Long-Term and Pension Savings

The Real Return

2020 Edition

BF BETTER FINANCE
The European Federation of Investors and Financial Services Users
Fédération Européenne des Épargnants et Usagers des Services Financiers

Pension Savings: The Real Return

2020 Edition

A Research Report by BETTER FINANCE

COORDINATORS

Aleksandra Mączyńska
Ján Šebo
Ştefan Dragoş Voicu

CONTRIBUTORS

Edoardo Carlucci
Lubomir Christoff
Lars Christensen
Michaël Deinema
Laetitia Gabaut
Yordanka Popova
Lisbeth Grænge-Hansen
Johannes Hagen
José Antonio Herce
Arnaud Houdmont
Matis Joab
Michal Mešťan
Gregoire Naacke
Dayana Nacheva
Carlos Nava
Guillaume Prache
Joanna Rutecka-Góra
Dr. Thomas Url

REVIEWERS

Ján Šebo
Michal Mešťan
Ştefan Dragoş Voicu

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

Pension Savings: The Real Return

2020 Edition

Country Case: Austria

Summarisch

Rund 90% des durchschnittlichen Alterseinkommens in Österreich stammen aus dem öffentlichen Pensionssystem. Damit ist die Altersvorsorge sehr stark auf die erste Säule konzentriert. Die betriebliche Altersvorsorge wird in erster Linie von Pensionskassen und Versicherungsunternehmen getragen. Direktzusagen sind ein alternatives Instrument deren Nutzung seit Jahren stagniert. Die Möglichkeit für beitragsorientierte Pensionspläne in Pensionskassen und über Versicherungen hat die Verbreitung der betrieblichen Altersversorgung in Österreich gestärkt. Während betriebliche Formen der Altersvorsorge im Laufe der Zeit beliebter wurden, dämpften niedrige Zinssätze und die hohe Liquiditätspräferenz die Nachfrage nach individuellen Lebensversicherungsverträgen. In den Jahren 2002 bis 2019 war die Performance der Pensionskassen real und nach Abzug der Verwaltungskosten positiv. Die annualisierte Durchschnittsrendite lag bei 1,4% vor Steuern. Die Lebensversicherungsbranche verfolgt eine deutlich konservativere Anlagepolitik und erzielte eine durchschnittliche reale Nettorendite vor Steuern von 2,1% pro Jahr.

Summary

With around 90% of the average retirement income coming from public pension entitlements, the Austrian pension system is very reliant on the first pillar. Occupational pensions are primarily offered through pension funds and insurance companies. Direct commitments are an alternative vehicle, but their usage stagnates. The option for defined contribution (DC) plans with favourable tax treatment offered by pension funds and insurance contracts definitely boosted the occupational pensions in Austria. While occupational pensions have become more popular over time, low interest rates and a high liquidity preference dampened demand for individual life insurance contracts. Over the years 2002 through 2019, the performance of pension funds in real net terms has been positive, with an annualised average return of 1,4% before tax. The life insurance industry followed a distinctly more conservative investment policy and achieved an average annual net real return before tax of 2.1%.

Introduction

The Austrian pension system consists of three pillars:

- Pillar I: Mandatory Public Pension Insurance
- Pillar II: Voluntary Occupational Pensions
- Pillar III: Voluntary Individual Pensions

The mandatory public pension insurance covers most of private sector employees (Pillar I). Civil servants have their own pension system which will gradually converge towards the public pension insurance system. The self-employed belong to various separate mandatory systems. The public pension system works as a PAYG scheme (Pay-As-You-Go) and was founded in 1945. The system covers 4.1 million people or 96% of the gainfully employed (2019). In 2019, all employees – except civil servants – were subject to a contribution payment of 22.8% of their income before taxes, with contributions shared between the employer (12.55%) and the employee (10.25%). Civil servants pay a contribution of 12.55% of their gross wage and the self-employed pay 18.5% of their profit before taxes into the pension system. The Austrian pension system will be fully harmonized across all insured persons by 2050. The public pension system has an income ceiling (maximum contribution basis) up to which contributions apply, income above this level is exempted from contributions but the ceiling also limits the pension benefit level. In 2019 the ceiling was between 5,220 € and 6,090 €, depending on the employment status. About 8% of the gainfully employed achieve an income above these ceilings. The theoretical gross pension replacement rate at the median income level for persons entering the labour market at age 22 corresponds to 76.5% of the average lifetime income while the net pension replacement rate is at 89.9% (OECD, 2019). Both theoretical replacement rates will be reached after 43 years of uninterrupted employment with earnings always at the average income level. Effective replacement rates are likely to be lower because careers are not continuous and life-time income profiles are not flat. Due to pension reforms gradually taking effect, the effective replacement rates are expected to fall for future pensioners. Nevertheless, high replacement rates for many of the gainfully employed limit the demand for occupational as well as private pension plans.

Accompanying a series of public pension reforms between 2003 and 2006 which implemented reductions in the expected benefit level, the Austrian government introduced the premium subsidised pension plan to make private old-age provision more attractive. This scheme became very popular until 2012 with 1.64 million contracts signed but it lost attraction after the government halved the premium subsidy in 2012 (to 4.25% of the premium paid) and after investment yields collapsed during the financial crisis on 2007. By 2018, only 1.2 million contracts were still active.

Introductory Table – Austrian Pension System overview

Pillar I	Pillar II	Pillar III
Mandatory Public Pension Insurance	Voluntary Occupational Pensions	Voluntary Personal Pensions
Practically all gainfully employed persons are subject to pension contributions of 22.8% of income before taxes	Employers can establish an occupational pension system of their preference	Supplement particularly for high earners
Means tested minimum pension	Direct commitments, pension funds, occupational life insurance. About 50% of employees are entitled	Life insurance with a coverage of about 50% of private households. The state-aided old-age insurance features 1.29 mil. contracts
Pension level depends on lifetime income (various kinds of supplementary insurance months are accounted, cf. motherhood, unemployment, military service		
Mandatory	Voluntary	Voluntary
PAYG	DB or DC	DC
Quickfacts		
Statutory retirement age is 60 (women) and 65 (men)		
The average effective age of retirement was 59,5 for women and 61.3 for men (2019, including invalidity pensions and early retirement schemes but excluding rehabilitation benefits)		
At 89.9% the theoretical net replacement rate in 2018 was considerably higher than the the OECD average (8.6%).		
The mandatory public pension system covers 4.13 mil. insured persons and pays pensions to 2.40 mil. Beneficiaries	The voluntary occupational pension system covers 1.69 mil. entitled persons and pays pensions to 0.2 mil. beneficiaries[1]	Voluntary personal pension plans cover 2.58 mil. entitled persons and pays pensions to 0.46 mil. beneficiaries
The average pensioneer receives 90% of his retirement income from public pensions	The average pensioneer receives 5% of his retirement income from an occupational pension	The average pensioneer receives 5% of his retirement income from a personal pension

S: BETTER FINANCE own composition.
[1] Values for 2017.

The annualised nominal, net and real net rates of returns for the Austrian retirement provision vehicles are summarised in the table below based on different holding periods: 1 year, 3 years, 7 years, 10 years and since inception (2002).

Summary Table Austria. Annualised Performance for Various Holding Periods (in %)

	Holding period	Nominal return before charges, inflation, and tax	Nominal return after charges, before inflation and tax	Real return after charges and inflation before tax
Pension	In years		In %	
	1	11.79	11.54	10.05
	3	4.02	3.81	1.85
	5	3.71	3.51	1.98
	7	4.49	4.30	2.70
	10	4.30	4.09	2.18
	Since	3.55	3.30	1.40
Pension				
	1	2.84	2.47	0.98
	3	3.14	2.78	0.84
	5	3.42	3.06	1.54
	7	3.61	3.27	1.67
	10	3.79	3.44	1.54
	Since	4.32	3.96	2.09

S: Compare Tables AT5 and AT6. Annualised performance corresponds to geometric mean over the holding period.

Occupational and voluntary personal pension vehicles

Private pensions are divided into voluntary occupational and voluntary personal pensions. About 6.5% of today's retirees receive regular benefits from an occupational or personal pension. This figure is made up by 4% of retirees receiving benefits from an occupational pension and 2.5% of retirees receiving annuities from a personal pension plan (Pekanov – Url, 2017). Given todays numbers of active plan members these shares can be expected to increase substantially over time.

Occupational pension vehicles (Pillar II)

At the beginning of 2003, the system of severance payments has been replaced by mandatory contributions towards occupational severance and retirement funds (Betriebliche Vorsorgekassen). While the old severance payment regulations continue to apply to existing employment relations, employment contracts established after the end of 2002 feature mandatory contributions of 1.53% of gross wages to these funds. The main characteristics of severance payments have been transferred to the new system, i.e. in case of dismissal the fund will pay out the accumulated amount. Beneficiaries, however, may voluntarily opt to use this instrument as a tax-preferred vehicle for old-age provision. Less than one percent of the beneficiaries use this option. We therefore do not count occupational severance and retirement funds as pension vehicles in the following.

Voluntary Occupational Pensions (Pillar III)

Occupational pension plans are typically provided on a voluntary basis by firms, only a few collective bargaining agreements include an obligation for member firms of the respective sector. Employers can also choose the coverage and the vehicle of their pension plan. There are three types of occupational retirement schemes:

- direct commitments funded by book reserves,
- pension funds and
- several types of life insurance schemes.

Each of these schemes has advantages and drawbacks. While direct commitments create a stronger link between employees and the firm, the future pension payments are subject to bankruptcy risk and, during the accumulation phase, the firm must either manage the assets backing the book reserves or seek some sort of reinsurance. External vehicles like pension funds or life insurance contracts imply less bonding because the vesting period is much shorter, but they also outsource the effort of investment choice and annuity payments to a financial intermediary. The design of a voluntary pension plan is at the full discretion of the employer, but usually an arrangement with the firm's workers council is necessary.

Over the last decades many firms switched from direct commitment schemes to pension funds. On the one hand, this was a strategy to reduce the cost of existing defined benefit pension schemes by switching to defined contribution plans, and on the other hand, these efforts shortened balanced sheets and cleaned them from items unknown to international investors.

Direct commitments ("Direktzusage")

Direct commitments are pension promises by the employer to the employee that are administrated within a firm. These types of arrangements dominated until the 1980s, when several large bankruptcies or near bankruptcies revealed their fragility. The main two characteristics of this arrangement are direct administration of the pension obligation within the firm and a defined benefit type of the pension plan: the pension level is related to the wage level of employees. The plan administration comprises the computation of individual pension obligations and the respective book reserves, their coverage by invested assets, as well as the annuity payment. Nevertheless, many activities can be outsourced to actuaries, investment funds, and insurance companies. Pension claims based on direct commitments are not subject to any reinsurance requirement, but the reserve funds dedicated to back book reserves are protected from creditors. Besides outsourcing, the Insolvenz-Entgelt-Fonds provides a further safeguard for entitled employees and pensioners to bankruptcy risk. This fund is a public fund covering wage entitlements by employees in case of bankruptcy. Currently, the Insolvenz-Entgelt-Fonds covers a maximum of 2 years of benefit payments or accrued entitlements (Insolvenz-Entgeltsicherungsgesetz § 3d). Due to their voluntary character and a lack of supervision the incidence of direct commitments is hardly documented.

Pensions funds ("Pensionskassen")

Pension funds are specialised financial intermediaries providing only services related to occupational pensions, i. e. they collect contributions, manage individual accounts, invest the accumulated capital, and they pay out an annuity to beneficiaries. Pension funds were introduced in 1990 with the Occupational Pension Law and the Pension Fund Law (Betriebspensions- und Pensionskassengesetz) which established a general legal basis for occupational pension schemes including pension funds. These laws facilitated the outsourcing of asset management and accounts administration from direct commitment systems into pension funds. This made individual pension entitlements transferable between companies, it made possible additional contribution by employees, but it also enabled firms

to switch from defined benefit to defined contribution pension plans. By now most pension plans are of the defined contribution type and beneficiaries are directly exposed to investment risk as well as to changes in mortality risk. For example, plan members whose entitlement was converted from a direct commitment into an entitlement vis-a-vis a pension fund still suffer from investment losses shortly after transferring the assets into pension funds around the year 2000 because the imputed interest rates used at that time were overly optimistic (Url, 2003B).

Pension funds may be either multi-employer pension funds, i. e. they are open to other firms, or alternatively, they may be firm specific pension funds (single-employer pension funds) administrating the pension plan for a single firm or a holding group. Over the last couple of years, many firm specific pension funds have been merged into multi-employer pension funds building independent risk and investment pools like UCITS. Pension funds are subject to supervision by the Austrian Financial Market Authority and they feature investment advisory boards, where representatives of workers and employers can advance their opinion on the investment strategy. Nevertheless, the results from asset-liability management strategies dominate the portfolio choice of pension funds.

Pension funds offer primarily annuities because lump-sum payments are restricted to accounts with very small accumulated assets. Pension funds have to offer accounts with guaranteed long-term yields on investment linked to the market yield of Austrian government bonds, although this option lost attractiveness due to the high costs of guarantees and a substantial weakening of the guarantee type. The guarantee is backed by the own capital of the pension fund and by a minimum return reserve fund financed by contributions from beneficiaries (Mindestertragsrücklage). In case of bankruptcy of the pension fund, all entitlements are protected by separate ownership of the assets associated to each account (Deckungsstock).

Direct insurance

Firms can alternatively sign a contract with a life insurance company. This contract is either subject to the regulation covering occupational pensions (Betriebliche Kollektivversicherung) or it is designed as a life insurance policy and is subject to the regulation for life insurance products. Insurance companies also underwrite risks embedded in direct commitments. Direct insurance of occupational pension plans implies that the sponsoring firm will pay contributions into a life insurance contract with employees as beneficiaries. In this case, the firm outsources the management of personal accounts and assets, as well as the annuity payments to an insurance company.

The number of working and retired persons with an entitlement to a life insurance policy almost matches the number of beneficiaries from pension funds because life insurance policies benefit from a tax loophole. Contributions up to € 300 annually (§ 3/1/15 EStG) are tax exempt and as a result almost 650.000 contracts have been signed until 2019. Given the small pension wealth accumulated in these accounts one cannot expect reasonable annuity payments resulting from this vehicle.

The Betriebliche Kollektivversicherung, on the other hand, provides occupational pensions with a favourable tax treatment up to 10% of individual gross wages. It is regulated according to the Occupational Pension Law, but this vehicle allows for more substantial long-term guarantees usually offered by classic life insurance contracts. Insurers also freeze mortality tables at the date of joining a pension plan.

Table AT1. Entitlements to active occupational pensions (in million persons)

	Direct commitments	Pension funds	Life insurance	Total
2001	-	0.32	0.09	-
2002	0.13	0.34	0.08	0.56
2003	-	0.37	0.21	-
2004	0.14	0.40	0.27	0.81
2005	-	0.43	0.31	-
2006	-	0.48	0.33	-
2007	0.13	0.49	0.37	0.99
2008	-	0.51	0.39	-
2009	-	0.74	0.41	-
2010	0.14	0.76	0.43	1.33
2011	-	0.79	0.49	-
2012	-	0.82	0.54	-
2013	-	0.84	0.62	-
2014	-	0.86	0.70	-
2015	0.14	0.88	0.77	1.79
2016	-	0.90	0.73	-
2017	-	0.92	0.87	-
2018	-	0.95	0.87	-
2019	-	-	0.88	-

S: Fachverband der Pensionskassen, Austrian Insurance Association, Url (2003A), Url (2009), Url (2012), Pekanov - Url (2017). - Includes working and retired beneficiaries.

Life insurance and pension insurance contracts

Life insurance policies are signed by private persons who pay contributions over an agreed period into their own pension account. The insurance company administrates the account and manages the accumulated assets. At the end of the contribution period, either a lump-sum amount is paid out to the insured person or alternatively the insurer converts the accumulated capital into an annuity.

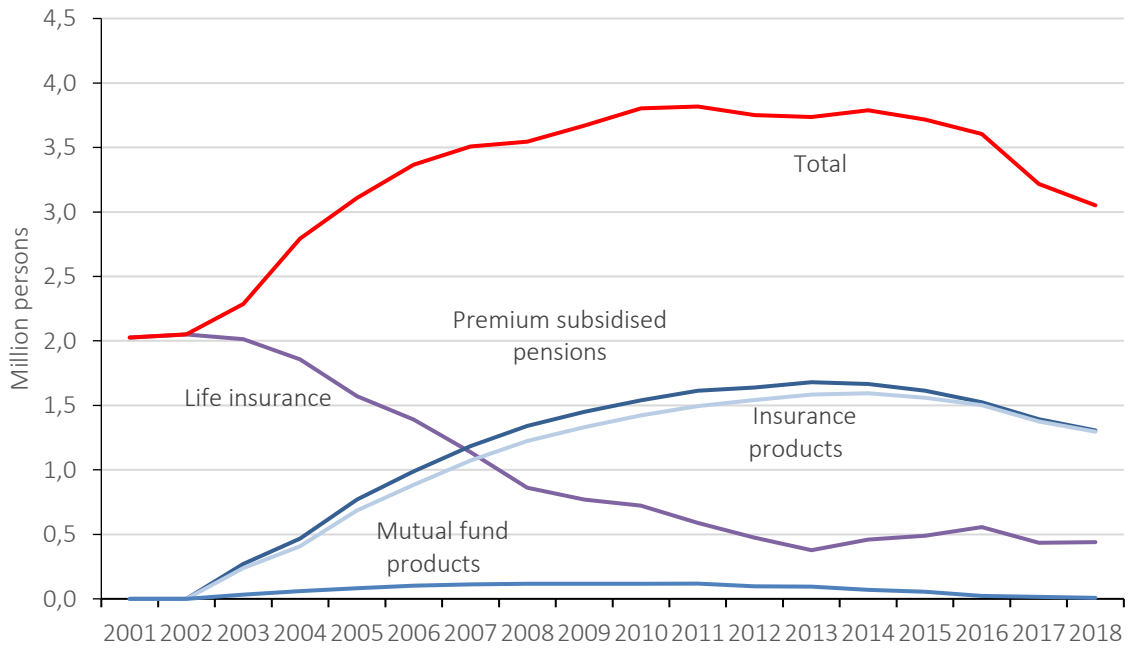
There are two types of insurance contracts available which can be distinguished according to who is the bearer of investment risks. Insured persons with a unit-linked policy assume the investment risk and must choose their investment portfolio. Classic life insurance products, on the other hand, offer a minimum return guarantee but investment decisions are delegated to the insurance company. The maximum possible guaranteed rate of return is regulated by the Austrian supervisory authority; currently this rate is fixed at 0.5% per annum (since 1.1.2017; BGBl. II Nr. 266/2016). Investment returns in excess of the guaranteed level are distributed across the insured as variable profit participation.

The major public pension reforms between 2003 and 2006 left many private employees, employers, and civil servants with a lower expected public pension payment. As a compensation the Austrian government introduced the premium subsidised pension plan (Prämienbegünstigte Zukunftsvorsorge). Originally the premium was fixed at 9.5% of the annual contribution, but in 2012, fiscal consolidation measures resulted in a halving of the subsidy rate; it is currently fixed at 4.25%. Additionally, the yield on investment is fully tax exempt. Premium subsidised pension plans have a minimum contract length of 10 years. About one third of the contracts feature a length of more than 30 years and two thirds of the contracts have a minimum duration of 20 years. The portfolio choice for the assets of subsidised

pension plans is restricted by law. A minimum share of the assets must be held in equities noted on underdeveloped stock exchanges. This measure was targeted to foster the Vienna stock exchange, but it resulted in highly concentrated investment risk. The strict regulation of investments has been weakened over the past years allowing for example life cycle portfolios with a reduction in the equity exposure when the retirement of entitled persons comes closer.

The halving of the subsidy premium and considerably negative returns on stock exchanges during the year 2008 reduced the interest in this new pension saving vehicle. The number of contracts is falling and contracts with the shortest possible duration of ten years have been mostly terminated with a lump-sum payment. This triggers an exit from the annuity phase with a mandatory repayment of the subsidy.

Chart AT2. Entitlements to active personal pensions



S: Austrian Insurance Association, WIFO. - Includes contributing and retired policy holders.

Charges

Information on all types of charges for occupational and private pension products are hard to obtain. Within direct commitment systems, pensions are of the defined benefit type and firms cover all expenses. The remaining vehicles for occupational pensions are subject to some degree of competition between financial intermediaries, although most pension funds are owned by alliances of banks and insurance companies. Because occupational pension plans are always group products, i. e. the individual entitled person has only limited or even no choice during the savings and annuity phases, these products have a cost advantage over individual pension plans. Large firms also receive quantity discounts or customised tariffs with lower administrative charges. In Table AT3 administrative charges and investment expenses for pension funds are expressed as a percentage of the funds' total invested assets. There are no data published on acquisition costs.

Table AT3. Operating expenses as % of total assets for pension funds

	Administrative charges	Investment expenses
2003	0.23	0.18
2004	0.23	0.12
2005	0.38	0.14
2006	0.39	0.15
2007	0.26	0.16
2008	0.32	0.16
2009	0.35	0.17
2010	0.28	0.17
2011	-	-
2012	-	-
2013	0.30	0.16
2014	0.00	0.17
2015	0.18	0.18
2016	0.19	0.18
2017	0.19	0.18
2018	0.20	0.19
S: OECD Pension indicators		

Table AT4. Life Insurance expense ratios

	Acquisition charges	Adminstrative charges
	In % of total premiums	In % of mean capital investments
2005	11.28	0.43
2006	11.49	0.38
2007	11.10	0.38
2008	10.66	0.38
2009	9.97	0.37
2010	10.75	0.36
2011	11.01	0.39
2012	11.68	0.33
2013	11.37	0.32
2014	10.67	0.33
2015	10.80	0.33
2016	11.49	0.35
2017	10.44	0.36
2018	10.27	0.37
2019[1]	10.36	0.37
S: Financial Market Authority, Austrian Insurance Association. - [1] Forecast.		

The costs of acquisition and administration for life insurance products are published by the Financial Market Authority. Acquisition costs amount to roughly one tenth of total premium income. Since 1 January 2007 the Insurance Contract Law includes a provision that acquisition fees have to be distributed over at least the first five years of the contract length. Before 2017 it was possible to charge

the full acquisition fee in the first year, making the cancellation of a life insurance contract extremely costly. Administration costs are presented as a ratio to the mean of the invested assets.

Since 1 January 2017, every consumer receives a short product information (Key Information Document) before signing an insurance contract. These information sheets are standardised and contain details of individual charges and investment fees allowing a better comparison of offers.

Taxation

The taxation of old-age provision varies over different vehicles and depends mainly on the history associated to the vehicle. For example, the taxation of occupational pensions is very much oriented towards the treatment of direct commitments, which were the first vehicle used for occupational pensions. Direct commitments work like a deferred compensation and therefore they are only taxed in the year of the payment. This corresponds to a system with tax-exempt contributions, tax-exempt capital accumulation, and (income) taxed benefits (EET system). This philosophy carries over to contributions paid by the employer into a pension fund or a group insurance product following the pension fund regulation (Betriebliche Kollektivversicherung). Contributions to pension funds and group insurance products (Betriebliche Kollektivversicherung) are subject to a reduced insurance tax of 2.5%. Contributions by employees are fully taxed but the resulting annuity is subject to reduced income taxation.

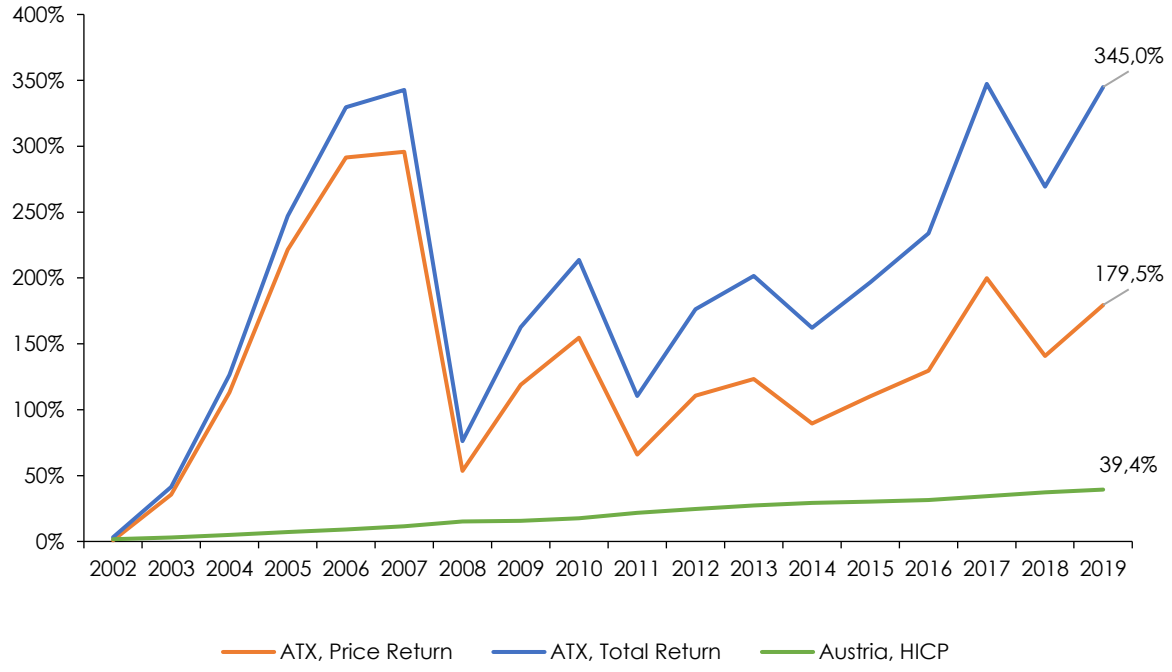
Contributions to classic life insurance products are not tax deductible and are subject to an insurance tax of 4%. During the capital accumulation phase all investment returns are tax exempt, and the taxation of benefits depends on the pay-out mode. Lump-sum payments are tax-free while annuities are subject to (reduced) income taxation. Additionally, premium subsidised products carry a premium based on the contribution, the capital accumulation phase is tax-exempt, and benefits are also tax free if they are converted into an annuity. Pekanov – Url (2017) provide a survey of the tax treatment of all vehicles for old-age provision using the present value approach as suggested by the OECD (2015, 2016). This approach compares the tax treatment of each vehicle to the tax treatment of a standard savings account. Expressed as a ratio to the present value of contributions, the tax advantage of employer payments into pension funds amount to 20%, i. e. the value of the tax subsidy corresponds to one fifth of life-time contributions. The lowest tax advantage results for life insurance products with an annuity payment. In this case, the tax subsidy makes up for 7% of life-time contributions. The maximum tax preference is associated with occupational life insurance policies subject to § 3/1/15 EStG. In this case, the subsidy amounts to 60% of life-time contributions, however, payments into this vehicle are restricted to a negligible € 300 per year.

Austrian Capital market returns

The performance of the Vienna stock exchange is shown in Graph AT5, where we distinguish between the price development of shares and the total return to equity investments in Austria including reinvested dividend payments. It is not surprising to observe that both indices have a positive long-term real return and are well above the cumulated inflation rate in 2019. Because the Austrian equity market is small, financial intermediaries spread their equity investment throughout Europe and the rest of the world. Therefore, equity returns of the Vienna stock exchange provide no guidance for the investment

performance of Austrian pension products, except premium subsidised pension plans carrying an obligation to invest in under-developed equity markets.

Graph AT5. Cumulated Austrian Equity Market Performance, 2002-2019



S:

Macrobond, Statistik Austria. Year-end values.

Pension Returns

Due to the defined benefit character of pensions derived from direct commitments and because accumulated assets for direct commitments have the narrow purpose of protecting individual pension claims in case of a firm bankruptcy, we do not compute pension returns for this vehicle. Furthermore, the asset class in which firms can invest are restricted to government bonds issued by OECD member countries.

The way of taxing contributions, investment returns, and pension payments varies according to the vehicle chosen, the party paying the contribution, i. e. employers or employees, and the personal income tax break of the retiree (cf. chapter on taxation). For this reason, we cannot compute a general after-tax return for Austria. Instead, we present the:

- nominal returns before charges, inflation, and tax,
- nominal returns after charges but before inflation and tax
- real returns after charges and inflation but before tax

for the two most important vehicles, i. e. pension funds and classic life insurance policies. The returns on classic life insurance policies are also representative for occupational pension plans using life insurance products under the occupational pension law (Betriebliche Kollektivversicherung).

Pension funds

Table AT6 shows the returns on assets held by pension funds. In the case of a defined benefit pension plan, investment returns are important for the sponsoring firm because if the return falls short of the imputed interest rate used for the computation of the expected pension level, the firm will have to provide additional contributions covering the shortfall. On the other hand, if a defined contribution pension plan has been established, the beneficiaries bear the risk of a shortfall in the realised return on investment, and consequently the realised pension level falls below its expected value.

Information on the performance of pension funds is published continuously by an independent third party, the Oesterreichische Kontrollbank[63], following a standardised procedure. The returns are available for all pension funds and separately for multi- and single-employer pension funds. The long-term performance of firm specific pension funds is about 0.7 percentage points higher as compared to multi-employer pension funds. The difference results probably from a less risk-oriented investment style followed by multi-employer pension funds, due to the wider usage of return guarantees in multi-employer pension funds. Nominal investment returns after charges but before inflation and taxes result from the subtraction of administrative charges of pension funds as presented in the chapter on charges. Real returns are computed by subtracting the HICP-inflation rate for Austria.

The Financial Market Authority publishes the asset allocation of pension funds as of year end (FMA, 2020). The portfolio in 2019 was dominated by bond holdings (43.3%) and equity investments (34.2%). The good performance of equity markets in 2019 let to a significant drop in the demand for liquid holdings in current bank accounts (7.0%). Real estate investments accounted for 4.7% of assets while the remainder was mixed throughout smaller asset categories. Given the strong exposure to equity, we find several years with negative returns, i. e. investment losses. Specifically, during the years after the bursting of the dotcom bubble (2000), the international financial market crisis (2007), and the public debt crisis in the euro area (2011), but also in 2018, when both bond and equity markets turned downwards. Nevertheless, pension funds achieved between 2002 and 2019 an annual average net real yield on investment of 1.4%. This corresponds to an average excess return over Austrian government bonds (benchmark) of 1.4%.

Table AT6. Pension funds' average annual rate of investment returns (in %)

	Nominal return before charges, inflation, and tax	Nominal return after charges, before inflation and tax	Real return after charges and inflation before tax
2002	-6.31	-6.56	-8.28
2003	7.60	7.37	6.06
2004	7.34	7.11	5.16
2005	11.37	10.99	8.69
2006	5.55	5.16	3.46
2007	1.95	1.69	-0.50
2008	-12.93	-13.25	-16.47
2009	9.00	8.65	8.25
2010	6.45	6.17	4.49
2011	-2.96	-3.19	-6.72
2012	8.40	8.17	5.61
2013	5.14	4.84	2.72

[63] https://www.oekb.at/kapitalmarkt-services/unser-datenangebot/veranlagungsentwicklung-der-pensionskassen.html.

2014	7.82	7.82	6.36
2015	2.32	2.14	1.33
2016	4.18	3.99	3.01
2017	6.13	5.94	3.72
2018	-5.14	-5.34	-7.44
2019[1]	11.79	11.54	10.05
Annual	3.55	3.30	1.40

S: Fachverband Pensionskassen, OECD Pension indicators, Statistik Austria. - Charges estimated by mean value for the years 2002-2010 and 2013-2019, cf. Table AT3. Annual average corresponds to geometric mean. - [1] Forecast.

Life insurance contracts

The return on investment in the classic life insurance industry is regularly computed by the Austrian Institute of Economic Research (WIFO). This computation excludes unit-linked contracts because the investment risk is borne by the insured and returns are usually retained within mutual funds and reinvested. The calculation of investment returns is based on investment revenues of the insurance industry and the related stock of invested assets in classic life insurance as provided by the Financial Market Authority. The method uses the mean amount of invested capital as the basis for the computation and is documented in Url (1996). The charges used to correct the yield for administrative expenses are based on Table AT4. Real returns result from subtracting the HICP-inflation rate for Austria from the nominal return.

Obviously, nominal gross returns in the insurance industry are less volatile than in the pension fund industry (Table AT7). The main reason for this divergence is the more conservative asset allocation of insurance companies, i. e. they invest more heavily in bonds (46%) and their mutual fund investments of 20% of the portfolio are also concentrated in bonds, creating a high exposure to fixed interest securities (FMA, 2020). Another important asset class in the insurance industry are shareholdings in group members (18%), which are usually not listed at a stock exchange. Real estate investments sum up to 8% of the assets, while equity holdings form just 1% of the portfolio. This gives insurance companies small exposure to volatile asset categories and consequently their investment performance is steadier. The resulting average net real rate of return of 2.1% was thus mainly due to the avoidance of losses during the period 2002 through 2019. The insurance industry achieved an average excess return over Austrian government bonds (benchmark) of 2.2% over this period, and their investment return was above the one delivered by pension funds.

The particular way of distributing investment returns in classic insurance policies makes their performance even more steady. Insurance companies separate their investment income into two parts. The first part serves to cover underwritten minimum return guarantees and it is immediately booked towards the individual account. Any excess return will be distributed over a couple of years through the build-up and reduction of profit reserves. By transferring accumulated profit reserves smoothly into individual accounts, insurance companies make the individual accrual of investments returns less dependent on current capital market developments although asset values are marked to market.

Yields on fixed interest securities from highly rated debtors are low or even negative since a couple of years. This environment forces insurance companies to replace maturing securities featuring high yields with new lower yielding securities. In a few years, insurance companies will have completely replaced

their stock of high-yield-high-grade securities and accordingly their average yields will continue to be low.

Table AT7. Pension insurances' average annual rate of investment returns (in %)

	Nominal	Nominal return	Real return after
2002	3.96	3.60	1.88
2003	5.60	5.24	3.93
2004	5.93	5.57	3.62
2005	6.32	5.88	3.77
2006	5.86	5.48	3.79
2007	5.18	4.80	2.61
2008	3.35	2.97	-0.25
2009	3.80	3.43	3.02
2010	4.47	4.11	2.42
2011	3.70	3.31	-0.22
2012	4.42	4.09	1.53
2013	4.31	3.99	1.88
2014	3.90	3.58	2.12
2015	3.94	3.61	2.81
2016	3.73	3.38	2.40
2017	3.49	3.14	0.91
2018	3.10	2.73	0.62
2019[1]	2.84	2.47	0.98
Annual	4.32	3.96	2.09

S: Financial Market Authority, Statistik Austria. – For the years 2002-2004 charges are estimated by their sample mean, cf. Table AT4. Annual average corresponds to geometric mean. - [1] Forecast.

Conclusions

The performance of pension funds in real terms has been positive over the whole period from 2002-2019, with an annualised average real return of 1.4% after service charges and before taxation. Especially the difficult years after 2000, in 2008, 2011, and recently 2018 dampened the investment performance considerably. The consequences are either additional payments by sponsoring firms (defined benefit plans) or reduced expected and realised pension levels (defined contribution plans). A mediocre investment performance will be more intensively felt in risk and investment pools with a high imputed interest rate used for the computation of the expected pension level. For example, plan members whose entitlement was transferred from a direct commitment to a pension fund around the year 2000 still suffer from investment losses after the dotcom bubble because overly optimistic imputed interest rates had been used at that time.

The average real rate of return on investments by insurance companies benefits from a conservative asset allocation with strong government bonds holdings. This allowed insurers to avoid large losses in years with a financial market crisis and reach an average real rate of return of 2.1% annually after service charges and before taxation. The net nominal rate of return, however, declines since the beginning of the public debt crisis in Europe in 2012. Higher inflation after 2015 increased the pressure on net real rates of return. Insurance companies benefit from the long duration of their investment portfolio, i. e. they still own bonds featuring high interest coupons, but these bonds will expire during the next few years creating a potential for low yield reinvestments. Consequently, demand for classic life insurance by individual households is shrinking and even premium subsidised pension insurance is

in low demand now because subsidies were halved in 2012 and investment losses, due to the concentrated investment in small and under-developed markets, affected this vehicle disproportionally.

The opportunity to offer defined contribution plans has certainly boosted the spread of occupational pensions in Austria. Within pension funds around three quarters of the entitlements are defined contributions plans, while occupational pensions based on insurance contracts are all of the defined contribution type.

Note: The addition of the Austrian Country Case was possible also thanks to our partners from Pekabe (the Austrian Association for the Protection of Pension Fund Investors), who reviewed the Country Case and co-funded it with BETTER FINANCE.

References

- FMA (2020): Jahresbericht der Finanzmarktaufsichtsbehörde 2019, Financial Market Authority, Vienna.
- Pekanov, A., Url, T. (2017): Kosten der privaten und betrieblichen Altersvorsorge für die öffentliche Hand, Bundesministerium für Soziales, Arbeit und Konsumentenschutz, Vienna, 2017.
- OECD (2015): Stocktaking of the Tax Treatment of Funded Private Pension Plans in OECD and EU Countries, Organisation for Economic Development and Cooperation, Paris.
- OECD (2016): Pensions Outlook 2016, Organization for Economic Development and Cooperation, Paris.
- OECD (2019): Pensions at a Glance 2019, Organization for Economic Development and Cooperation, Paris.
- Url, T. (1996): Kennzahlen der österreichischen Versicherungswirtschaft, Austrian Institute of Economic Research (WIFO), Vienna.
- Url, T. (2003A): Die Entwicklung der betrieblichen Altersvorsorge in Österreich, Austrian Institute of Economic Research (WIFO), Vienna.
- Url, T. (2003B): Einschätzung langfristiger Kapitalrenditen in der Veranlagung zur Altersvorsorge, Austrian Institute of Economic Research (WIFO), Vienna.
- Url, T. (2009): Die Verbreitung der betrieblichen Altersvorsorge in Österreich 2007, Austrian Institute of Economic Research (WIFO), Vienna.
- Url, T. (2012): Die Rolle von Lebensversicherungen in der betrieblichen Altersvorsorge, Austrian Institute of Economic Research (WIFO), Vienna.
- Url, T. (2013): Volkswirtschaftliche Daten zur Pensionsvorsorge in Österreich, in Urnik, S., Pfeil, W., J., (Eds.), Betriebliche Altersvorsorge in der Krise, Manz, Vienna, 2013, S. 1-18.

Imprint

Editor and Publisher
The European Federation of Investors and Financial Services Users
Rue d'Arenberg 44
1000 Brussels
Belgium
info@betterfinance.eu

Coordinators

Aleksandra Mączyńska
Ján Šebo
Ştefan Dragoş Voicu

Contributors

Edoardo Carlucci
Lubomir Christoff
Lars Christensen
Michaël Deinema
Laetitia Gabaut
Yordanka Popova
Lisbeth Grænge-Hansen
Johannes Hagen
José Antonio Herce
Arnaud Houdmont
Matis Joab
Michal Mešťan
Gregoire Naacke
Dayana Nacheva
Carlos Nava
Guillaume Prache
Joanna Rutecka-Góra
Dr. Thomas Url

BETTER FINANCE activities are partly funded by the European Commission. There is no implied endorsement by the EU or the European Commission of work carried out by BETTER FINANCE, which remains the sole responsibility of BETTER FINANCE.