Long Term & Pension Savings: The Real Return
2017 Edition

A Research Report by

BF BETTER FINANCE

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

About Better Finance

Better Finance, the European Federation of Investors and Financial Services Users, was founded in 2009 under the name of EuroInvestors. In 2012 it merged with 20 year old Euroshareholders.

Better Finance advocates for all financial services users: shareholders, bond holders, fund investors, pension plan participants, life insurance policy holders, bank savers, mortgage borrowers, etc.

Today Better Finance represents about 50 national associations which in turn have about 4.5 million European citizens as members. Its activities are supported by the European Union.

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Why is this pension savings performance report unique?

Pension savings appear to be one of the few retail services where neither the customers nor the public supervisors are properly informed about the real net performance for customers of the services rendered.

There is no recent and comprehensive study on the real net pension savings returns for EU countries. Even OECD data is unfortunately quite incomplete.

The European financial supervisors fail to report on the actual performance of products and services they regulate and supervise.

It is extremely and more and more difficult to find data on the returns of long term and pension savings

OECD reports on pension fund real returns

OECD table: Pension fund nominal and real 10-year geometric average annual returns 2005-2015

Country	10-year average (%)	
	Nominal	Real
Iceland	6.9	1.2
United Kingdom	7.3	4.7
Netherlands	5.5	3.8
Denmark	5.8	4.0
Belgium	5.1	3.2
Norway	5.5	3.4
Spain	..	..
Luxembourg	3.0	1.1
Austria	2.6	0.6
Slovenia	..	..
Italy	3.2	1.6
Portugal	3.2	1.8
Greece	..	..
Latvia	3.0	-0.7
Estonia	1.0	-2.2
Slovak Republic	..	..
Czech Republic	2.1	0.1

Source: Pension markets in Focus, 2016, OECD, pp.18

OECD reports :

- cover 10 years maximum
- 10 year reports do not cover Bulgaria, France, Poland, Romania, Slovakia, Spain and Sweden
- do not cover insurance regulated and bank regulated pension products (both occupational and personal)
- disclose « investment returns », not the returns net of all fees to the pension saver
- before tax returns at saver level

Why are pension returns critical ?

- The Pension time bomb: saving “***more and for longer periods***” as stressed by Public Authorities and the Industry is not sufficient, and even too often detrimental.
- **Unless long term net returns are significantly positive, saving early and significantly will not provide a decent replacement income through retirement**

Annual net return of pension savings	Replacement income (as % of activity income)
negative 1%	10%
zero	12%
2%	17%
8%	49%

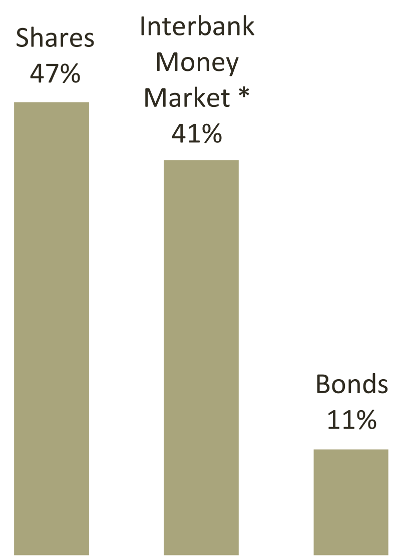
Assumptions: no inflation, saving 10% of same activity income for 30 years (as recommended by Public Authorities), 25 year life expectancy at retirement, and excluding impact of taxes

EU Authorities do not report savings' returns

Composition of EU households' savings

(as used to assess retail investor returns)

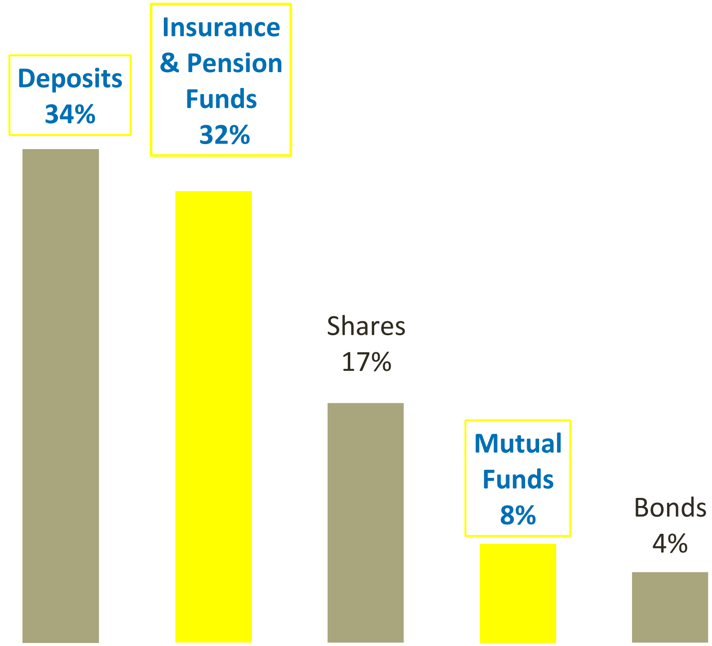
The view of the EU Supervisor



Share of "packaged" products returns = 0%

Source: ESMA

The reality



Share of "packaged" products returns = 74%

Source: ECB, ESMA

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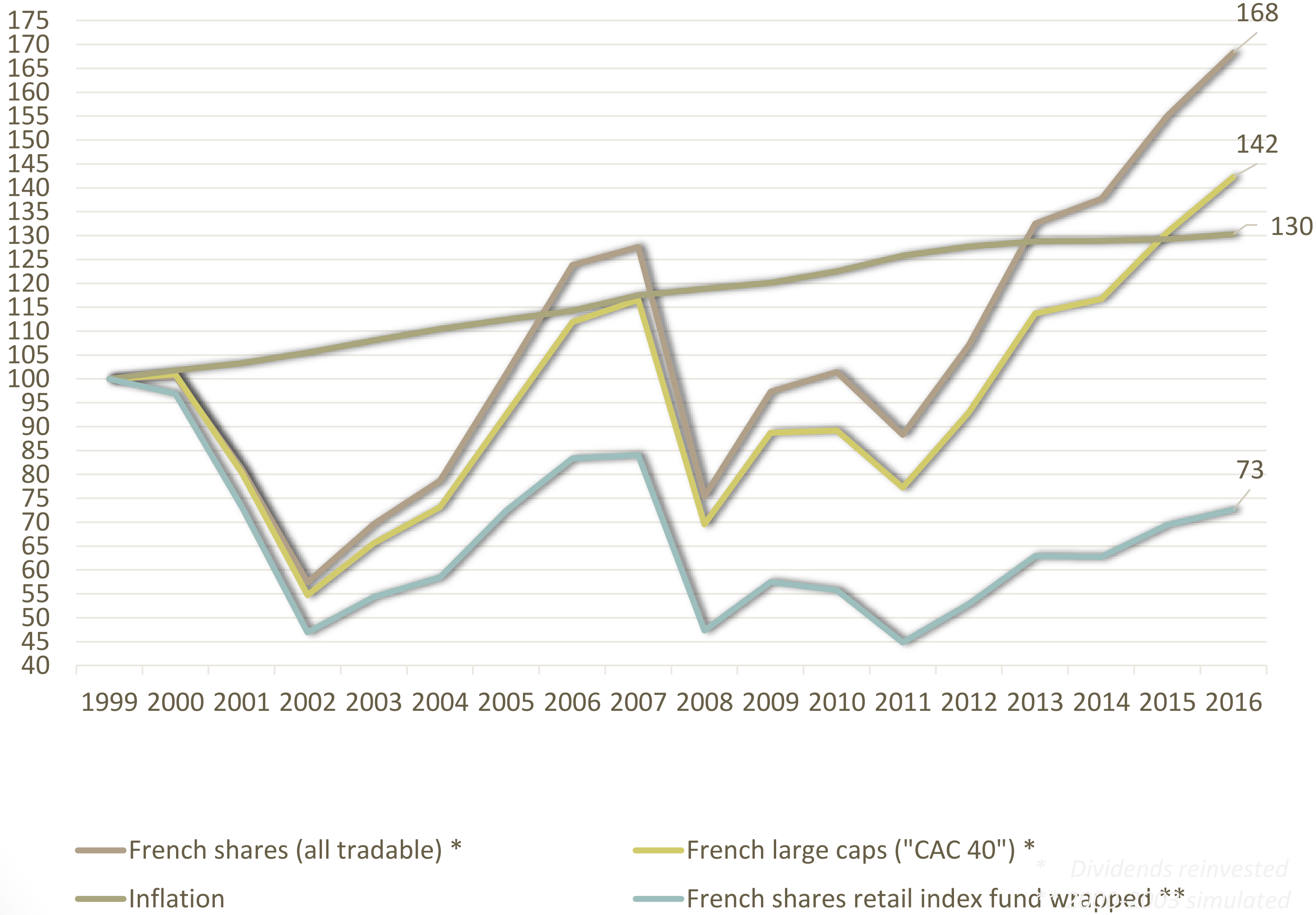
* Return proxy for bank deposits used by regulator is 1y Euribor: a (rather long) interbank money market rate, not a (shorter) retail banking rate.

1) Returns: Savings products have little in common with “capital markets” (index equity fund example)



* Dividends reinvested

** 2000-2003 simulated

Source: BETTER FINANCE research, fund manager

2) Returns: Savings products have little in common with capital markets (occupational pension example)

Capital markets vs. Belgian Occupational pension insurance 2000-2016* performance

<u>Capital markets (benchmark index**) performance</u>

Nominal performance	**100%**
Real performance (before tax)	**44%**

<u>Pension insurance performance (same benchmark**)</u>

Nominal performance	**33%**
Real performance (before tax)	**-4%**

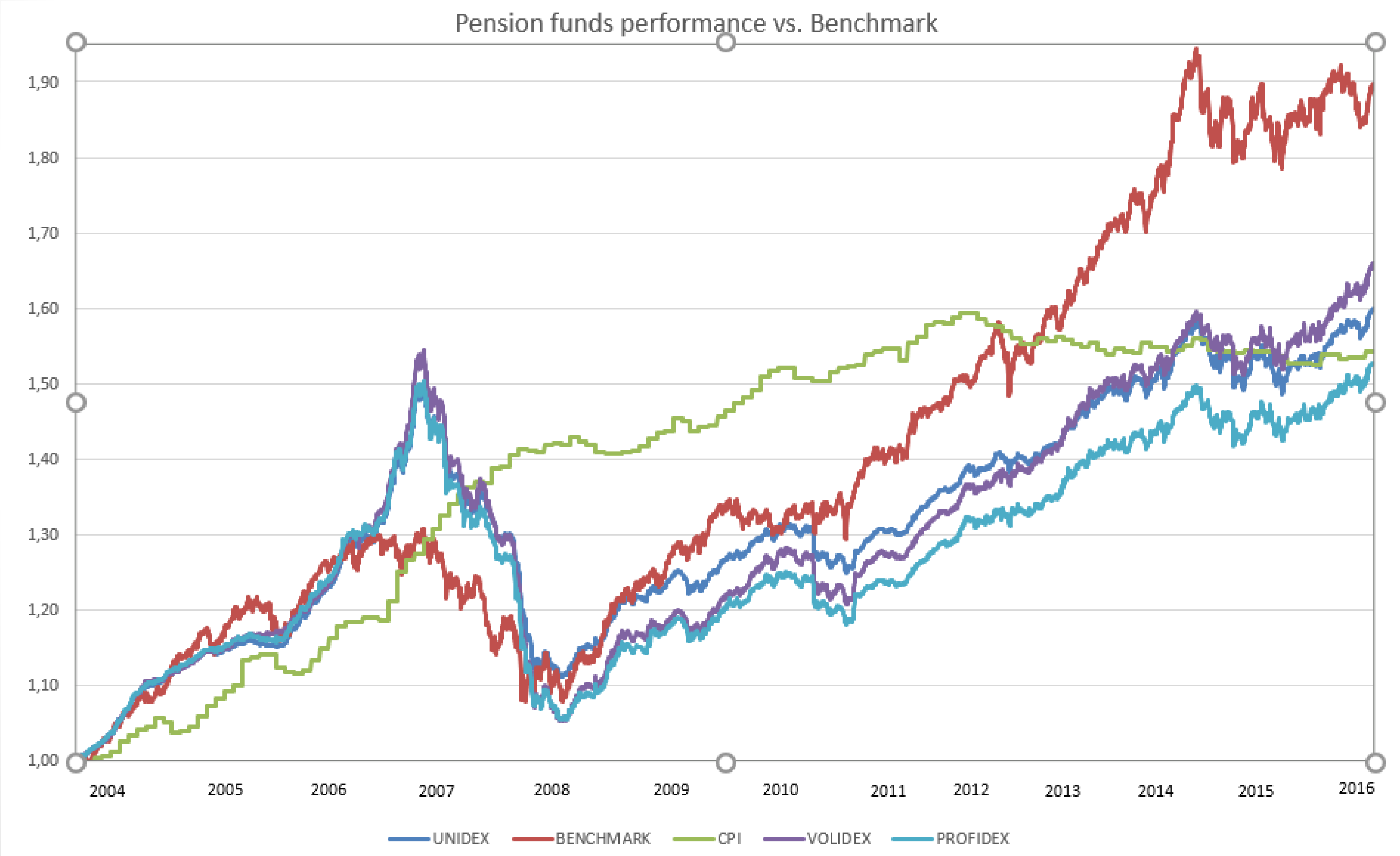
* To 30/06/2016

** 50 % Equity / 50 % bonds (MSCI World equity index and JPM Euro Govt Bond Index invested on 31/12/1999

<u>Sources</u>: BETTER FINANCE, provider

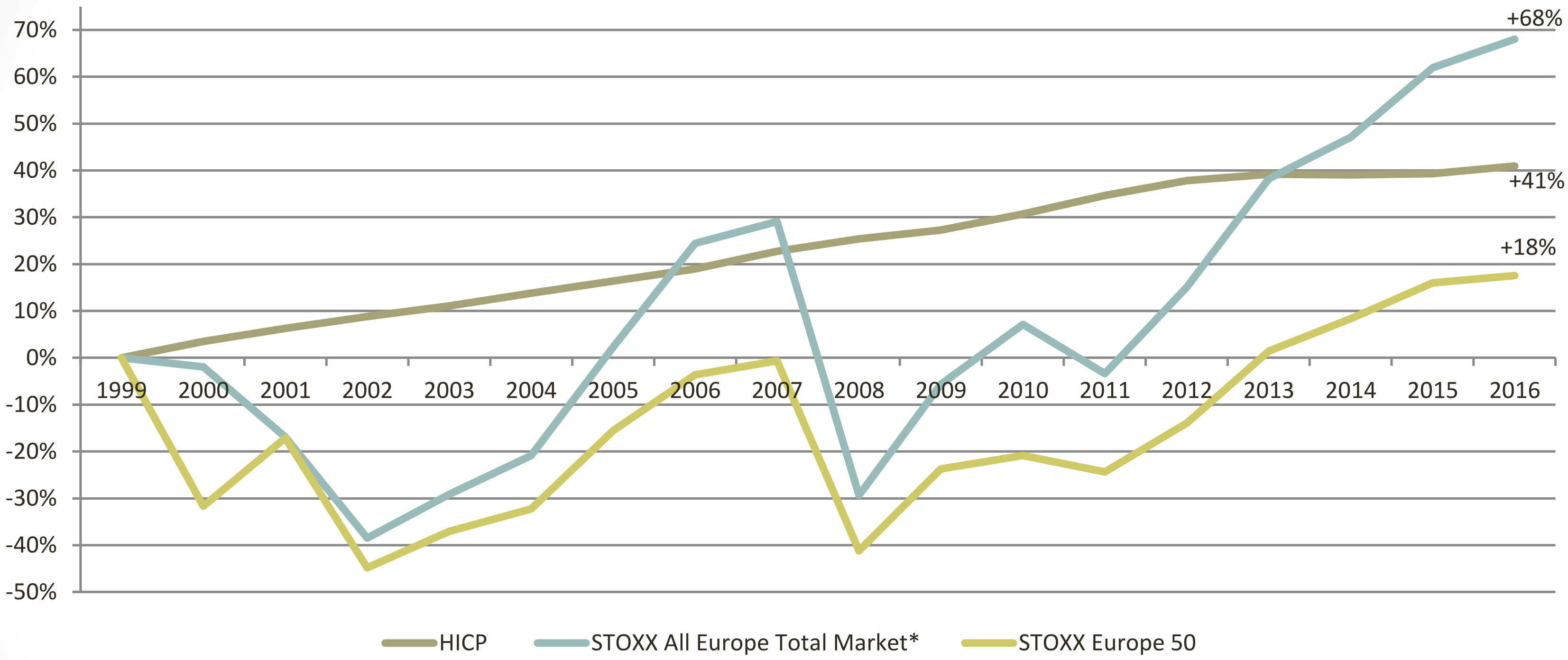
[1] « Information has been obtained from sources believed to be reliable but J.P. Morgan does not warrant its completeness or accuracy. The Index is used with permission. The Index may not be copied, used, or distributed without J.P. Morgan's prior written approval. » (J.P. Morgan).

3) Returns: Savings products have little in common with capital markets (Bulgarian Pension Funds)



Source: BETTER FINANCE

European Equity market performance: broad market vs. big caps market 16 years (2000-2015)

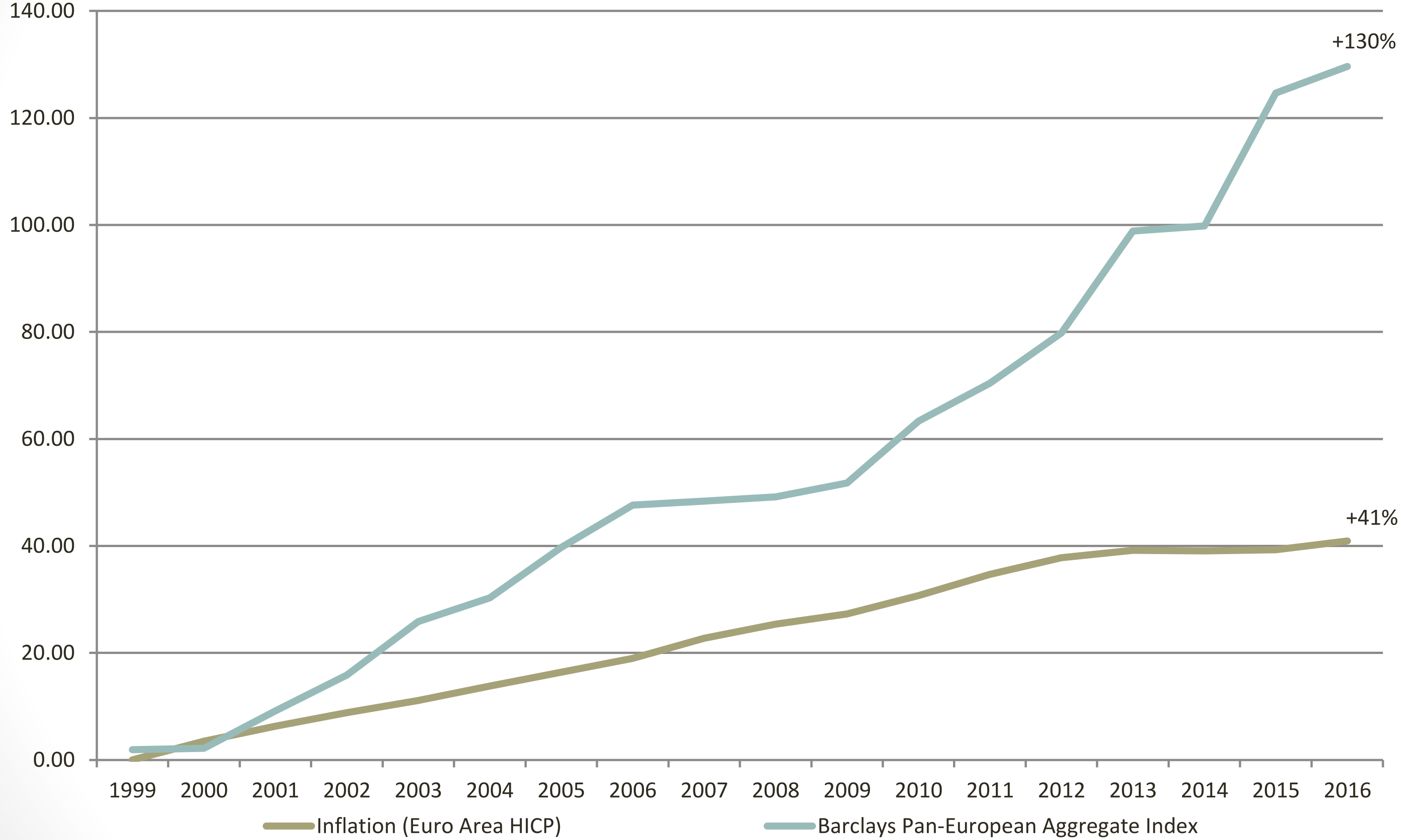


* Inflation used is HICP (2015 = 100), European Union 28. Monthly data index
* MSCI Europe data used for 2000-2001 as proxy for STOXX All Europe Total Market (no data)
*Gross returns used for both STOXX All Europe Total Market and Euro STOXX 50 except for Euro STOXX 50 2000 (net returns)

We used the MSCI Europe GR index as a proxy for the 2000 and 2001 performances because we could not find those years for the STOXX All Europe Total Market index (these two indices are broad ones).

Source: BETTER FINANCE

European bond market 16-year performance (2000-2015)



Sources: Barclays Pan-European Total Returns & Eurostat HICP Europe 28 Monthly

BETTER FINANCE methodology (1)

- **Coverage** – 15 Member States; 86% of the EU population. Three country profiles:
  - ✓ NL, DK, UK: pension funds assets represent far more than the annual GDP: real returns of private pensions is of crucial importance
  - ✓ ES, IT: Pensions mainly depend on the quality and sustainability of PAYG schemes
  - ✓ Countries in an intermediate position where the standard of life of retirees depends both on pension funds and PAYG schemes

- **Coverage** – Main product categories per Member State
  - ✓ A limitation of the report: the absence of residential property as an asset for retirement. But residential are often less suitable to retirement and dependency than financial assets

BETTER FINANCE methodology (2)

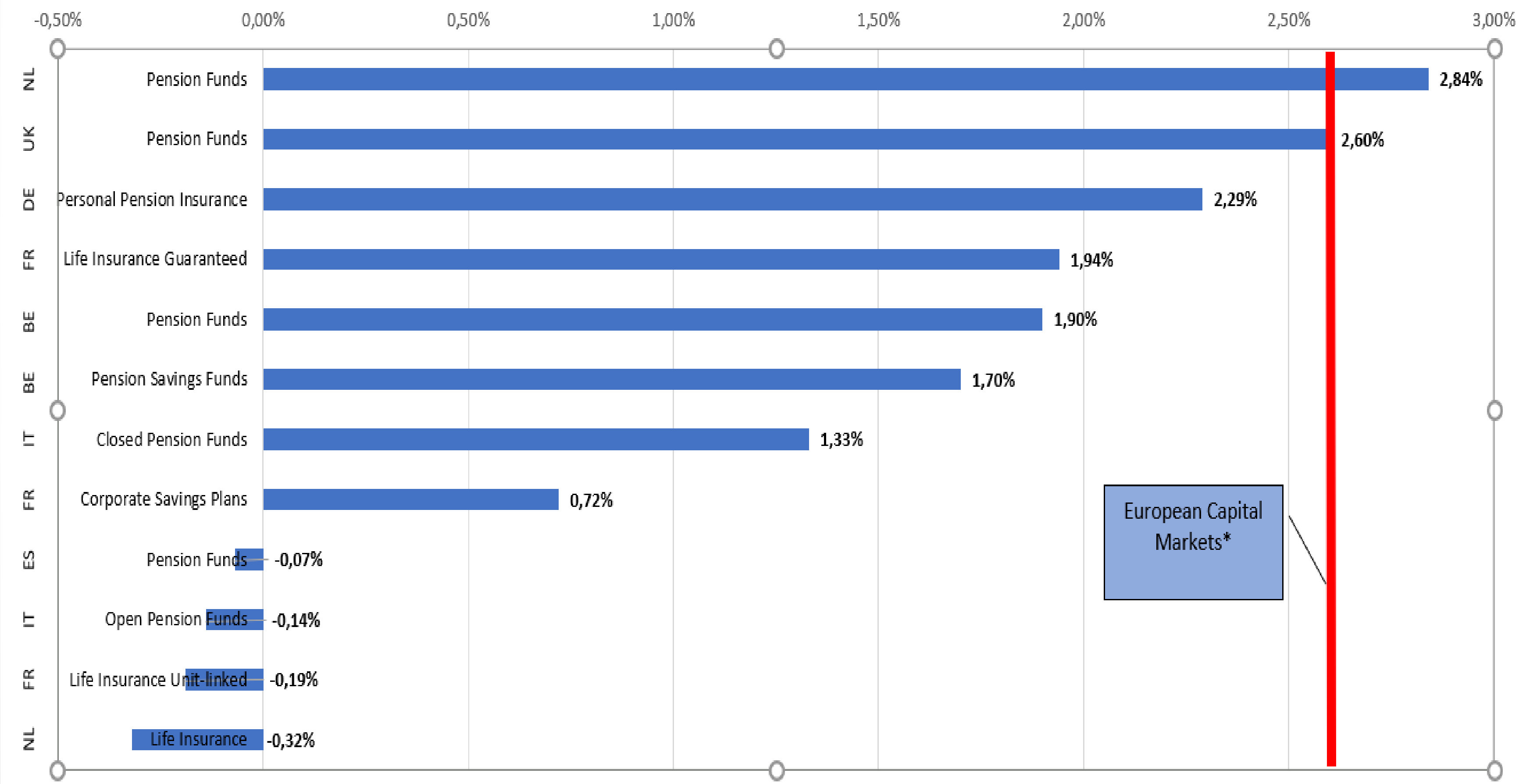
- **Time span** – 17 years (Dec 1999- Dec 2016) **whenever available** (which is too often not the case). Includes
  - ✓ Two market upturns (2003-2006; 2009-2016)
  - ✓ Two downturns (2001-2003; 2008)

- **Net Real return**
  - ✓ Nominal returns (net of fees and commissions borne by pension savers, including entry and exit fees whenever possible)
  - ✓ minus inflation (HICP)
  - ✓ minus taxes (data permitting: not often)

- **Compounded and geometric annual mean returns** for investing at end of 1999. Also for one case returns for annual savings over the last 17 years.

Most pension products recently improved but underperformed

Real geometric average annual net returns of Pension Savings (%)
(2000-2016 before tax)**



* 50% equity-50% bonds rebalanced
Source: BETTER FINANCE Research

** UK- 2000-2015

Why low returns for pension savers?

Return attribution (1)

1. Fees and commissions

✓ Introduction of transparent, limited and comparable charges in the UK, less advanced in other countries

2. Asset mix

✓Stricking differences across countries

✓For most countries 2005-2015 shows a decrease in equities and an increase in public debt due to unrealised capital gains generated by the historical decrease of interest rates

Why low returns for pension savers?

Return attribution (2)

3. Asset performance (see previous slides)

- ✓The only country with a negative average return of equity market on the whole period was Italy
- ✓Over the last 17 years, European bonds enjoyed a very positive nominal return due to capital gains

4. Asset manager competence

- ✓The majority of funds do not outperform their relative benchmark

5. Taxation

- ✓EET regime is predominant: contribution and investment returns are exempt; benefits are taxed
- ✓Part of pension benefits can be withdrawn as a tax exempt-lump sum in some cases.
- ✓Financial repression in several countries.

6. Inflation

- ✓Inflation rates had a severe impact on real returns in several countries

The outlook for future long term and pension returns

➔Fees and commissions are not going significantly down and are still very opaque

🡻Asset allocation has tilted towards more fixed income and less equity in the recent years

🡻Financial repression (« non conventional” monetary policy coupled with forced LT savings into Sovereign bonds) is unabated in Europe

🡻🡻The interest rates decades long decline is over: it has provided exceptionally high fixed income returns over the last decades

🡻Taxes on long term savings are still on the rise

- EU reforms:

🡻PRIIPs Key Information Document

🡹? transparency on performance (CMU Action not started yet)

? PEPP

« *Sunlight is said to be the best of disinfectants; electric light the most efficient policeman.* »

(Louis D. Brandeis, Other People's Money and How the Bankers Use It, 1914)

Transparency is very poor and deteriorating for actual net returns of long term and pension savings

- **All supervisory authorities to better comply with their legal duty to "*take a leading role in promoting transparency, simplicity and fairness in the market for consumer financial products*"**

- **Implement the European Commission's September 2015 CMU Action without further delay:**

  *"To further promote transparency in retail products, the Commission will ask the European Supervisory Authorities (ESAs) to work on the transparency of long term retail and pension products and an analysis of the actual net performance and fees, as set out in Article 9 of the ESA Regulations"**

- **Revise asap the rules on the Key Information Document for packaged retail investment products ("PRIIPs"), restoring the disclosure of the products' past performances and of their benchmarks**

- **The PEPP** must have a really simple, cost effective and safe default option, and other options open to direct equity investments; and it must be rolled out asap**

- **Thoroughly recalibrate solvency requirements for pension liabilities to stop penalizing equity investments by insurers**

*European Commission: Action Plan on Building a Capital Markets Union, 2015

** PEPP: Pan-European Personal Pension product

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