Table RO6. Pillar II pension vehicles			
Risk Profile	**Mandatory pension fund**	**Fund Inception Day**	**Fund closing date**
High	FPAP ARIPI	May 2008	Open
Medium	FPAP METROPOLITAN LIFE	May 2008	Open
	FPAP AZT VIITORUL TAU	May 2008	Open
	FPAP BCR	May 2008	Open
	FPAP BRD	May 2008	Open
	FPAP ING	May 2008	Open
	FPAP VITAL	May 2008	Open
No longer in operation	FPAP EUREKO	May 2008	Closed September 2014
	FPAP PENSIA VIVA	May 2008	Closed January 2013
	FPAP BANCPOST	May 2008	Closed May 2009
	FPAP KD	May 2008	Closed March 2010
	FPAP OMNIFORTE	May 2008	Closed June 2009
	FPAP OTP	May 2008	Closed January 2010
	FPAP PRIMA PENSIE	May 2008	Closed January 2010

Source: Own elaboration based on CSSPP data, 2019 (data as of 31 December 2018)

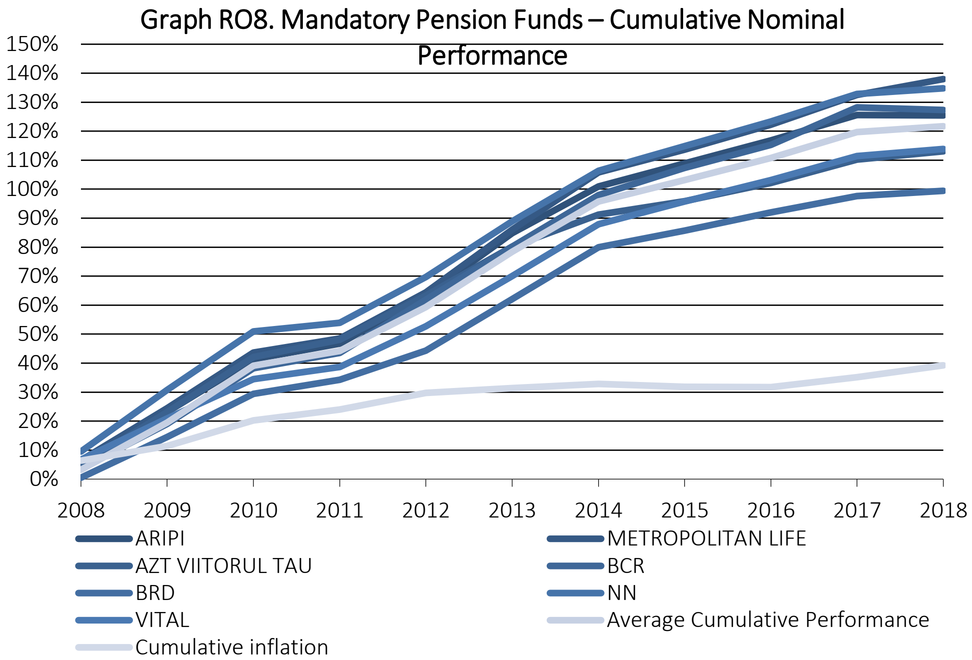
According to CSSPP database, all mandatory pension funds can invest into 16 asset classes:

Table RO7. Allowed asset classes for Pillar II pension funds	
Allowed asset classes for Pillar II pension funds	**Asset classes used for the purpose of the study**
Bank deposits	Bank deposits
Government Securities / Municipal Bonds	Government Securities and Bonds
Government Securities	
Corporate Bonds	
Supranational Bonds	
Shares	Stocks
Undertakings for Collective Investment in Transferable Securities – UCITS	Collective Investments
Other Collective Investment Undertakings – non UCITS	
Commodities and Precious Metals	Commodities and Precious Metals
Commodities and Precious Metals Funds	
Instruments for hedging risk	Other
Private Equity	
Infrastructure	
Other financial instruments	
Amounts in settlement at the end of reporting date	
Instruments for hedging risk	

Source: Own elaboration, 2018

For the purpose of this study, we simplified the portfolio structure to only six main asset classes (see the table above). Romanian mandatory pension funds invest mostly in government securities and bonds asset classes. The second most important asset class (from the portfolio structure point of view) are equities and the third most important are bank deposits. Three other classes have minimal impact on pension fund's performance.

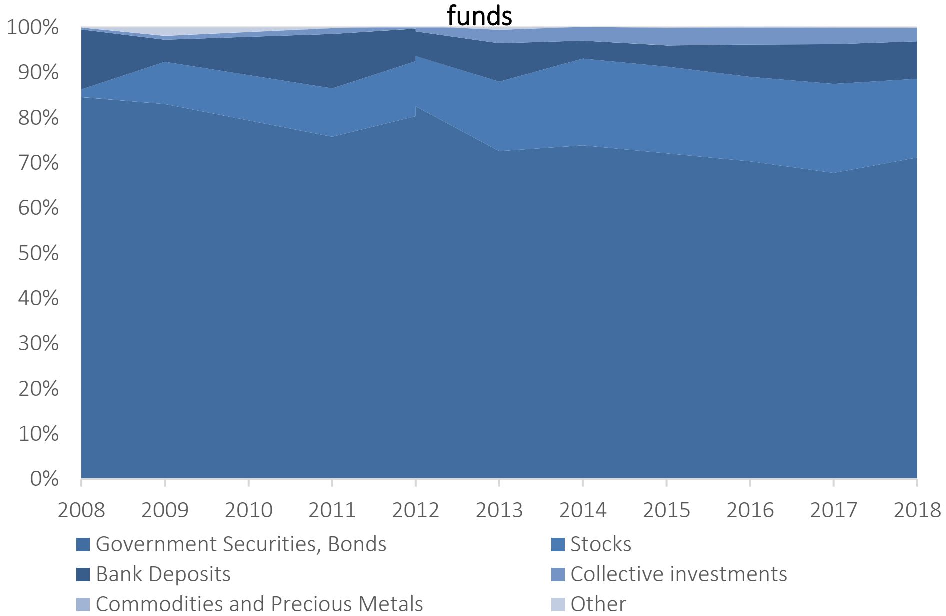
Mandatory Pension Funds' performance compared to the inflation index is presented below.



Source: Own calculations based on CSSPP data, 2019 (data as of 31 December 2018)

The portfolio structure of the Romanian Pillar II is presented below. According to the data available, currently almost 71% of all investments in Pillar II pension funds are bond investments and less than 17% is invested in equities. More detailed data on Pillar II portfolio structure is presented below.

Graph RO9. Portfolio structure of Pillar II mandatory pension funds



Source: Own calculations based on CSSPP data, 2019 (data as of 31 December 2018)

Nominal as well as real returns of Pillar II pension funds in Romania, weighted by AuM, are presented in a summary table below.

Table RO10. Nominal and Real Returns of II. Pillar in Romania						
2008	Nominal return after charges, before inflation and taxes	6.40%	7.70%	Real return after charges and inflation and before taxes	0.02%	4.64%
2009		17.57%			12.88%	
2010		15.04%			7.09%	
2011		3.22%			0.05%	
2012		10.55%			5.98%	
2013		11.48%			10.16%	
2014		8.92%			7.88%	
2015		3.69%			4.7%	
2016		3.76%			3.85%	
2017		4.26%			1.67%	
2018		1.06%			-1.96%	

Source: Own calculations based on CSSPP data, 2019 (data as of 31 December 2018)

Pillar III – Voluntary private pensions

The eight asset managers offer 10 voluntary pension funds in Romania. AZT and NN are the only providers which offer two voluntary pension funds. The performance of all pension funds shows the same finding as with Pillar II mandatory pension funds - there is similarity in voluntary pension funds' investment strategy. Performance results also imply a similarity in pension funds' portfolio structure.

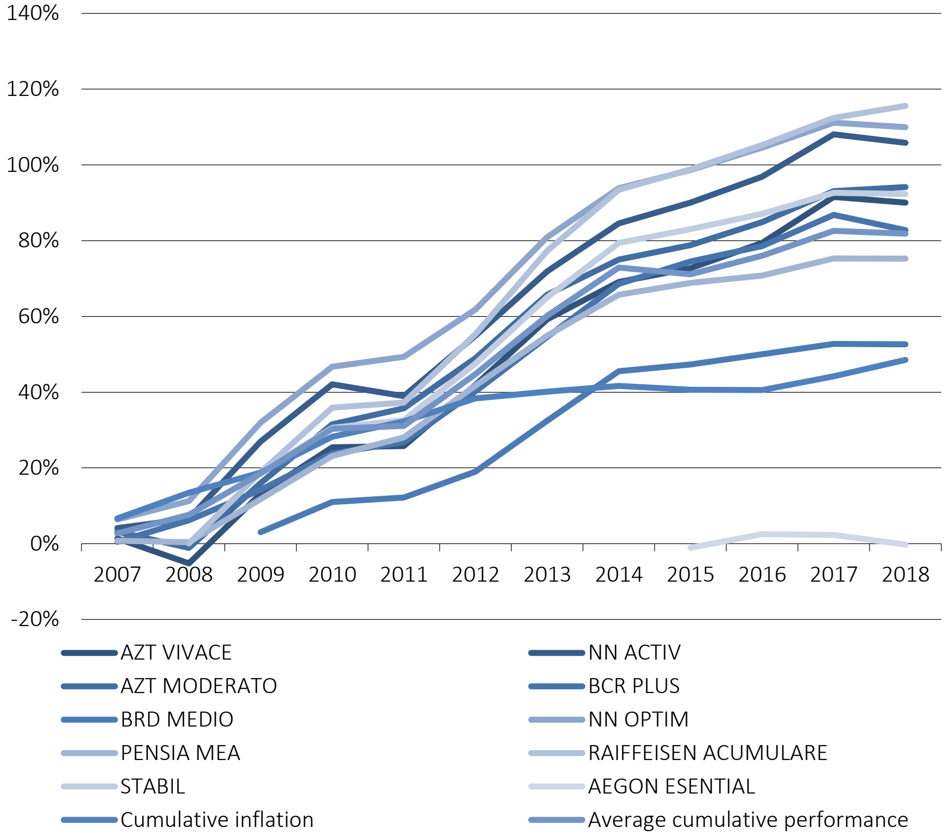
Table RO11. Pillar III pension vehicles

Risk Profile	Voluntary pension fund	Fund Inception Day	Fund closing date
High	FPF AZT VIVACE	May 2007	Open
	FPF NN ACTIV	May 2007	Open
Medium	FPF AZT MODERATO	May 2007	Open
	FPF BCR PLUS	May 2007	Open
	FPF BRD MEDIO	July 2009	Open
	FPF CONCORDIA MODERAT	*September 2008*	*Closed February 2013*
	FPF EUREKO CONFORT	*February 2009*	*Closed in June 2015*
	FPF NN OPTIM	May 2007	Open
	FPF PENSIA MEA	May 2007	Open
	FPF RAIFFEISEN ACUMULARE	July 2008	Open
	FPF STABIL	April 2009	Open
	FPF AEGON ESENTIAL	May 2015	Open
Low	*FPF BRD PRIMO*	*July 2009*	*Closed December 2011*
	FPF OTP STRATEG	*December 2007*	*Closed December 2011*

Source: Own elaboration based on CSSPP data, 2019 (data as of 31 December 2018)

All voluntary pension funds' performance on a cumulative basis compared to the inflation index is presented in the graph below.

Graph RO12. Voluntary Pension Funds – Cumulative Nominal Performance

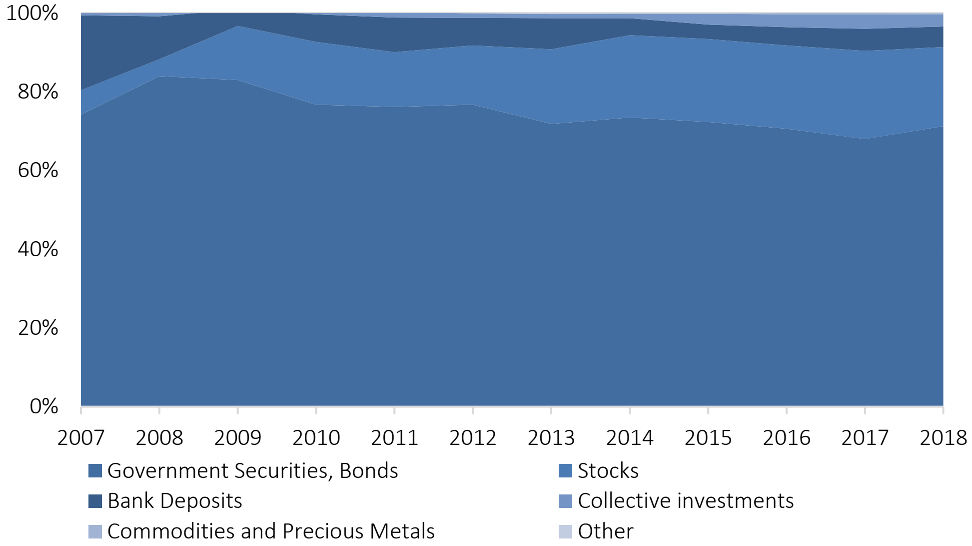


Source: Own calculations based on CSSPP data, 2019 (data as of 31 December 2018)

Analyzing the portfolio structure of voluntary pension funds based on CSSPP data, we can conclude that most of the performance is tied to the Government Securities and Bonds asset classes. The second most important asset class (from the portfolio structure point of view) is equities and the third most important is bank deposits. The three other classes have minimal impact on pension fund's performance results.

Portfolio structure of Romanian Pillar III voluntary pension funds is presented below. According to the data for 2018, around 70% of all investments in Pillar III pension funds are bond investments and about 20% is invested in stocks with rising portion of collective investment vehicles (UCITS funds). Overall, Pillar III portfolio structure is very similar to that of Pillar II over the whole analysed period. The difference in the performance could therefore be devoted to the negative impact of fees, which are significantly higher in Pillar III.

Graph RO13. Portfolio structure of Pillar III voluntary pension funds



Source: Own calculations based on CSSPP data, 2019 (data as of 31 December 2018)

Nominal as well as real returns of voluntary pension funds in Romania, weighted by AuM, are presented in a summary table below.

Table RO14. Nominal and Real Returns of III. Pillar in Romania						
2007	Nominal return after charges, before inflation and taxes	1.86%	5.67%	Real return after charges and inflation and before taxes	-4.80%	2.27%
2008		1.72%			-4.66%	
2009		15.51%			10.82%	
2010		11.14%			3.19%	
2011		1.59%			-1.59%	
2012		9.96%			5.40%	
2013		11.36%			10.05%	
2014		7.48%			6.44%	
2015		2.55%			3.22%	
2016		2.91%			3.00%	
2017		3.96%			1.38%	
2018		-0.66%			-3.68%	

Source: Own calculations based on CSSPP data, 2019 (data as of 31 December 2018)

Conclusions

Romania's population is rapidly decreasing and aging, which – unless they adopt the necessary reforms - will lead to the explosion of the demographic bomb in a few decades. That is why Romania introduced the private pensions system in 2007, which is based on the model tested and recommended by the World Bank. The multi-pillar private pensions system includes Pillar II (mandatory schemes) and Pillar III (voluntary schemes).

In the public PAYG pensions system, the state collects contributions from employees and redistributes the money among existing pensioners. Demographics show that this redistribution logic is no longer viable, as contributors' numbers will fall, and the number of pensioners is already going up. The departure from this dilemma takes the form of the private pensions system, allowing each active person to save for their own future retirement.

Romanian pillar II is a fully funded system based on personal accounts and on the defined contribution (DC) philosophy. Pillar II is mandatory for all employees aged under 35 years and voluntary (optional) for employees aged 35 to 45. The starting level of contribution was set at 2% of the participant's total gross income and increases by 0.5 percentage points annually until it reaches 6 of total gross income in 2017. However, this level has not been reached, and the contribution system has inversed.

Mandatory pension funds are managed by their administrators - Pension Management Companies (PMCs). Each PMC is obliged by respective law to administrate and manage just one mandatory pension fund. Currently, there are seven PMCs managing seven mandatory funds on the Romanian Pillar II market. The market is dominated by two PMCs (AZT and NN).

Romanian pillar III is also a fully funded system based on personal accounts and on the defined contribution (DC) philosophy. Pillar III represents privately managed supplementary pensions. This system is opened to all income cohorts. The tax advantage contribution is limited to 15 of participant's total gross income.

Voluntary pension funds in Pillar III are managed by their administrators - Pension Management Companies (PMCs), Life Insurance Companies (LICs) or Asset Management Companies (AMCs). Each administrator is obliged to establish and operate at least one voluntary pension fund. Currently, there are eight providers offering 10 voluntary pension funds. Pillar III market is fairly concentrated, where three dominant players cover almost 90 of the market.

Mandatory as well as voluntary pension funds' investment strategy is strictly regulated. The law imposes percentage limits and restrictions for different asset classes. It must be noted that investment rules in mandatory and voluntary system are very similar. This fact logically causes implications on portfolio structure, thus also on performance of mandatory and voluntary pension funds in Romania. Currently about 70 of all investments in Pillar II as well as Pillar III pension funds are bond investments (Romanian Government Money market instruments and Bonds) and only about 19 is invested in equities.

Overall, the real return of pension funds in Pillar II as well as Pillar III are positive and well above the inflation. However, considering the fee structure, Pillar II savers are better positioned as the charges are almost 4-times lower than the fees applied in Pillar III.

Policy considerations

We strongly advise Romanian public authorities to not destroy the private managed pensions system, considering that for 11 and, respectively, 12 years privately managed pension schemes in Romania have functioned quite well and returned performances above inflation. However, considering the "lucky timing" of their start, i.e. after the market downfall of the 2008 crisis, some may argue that Romanian private pension plans must pass a market correction to prove their resilience. Therefore, these policy considerations are forward looking and meant to further enhance this system.

First, bearing in mind the general and constant research results on the correlation between cost and performance in investment funds, one consideration would be to further cap the total costs for privately managed occupational pension funds (Pillar II).

Second, considering the concentrated market for Pillar II funds and the fact that enrolment is mandatory, the Romanian public authorities should consider including a mandatory minimum rate of return for these plans (e.g. inflation + 1%), in order to ensure that this well performing track record is maintained.

Last, Romanian citizens should be further incentivised through financial education and fiscal stimulents to increase their savings rate into voluntary pension plans (Pillar III).

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