PensionsEurope remarks about Better Finance Report "Pension savings – the real return"

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About PensionsEurope

PensionsEurope represents national associations of pension funds and similar institutions for workplace pensions. Some members operate purely individual pension schemes. PensionsEurope Members are large institutional investors representing the buy-side on the financial markets.

PensionsEurope has **24 member associations** in 19 EU Member States and 3 other European countries with significant – in size and relevance – workplace pension systems[1].

PensionsEurope member organisations cover different types of workplace pensions for over **110 million people**. Through its Member Associations PensionsEurope represents more than **€ 4 trillion of assets** managed for future pension payments. In addition, many members of PensionsEurope also cover personal pensions, which are connected with an employment relation.

PensionsEurope also has **25 Corporate and Supporter Members** which are various service providers and stakeholders that work with IORPs.

PensionsEurope has established a **Central & Eastern European Countries Forum (CEEC Forum**) to discuss issues common to pension systems in that region.

PensionsEurope has established a **Multinational Advisory Group (MAG**) which delivers advice on pension issues to PensionsEurope. It provides a collective voice and information sharing for the expertise and opinions of multinationals.

Contact:

Mr Matti LEPPÄLÄ, *Secretary General/CEO*
Koningsstraat 97, rue Royale – 1000 Brussels
Belgium
Tel: +32 (0)2 289 14 14 – Fax: +32 (0) 289 14 15
matti.leppala@pensionseurope.eu
www.pensionseurope.eu

[1] EU Member States: Austria, Belgium, Bulgaria, Croatia, Estonia, Finland, France, Germany, Hungary, Ireland, Italy, Lithuania, Luxembourg, Netherlands, Portugal, Romania, Spain, Sweden, UK. Non-EU Member States: Iceland, Norway, Switzerland.

1. Introduction

The European organisation Better Finance[2] published the fourth edition of its report[3] on the real returns of pension savings in the EU on 27 September 2016. Better Finance's report aims to show the real returns of pension savings in various countries. The latest edition of the report covers 15 EU Member States, as it did in 2015 as well, whereas 2014 edition covered 8 countries, and 2013 edition 3 countries.

Taking into account the diversity of the European pension landscape, Better Finance's goal to compare the real returns of pension savings across Europe is ambitious. Particularly, the workplace pensions are mostly based on collective agreements, and in Central and Eastern Europe (CEE) the second and third pillar pension plans fall under national social and labour law. It is therefore difficult to compare them with pure financial market products.

In general, PensionsEurope welcomes the research on the quality of occupational and personal pensions and the outcome of pension savings. However, we would like to draw attention to the fact that the methodology of Better Finance's report needs improvements. In this paper, we provide our general remarks about the report, and the country-specific comments from PensionsEurope's Member Associations are included in four Annexes of this paper. Together with our Member Associations, we are willing and ready to cooperate with Better Finance in order to improve the methodology of Better Finance's report.

2. Pension funds are first and foremost institutions with a social purpose

We would like to invite Better Finance to make a distinction between retail products and pension arrangements offered in the second pillar. While personal pensions are often bought as products, occupational pensions and collective second and third pillar pensions in CEE are benefits provided by employers to their employees – in some countries voluntarily, in others based on legislation or tariff agreements. In fact, no matter how a pension product (with the main goal to provide for income after retirement instead of just aiming at maximizing the investment yield as in other investment vehicles) is marketed (as a collective, employer, occupational, workplace plan, employment-related, or on a pure individual basis not necessarily related to employment or professional activity), it should be excluded from the financial legislation of pure retail financial products and services. Furthermore, pension funds are first and foremost institutions with a social purpose, and they should not be

[2] According to Better Finance (European Federation of Investors and Financial Services Users) it is the public interest non-governmental organisation advocating and defending the interests of European citizens as financial services users at European level to lawmakers and the public in order to promote research, information and training on investments, savings and personal finances. It is the only European-level organisation solely dedicated to the representation of individual investors, savers and other financial services users.

[3] See Better Finance's report about the real returns of pension funds in the EU.

treated as purely financial service providers. This is also laid down in the recently adopted IORP II Directive (see the Recital 32 of the IORP II Directive[4]):

IORPs are pension institutions with a social purpose that provide financial services. They are responsible for the provision of occupational retirement benefits and should therefore meet certain minimum prudential standards with respect to their activities and conditions of operation, taking into account national rules and traditions. However, such institutions should not be treated as purely financial service providers. Their social function and the triangular relationship between the employee, the employer and the IORP should be adequately acknowledged and supported as guiding principles of this Directive.

PensionsEurope proposes Better Finance to consider the role of sponsoring employers and trustees or governing bodies in running collective pension plans. The main purpose of pension plans is to provide a retirement income for the individual member. With regard to workplace pensions, next to the asset side of the balance sheet, liabilities are also important - as well as longevity trends/risk, interest rate (for conversion into pension/annuity), and inflation. Therefore PensionsEurope calls for Better Finance to take into consideration liability matching, risk appetite, diversification, regulatory requirements or any of the other factors that go into investment strategy of workplace pensions. Better Finance's report gives a partial insight on what historical returns would have meant for pensions.

Particularly, the report states that asset allocation differs significantly between countries and products (see pages 17 and 28). Better Finance could consider listing some of the reasons for this, including: general risk appetite (which depends on the decisions of the management boards including stakeholders in the boards of pension funds), inclusion of guarantees (if a guarantee is given, this will impact on the asset allocation), regulatory requirements, liquidity (for example, local regulation recognises the participant's right to switch among different personal plans), and other factors.

Comparing the retirement systems of different countries is a very complex exercise; it includes an overview of social security systems, characteristics of the labor market, the way of organising pensions, the nature of the pension promises (e.g. guarantees and risk sharing) etc. As all of these elements help to define the plan design, the pension vehicle, and the asset allocation, they also impact on the returns: x% return might be very good in one system but rather poor in another system.

PensionsEurope welcomes that Better Finance explores the costs. At the same time we would also advise to look at the benefits. When comparing pension savings, not only their return should be compared, but also what they offer to their beneficiaries (in the second pillar) or their consumers (in the third pillar).

On page 15, the report lists the pension returns drivers and states that *"net real returns of private pensions are however most affected and influenced by the fees and commissions charged by asset managers and other financial intermediaries."* PensionsEurope would like to add the impact of a

[4] See Directive (EU) 2016/2341 of the European Parliament and of the Council of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision (IORPs) (recast).

persisting low interest rate environment which puts a serious strain on pension savings and should be considered in this analysis.

What is the social policy objective of supplementary pensions?

While a large part of retirement income in many countries is provided by the first pillar, reforms over the past decade have scaled back state pension provision. From our perspective, the social policy objective of supplementary pensions is to fill this gap and to ensure that individuals have an adequate income in retirement. This could be best achieved by providing a life-long pension payment, provided that a sufficient accumulation level is achieved. Therefore, the report should take into consideration different payment options, but to the contrary, it seems to encourage the withdrawal only as a lump sum, even though this option is not always the best for the individual's needs.

We understand that from a methodologic perspective a withdrawal as a lump sum simplifies the calculation of returns after inflation and taxes, but assuming that Better finance puts the interest of individuals at the core of its work, life-long pension payments should not be missed and statements like *"Our calculations of net returns are based on the most favorable case, i.e. assuming that the saver withdraws the maximum lump sum possible"* should be avoided (see page 18 of the report).

A lump sum can be spent straight away, or even if withdrawn at regular intervals, the individual might still outlive the savings and in the end fall back on social assistance. A life-long pension safeguards the individual both against imprudent spending decisions as well as against miscalculations regarding his or her own life expectancy. This is also beneficial for the state, because the need to pay social assistance is reduced.

PensionsEurope invites Better Finance to include this aspect in its report. We understand that Better Finance puts the interest of financial service users at the core of its work, and that sometimes individuals might prefer a lump sum to a lifelong pension. However, this wish often derives from a desire of instant gratification rather than prudent financial planning, a factor recognized in behavioural economics. Better Finance should take the prudent long-term view and campaign for a framework which offers the best solution for the majority of individuals – rather than the highest lump sum payment.

3. What does Better Finance's report compare?

We would like to take a closer look at what is compared in the report. On the one hand the report compares capital market performance with the returns of pension savings, and on the other hand it compares "pension savings" within countries and across Europe. Following we will shed light on these two aspects.

a. Pension saving returns and capital market performance

From our perspective the performance of capital markets and the returns of pension savings are difficult to compare because of two reasons: pension funds need to administer pensions of their beneficiaries, they need to collect contributions and invest them, pay out pensions, provide information etc. This service is done against low administrative costs.

Collective investments of retirement savings have a lot of advantages in comparison with individuals investing on their own. The risk for individual retirement savings is much higher than if these risks are shared between the cohort of a collective pension agreement. Caring for their own retirement might be interesting and attractive for a very small minority, but the average individual lacks skills, time, and interest to do better than a professionally run occupational pension plan. From our perspective it is rather beneficial for individuals to use "packaged products" or e.g. occupational pensions to participate in the capital markets[5].

In some countries a pension is more than a savings account which accumulates money. If a life-long pension is promised, it is an insurance against old age poverty in case of longevity; it might include a disability and/or survivors' pension. Insuring these risks comes at a price – which reduces the return. However, with this reduction the beneficiary is covered potentially against three different risks. If the returns of a pension fund covering these risks are compared to capital market performance, equivalent risk premiums need to be deducted from the capital market returns to achieve a meaningful comparison. Guarantees work in a similar vein, they provide certainty but do cost money and ultimately "reduce the return".

b. "Pension savings" across Europe

This challenge also applies when comparing pension savings within countries and across Europe. As stated earlier, in some countries pension savings can mean an entitlement to a life-long pension; it can include protection in case of disability and/or death. In other countries, the term "pension savings" refers to an accumulation of assets which are taken out as a lump sum at the moment of retirement (potentially with an annuity purchased from a different provider). Again, these two types of "pension savings" are not comparable because they include different benefits. If risks are covered, this will come at a cost. We therefore ask Better Finance to take this into account in future reports.

The term "pension savings" also refers to both second and third pillar pensions. While it can be adequate to compare both pillars to some extent (because individuals might choose where to put their money), care should be taken to compare them adequately.

c. What is covered – and which conclusions are drawn?

The returns on pensions can be heavily influenced by the fees levied by asset managers and intermediaries. On the other hand, the research has shown that focusing on cost alone may ultimately result in poorer investment outcomes for pension savers. Therefore, focusing purely on

[5] See page 10 of Better Finance's report.

costs is not enough. Investing in more complicated investment products can be more costly, but at the same time it can lead to higher returns.

We note that the importance of cost is different for members of different pension plans: if a beneficiary receives a defined benefit (DB) promise, costs matter less to the beneficiary because a benefit was promised – the costs are borne by the sponsoring employer. In contrast, for a member of a pure defined contribution plan costs matter more, because they reduce the accumulated assets and ultimately the pension. Based on these arguments, it makes sense to exclude certain arrangements from the analysis, such as the German book reserves.

However, excluding certain (and in the case of German book reserves significant) parts of the occupational pension system means that one should be careful when drawing the conclusions. They can only apply to the part of the occupational pensions system analysed, not to occupational pensions in general. We urge Better Finance to be careful to draw general conclusions on occupational pensions when – at least for some countries – a large part of occupational pensions is not included in the analysis.

Furthermore, Better Finance's policy recommendations on pages 46-47 have a strong focus on personal pensions. While the analysis partly includes occupational pensions, only recommendation number 6 *"Improve the governance of collective schemes: at least half of the schemes' supervisory bodies should be designated directly by the pension schemes' participants"* is directly aimed at occupational pension plans. The recommendation number 8 refers to prudential regulation: *"Special treatment by prudential regulation of all long-term & pension products allowing for an effective asset allocation".* However, this topic is not analysed in depth in the report, so we wonder how is this recommendation derived?

4. Appropriate comparison methodology is needed

PensionsEurope challenges the Better Finance's report with regards to the methodology used. PensionsEurope's Member Associations have found substantial discrepancies and wrong interpretations as presented in detail in the Annexes of this paper.

As regards calculations and estimates, there is no clear rule in selecting periods, market or book values or consistent data, which are randomly chosen. The graphic on page 20 and the table on page 42/43 show the "Annualised real returns of pension savings after charges, inflation and taxes". They compare the real returns in different countries even though they are not comparable at all, as they contain:

- 13 different time periods
- Different kinds of returns:
    - Returns after charges, inflation and taxes;
    - Returns after charges and inflation but before taxes;
    - Returns after charges but before taxes and inflation.

Returns over different periods of time are presented as if they were fully comparable. The annualized returns for some figures include the effects of the .com bubble in the early years 2000 and for others not. This might highly influence the results and as such make the figures less suitable to compare. Additionally, the results for pension funds include the early years 2000 and often the results for insurance companies do not. This information puts pension funds' results in a wrong perspective. Finally, as also Better Finance points out (on page 8 and a footnote on page 15), the selected time period of 10-15 years is too short for occupational pensions – accumulation and decumulation phase are often over 60 years.

5. Financial returns after inflation and taxes have been miscalculated

On page 13, Better Finance acknowledges that *"The complexity of the taxation of pension savings in EU countries makes it also extremely difficult to compute after tax returns".* PensionsEurope agrees with this statement and furthermore stresses that Better Finance's report should focus on both the payout and the accumulation phase of pensions. In some cases, including Spain, the information about the impact of taxation during the accumulation phase is available and even mentioned in Better Finance's report, but the calculations are still incorrect. Also for Belgium the calculation of the taxation is not correct and therefore showing lower returns than in reality.

Reporting on returns should go together with reporting on the risks that are taken. A more risky portfolio might be more costly to manage, but in the long run, it may result in a higher overall net return meaning better pensions for the beneficiary.

The risk that can be taken is not only linked to the time horizon of the retirement benefit cash flows, but is also linked to the plan design and even to the way the pension promise is organized. A cash balance plan design that increases balances with 2% on an annual basis will have a different risk profile than a defined benefit plan for a younger population where the first cash flow will most probably happen in 30 years' time.

An IORP that is fully backed by a successful sponsoring undertaking will invest differently than a life insurer that offers an annual guarantee based on fixed income securities. The more risky the investment portfolio is, the more volatile the returns are, and the more important it is to use the identical time periods and the periods which are long enough (at least 10 years) in order to properly compare the returns.

The level of risk is part of the investment decision processes in the IORP. In the context of occupational pension plans this is often an agreement between social partners. They have to make a trade-off between benefit, cost, return and risk, knowing that this balance needs to be compliant to prudential regulation in order to protect the participants' benefits.

6. The European Commission's Consumer Markets Scoreboard

On page 7 of the report, Better Finance states that *"Investment and private pension products are persistently the worst performing retail services market of all throughout the European Union according to the European Commission's consumer markets scorecards"*. This statement is incorrect, because it refers to "private pension products" in general (including occupational pensions), even though the latest version of the scoreboard[6] contains a footnote on page 48 clarifying that *"The consumer survey targeted private personal pension plans, i.e. situations where individuals independently purchase and select material aspects of the arrangements."*

Furthermore, the category "private pensions and securities" covers a wide range of different products in the questionnaire of the EC's consumer markets scoreboard, namely: *"Banking-Investments, Private pensions and securities, Packaged investments, Portfolio and Fund management, Private Personal pensions, Stockbroking and derivatives"*. PensionsEurope has called for the EC to revise and specify its questionnaire, because for instance the characteristics of occupational pensions are very different from the characteristics of derivatives, and therefore, they should not fall under the same category. The second and third-pillar products in Bulgaria should also be taken out of the scope of personal pension plans, because the independent choice of a provider is not equivalent to independent purchase and selection of material aspects of the arrangement.

7. Conclusions

In this paper, PensionsEurope outlines some of the challenges of Better Finance's report on the real returns of pension savings in the EU. PensionsEurope also provides guidance to Better Finance how to improve the methodology of the report. Particularly, we would like to invite Better Finance to:

- Make a distinction between retail products and pension arrangements offered in the second pillar;
- Note that pension funds are first and foremost institutions with a social purpose;
- Consider the role of sponsoring employers and trustees or governing bodies in running collective pension plans;
- Note that collective investments of retirement savings have several advantages in comparison with individuals investing on their own;
- Explore the benefits in addition to the costs;
- "An entitlement to a life-long pension" is not directly comparable to "a lump sum at the moment of retirement", because they contain different benefits;
- Use the data and time periods that are consistent and comparable;
- Focus on both the payout and the accumulation phase of pensions;
- Take into account the reasons for different kinds of asset allocations;
- Have a clear link between the analysis and the recommendations.

[6] See 2016 edition of the EC's Consumer Markets Scoreboard.

We would like to stress that good occupational pensions as well as collective second and third pillar plans in CEE are the solution to many of the problems shown in Better Finance's report: they can provide good value for money, they do not face the problems of the retail annuity market, they are relatively easy to understand for their beneficiaries, standardized to a certain degree (in order to attract tax relief), and they do not need distribution and marketing (pricing is aligned with interests of beneficiaries).

We would like to invite Better Finance to take the prudent long-term view and campaign for a framework which offers the best solution for the majority of individuals – rather than the highest lump sum payment. PensionsEurope would be ready to further cooperate with Better Finance in order to provide a more realistic picture of occupational pension savings as well as second and third-pillar products in CEE.

Annexes:

Annex I: Country-specific comments from PensionsEurope's Bulgarian Member Association

Annex II: Country-specific comments from PensionsEurope's German Member Association

Annex III: Country-specific comments from PensionsEurope's Italian Member Association

Annex IV: Country-specific comments from PensionsEurope's Spanish Member Association

Annex I

Country-specific comments from Bulgarian Association of Supplementary Pension Security Companies on Better Finance report

1. It is yet at the very beginning of the report on Bulgaria that the authors demonstrate their lack of information: The third pillar in Bulgaria started in 1994, and not as is stated in the report: ***„Privately managed pillars II and III were introduced and started collecting contributions in 2001 and 2002"*.**

2. The ignorance of the amendments to the Social Security Code leads to misinformation. Obviously, certain amendments (probably cherished by the authors) which have not materialized over time, keep on being manipulatively used to distort the picture of the established legal framework. All the people born after 1959 entering the labour market for the first time are obliged to participate in a second-pillar Supplementary Mandatory Universal Pension Fund (UPF) of their choice. (The second-pillar reference in the report is actually made in compliance with the national categorization of pension pillars and should be interpreted as reference to pillar 1+).

At the initial entry to the system new labour market entrants may not opt for the first-pillar National Social Security Institute (NSSI). The assertion in the report is different: ***„In addition the pension regime was changed. Under the new regime the Supplementary Mandatory Pension Scheme became optional. As of 2015 participants can elect whether:***

a. to contribute their entire mandatory pension insurance to Pillar I only or

b. split their contribution between Pillar I and Pillar II."

It is necessary for the authors of the report to explain the mechanism of initial choice of UPF, the switching option to NSSI and the re-switching option back to UPF. They have to elaborate on the advantages and disadvantages to members at each stage. In no way could they miss the lack of investment yield in the so-called Silver Fund (where the money is to be kept if members opt out of UPF to the first pillar).

3. Commenting on the proportionately reduced individual coefficient, the authors of the report are not aware that by the same argumentation of theirs regarding the assertion that the two pensions (first-pillar PAYG NSSI + second-pillar funded UPF) would be lower than the alternative sole pension from NSSI in fact they provide proof for the inefficiency of the mechanism for the calculation of the reduction in question. There would be economic sense and social fairness if that reduction of the NSSI pension for those who have both NSSI and UPF entitlements was calculated taking into account the total amount of the necessary contribution to the first pillar which would be **sufficient** for the payment of the NSSI pension. In their argumentation the authors of the report presume that the current ear-marked contribution paid to NSSI is sufficient to provide for the first-pillar pension, while forgetting that more than half of the money necessary for financing first-pillar pension payment comes not from the ear-marked contribution, but from a budget subsidy which in turn is also paid for through taxes by the same persons whose pensions are claimed to be reduced. The formula for the calculation of the individual coefficient of the people who are entitled to both first and second pillar pensions should take into account the entire amount of the contribution and subsidy securing the respective types of pensions to be compared (NSSI and UPF). As a matter of fact, while claiming a pension reform reversal by advocating for switching money from the second-pillar funded UPF to the first-pillar PAYG NSSI, the report does not even assume that members may be interested to know what would be the result if the so-called "free choice" is exercised in full, i.e. if members would have the right to receive their entire old-age pension benefit from the second funded pillar only. From an analytical point of view the report remains lopsided: ***„This opens the possibility that their total pension income might be lower compared to the pension they would have been entitled to from Pillar I only."***

4. Absolutely inadequate is the assertion made in the report that the adequacy of the UPF pension is defined by its ability to compensate for the reduction of the first-pillar pension, irrespective of the fact that the legal provisions for the gradual increase of the UPF contribution were abolished and the increase – redirected to the first pillar instead, as well as regardless of the first-pillar financing through the taxes paid also by those who participate in both NSSI and UPF, as described above. Forgetting about the additional financing through the budget *(which is more than 50 per cent of the NSSI pension payment costs)*, the authors manipulatively present the current ear-marked first-pillar contribution as sufficient to secure the first-pillar pension. In the comparison between the NSSI pension and the UPF pension, one should reasonably take into account the amount of NSSI pension which could be payable without any state subsidy. It is absolutely irrelevant to compare the market return in UPF to the budget subsidy in NSSI. Moreover, UPF was conceived to supplement the first-pillar by adding a funded element to the PAYG mechanism. The legal purpose has never been to compete with NSSI.

The comments were provoked by the following assertion in the report: ***„This will be the case if the pension from the SMPS is insufficient to compensate for the reduction of the public pension. Whether or not this is the case depends crucially on the return from the universal pension funds, comprising the largest part of SMPS."***

In brief, no financial education is necessary to comprehend the world oldest economic manipulation used by the report authors, namely: when resources are redirected from one place to another and direct subsidies keep on being poured into that same place, it should definitely always look better. In the specific situation:

- The contribution to the first pillar is increased at the expense of the unrealized increase of the UPF contribution;
- The budget subsidy to the first pillar is not taken into account.

5. The presentation of the types of pension funds is misleading: the mandatory occupational pension funds in the second pillar and the occupational pension schemes in the third pillar are unified under the general title of „professional". Similar linguistic simplification of our pension system is extremely **UNprofessional** because it does not take into account the substantial difference between "occupational schemes" under the IORP Directive (such as the Bulgarian voluntary pension funds with occupational schemes - VPFOS) and the mandatory pension schemes under Regulation 883-2004 (such as the Bulgarian mandatory occupational pension funds). The comment refers to the following assertion in the report:

„The privately managed pension funds come in four varieties. Universal and professional pension funds fall under Pillar II (SMPS), while Pillar III (SVPS) consists of voluntary supplementary pension funds and voluntary professional pension funds. Table BG 1. Privately managed pension funds in Bulgaria

	SMPS	*SVPS*
1. Universal pension funds	*X*	--
2. Professional pension funds	*X*	*X*
3. Voluntary pension funds"	--	*X*

Indicative of the absolute lack of detailed information on the Bulgarian pension system is the fact that in a paragraph below, the VPFOS are named "**occupational**", then again „**professional**", namely:

„As of end 2015, just one company offers all four pension fund types: universal, professional, voluntary and <u>voluntary occupational</u>, and the remaining eight companies offer three pension funds each (with the exception of the <u>voluntary professional</u> funds)."

The terminological frivolity of the report authors turn gradually to a cyclical semantic complexity, namely: ***„The universal pension funds are quasi-occupational..." „The advantage of arranging <u>occupational</u> pension funds at the national level as <u>universal</u> is in their portability."*** No one and in no way has ever thought of establishing occupational pension funds in Bulgaria as universal because the "occupational" ones assume a different organizational form (collective bargaining, entirely different responsibilities of the sponsoring undertaking etc.). UPFs are part of pillar 1+, which is fundamentally different from the occupational schemes related to employment, although the report authors are trying to suggest the opposite implication.

6. Incorrect is also the report assertion that the heirs of UPF members may obtain term annuities. In this case the Bulgarian legislation provides for lump-sum payments and planned withdrawals. The latter is not a „term annuity". According to the report: ***„In the case of a premature death of an insured member or retiree, the universal pension fund distributes the balance of the account to his or her heirs either as a lump sum or as a term annuity."***

In the report comments on VPF payments to heirs, the term annuities are missing, and only the planned withdrawals appear instead:

„The heirs of an insured or retired person who leaves a balance in his or her account at the time of death are entitled to the balance as either a lump sum or to payments over a specified term."

7. The presentation of fees is biased and manipulative:

„The law caps those fees and charges as follows (2015): Table BG 6. Legal caps to fees and charges

Fees	***SMPS***	***SVPS***
Front load	***5%***	***7%***
Management fee	***1%***	***10 %***
Transfer fee	***BGN 20.00***	***BGN 20.00***
Other administrative fees	***No***	***As determined by pension company"***

It is not clear what is meant under the category „Other administrative fees". The report comment that the other administrative fees in the third pillar are defined as "determined by the pension company" creates the wrong impression that besides the fees quoted *(fixed by law)*, there are other fees which are not included therein. On the contrary, all the fees are decided upon by the pension company in compliance with the legally set maximum limits within their Pension Fund Rules of Operation approved by the Bulgarian Financial Supervision Commission as part of the licensing procedure. Apart from that, the so called „management fee" is incomparable between the voluntary third pillar and the mandatory second pillar because in the first case it is deducted from the investment yield realized and in the second – from the assets under management. The following report assertion is not true: ***„the management fee applies to the balance of the account"***.

8. The following report assertion is also wrong: ***„Pension companies managing universal and professional funds are banned from charging any fees other than the ones listed."*** No matter whether the fund is a mandatory second-pillar one or a voluntary third-pillar one, there exists a common legal prohibition for charging fees which are not provided for in the law.

9. The following report assertion is also wrong: ***„Pension companies can typically collect higher fees and additional administrative fees for managing voluntary occupational pension funds."*** The report authors have quoted the maximum amount of fees. Nevertheless, they argue that pension companies may charge higher and additional fees, which is unallowable by law as explained above. Probably, the authors might have had in mind the possibility for pension companies under VPFOS to stipulate the exact amount of the fee in the contract with the sponsoring undertaking rather than in the Pension Fund Rules of Operation. However, the contracted fees may neither be higher, nor additional to the ones admissible by law.

Our general conclusion is that due to the substantial discrepancies and wrong interpretations, the assertions about Bulgaria made in the Better Finance report should not be treated as reliable and trustworthy.

Annex II

Country-specific comments from German Arbeitsgemeinschaft für betriebliche Altersversorgung on Better Finance report

Background information on Germany

First of all, we would like to point out the main differences between German occupational pensions and other occupational pension systems. In Germany, the pension promise which is governed by labour law is separate from the financing of the promise. The employer has several options to finance the given pension promise.

The costs related to these different forms of financing the pension promise are not directly comparable, because they encompass different services / activities. The existence of different financing methods – which in a way compete with each other – creates a pressure on cost. This ensures an efficient financing of the occupational pension promise. The freedom of the employer to choose the financing method of voluntarily provided occupational pensions should therefore not be questioned.

Going into more detail, we would like to point out the following **characteristics of German occupational pensions:**

- Both employer and employee contributions to occupational pensions in Germany are voluntary. However, every employee has the right to request salary conversion (Recht auf Entgeltumwandlung, introduced in 2002). Tariff agreements (in particular in the public sector) might include mandatory participation or automatic enrolment.
- The pension promise (which is governed by labour law) is at the heart of occupational pensions in Germany. The employer chooses the type of financing and the vehicle with which to deliver the occupational pension from a broad range of options.
- In Germany the pension promise can take three forms: traditional DB, contribution oriented DB with an annual minimum return guarantee (beitragsorientierte Leistungszusage) or contribution oriented with minimum guarantee of sum of nominal contributions at retirement (Beitragszusage mit Mindestleistung). All of these include guarantees, a pure DC scheme would not qualify as an occupational pension in Germany. Currently a reform which is set to introduce a pure DC pension promise within a specific framework is under way. The conditions of the framework are still being discussed.
- The character of the relationship between the sponsoring employer and the beneficiaries: the interests of the sponsor and the beneficiaries are aligned. The beneficiaries have a strong interest that the pension promise they were given is fulfilled. Since the employer has to stand in in case the pension fund cannot deliver the given promise, they also have a strong interest to make sure that the pension fund delivers. The existence of sponsor support aligns the interests of the sponsor with those of the beneficiaries.

- The requirement in German labour law for the employer to stand in for the given pension promise means that the employer has an interest in cost-efficient pension provision. Because of this, questions around cost are of no or only relatively low importance to employees.
- The employer chooses the vehicle (Durchführungswege: Direktzusage, Unterstützungskasse, Pensionskasse, Pensionsfonds, Direktversicherung) and with that the type of financing (e.g. internally or externally).
- Members and beneficiaries in Germany have very little to no choice. Generally, even in the case of salary conversion (Entgeltumwandlung), it is the employer who chooses the type of pension scheme and the provider, not the employee.
- Social partners are often involved in the governance of occupational pensions in Germany; in addition, representatives of the employees will be represented in the board of supervisors and can influence decisions at that level.

Comments on the section on Germany

- Is Direktversicherung (direct insurance) included in the analysis? Where? If not, why?
- The analysis of the German occupational pension system mainly looks at salary conversion (Entgeltumwandlung). While it might make sense to compare savings in the third pillar to salary conversion in the second pillar, this misses an important part of occupational pensions: co-financing by the employer and employees as well as pure employer-financed schemes. With this important part of occupational pensions not covered in the analysis, care should be taken when drawing conclusions – they cannot apply to all German occupational pensions.
- We have the impression that the focus of this report is on DC schemes. However, in Germany, there are currently only DB and hybrid systems.
- In Germany occupational pensions have to cover at least one biometric risk to fall under the definition of an occupational pension (which is necessary to attract the EET taxation). However, covering risks costs money, which, in the language of the report, "reduces return". When comparing different pension systems it has to be taken into account what benefits they provide, e.g. whether they cover risks such as longevity, disability and / or death. In particular, longevity premiums have risen over the past decades significantly, making it more expensive to provide a life-long pension, thus "reducing the return". From our perspective, this is a much more important factor than the impact of fees and commissions as stated on page 10.
- In Germany, occupational pensions also include a guarantee (see above for the different types of pension promises used in Germany). However, guaranteeing certain returns or even just the contributions made on a nominal basis affects the asset allocation and might result in lower returns.

Comments on the asset allocation table (p. 29) – on the data provided for Germany

- What are the sources for the data on Germany?
- What is included in the figures for Germany, Pensionskassen and Pensionsfonds?
- Is the asset allocation data consistent, is it based on book or market values?
- We are not sure what is included in the data, but would like to point out in general that it is often of limited use to aggregate the asset allocation of Pensionskassen and Pensionsfonds. They are two different vehicles which were created at different points in time, they are regulated differently and therefore their asset allocation differs. Aggregating data for the two vehicles does provide any meaningful insights. In addition, the type of liabilities is not considered in different asset allocation, e.g. the duration of liabilities versus the duration of assets and if liabilities have a longevity element.
- We do not understand why the allocation to investment funds is listed at 0% in the years 2000-2003. Please refer to BaFin bAV Jahresbericht 2001 – it shows that there was investment in investment funds in 2001, contrary to what the report states in the table. According to the BaFin, in 2001 Pensionskassen had an investment of Euro 27bn in investment funds (see p. 115, "Investmentanteile"), this was 38% of their total assets under management. Ignoring the underlying asset allocation of these 38% funds as part of the total assets makes the comparison meaningless.
- We would like to point out that the first years of the new millennium (2000-2004) were very advantageous, if they are included in an average, it is meaningless to compare this to an average based on another average starting in year 2002 or 2005.

Comments on specific points made in the report:

"However, doubts about the Riester personal pensions have augmented in recent times and even led to voices in the government demanding to bolster the public pension in spite of positive real returns of 1.6% since 2005. One should mention that beyond the returns of investment, the unfavourable determination of the annuity for a given capital has been challenged in the public debate." (p. 44)

- ➢ We are not aware of any debate in Germany around unfavourable determinations of annuities.

"In 2002, company pension plans (pillar II) that have traditionally been provided on a voluntary basis by employers were transformed into an employee's right to have a part of their earnings paid into a company pension plan under a deferred compensation arrangement. The same year, the "Riester" reform was introduced to boost personal pension savings and in 2005 the "Rürup" pension was introduced to further complement personal pension plans." (p. 172)

- We would like to point out that it is slightly misleading to present the reforms of the early 2000s as is done here, they were not separate initiatives, but part of one package: pension benefits from the first pillar pension were reformed, to set off the cut back in benefits, both occupational pensions (first sentence above) and third pillar pensions (second sentence) were strengthened.

"In order to strengthen occupational pensions and to counteract the fact that the number of active workers continually shrinks compared with the number of pensioners in a Pensionskasse or pension fund, the German government proposed the creation of industry-wide pension plans on a defined contribution basis. The abandonment of traditional guarantees was however quickly rejected by the pension industry. Amendments were quickly brought up by the German government in early 2015, and have been scrutinised and discussed with pension representative groups ever since, for instance regarding guarantees in the case of insolvency. (p. 173)

- The reforms are moving along – the Cabinet approved a draft at the end of 2016. In the spring of 2017 the proposal will be discussed in Parliament, if everything goes to plan, it is likely to be adopted in June 2017. This way the reform could become operative January 1st 2018. Both the Minister of Finance and the Minister for Labour and Social Affairs have made clear it is crucial to them to conclude the reform before the general elections in September 2017 (for more information, see Annex).

"Book reserves are pension provisions that the employer realises on the company's balance sheet in order to pay an occupational pension once the employee reaches the retirement age. It is also possible to transfer these provisions to a trust under a Contractual Trust Arrangement (CTA)." (p. 173)

- This is wrong – the provisions remain with the employer, there is no transfer of provisions. CTAs are set up for reasons due to international accounting standards. This is only a way of external funding of the provisions, it is not a transfer.

"Book reserves are the most widely utilised type of occupational pension plans and are well-suited for small companies due to their simplicity."(p. 173)

- First, we would like to point out that book reserves are wide spread in terms of assets under management, however, other vehicle are growing faster and have a higher number of active members (see p. 19 Alterssicherungsbericht 2016, see also the table on p. 176 in the Report). This should be added to make it clear what is meant here by the term "most widely utilised". Second, we would like to point out that the complexity and or simplicity of a pension promise is not necessarily determined by the vehicle chosen, but also depends on the structure of the promise given. Third, we would like to point out that today very few small companies set up new book reserve schemes. The German occupational pension system differentiates between a pension promise (liability) and the funding. There are different ways ("Durchführungswege") to fund a promise and insolvency protection measures to protect the beneficiaries. The type of funding is decided by the sponsoring employer and not depending on size of company. If book reserve schemes are not covered by a CTA they are implicitly covered by balance sheet assets.

It is often and exclusively referred to "social security contribution savings" (pp. 173)

- While in Germany occupational pension savings in the accumulation phase benefit from social security contribution savings, they are subject to social insurance contributions (statutory health and long-term care insurance) in the pay-out phase. From our perspective this is a good set-up: Together with the tax breaks, the exemption from social insurance contributions is an incentive to put money aside in an occupational pension. The state transfers a claim on both tax and social insurance contributions into the future, when the pension is being paid out. Considering that demographic pressures on the public budget are likely to grow in the future, this is to be welcomed.

Direktversicherung: "The insurance contracts can be continued with personal contributions if the employee leaves the company." (p. 174)

- While some individuals might want to continue their occupational pension with personal contributions when leaving their employer, the much more likely scenario is that they will want to take their pension to their new employer (this also applies to Pensionskassen and Pensionsfonds). The German occupational pensions law under certain circumstances grants the right to an individual transfer to a new employer.

"The new Pensionskassen, in place since 2006, must act like life-insurers." (p. 175)

- Many insurers set up Pensionskassen in 2002 and 2003 due to tax reasons (Art. 3.63 EstG). Today we distinguish between "regulierte" (the traditional form) and "deregulierte" Pensionskassen, see the Versicherungsaufsichtsgesetz (VAG).

Pensionsfonds: "Since their risk is higher, they are supervised by the German Federal Financial Supervisory Authority (BaFin) and protected by the PSVaG in case of insolvency." (p. 175)

- This is wrong, it should read: **– "Pensionsfonds:** "Since their risk is higher, they are supervised by the German Federal Financial Supervisory Authority (BaFin). The entitlement of members and beneficiaries are protected by the PSVaG in case of insolvency of the sponsoring employer."

Overall, the growth of entitlements to occupational pension plans was mainly effected from 2001 to 2005. Since then, the percentage of employees with such entitlements has hardly changed. However, in recent years, entitlements have particularly grown for "Pensionskassen". Pension funds, that have been available as occupational pension plans since 2002, also showed a dynamic increase, although implications are considerably smaller than for the more established funds. (p. 175, last paragraph)

- We would like to point out that due to the positive development in the German labour market, the absolute number of entitlements has increased in Germany.[7]

Regarding costs: "In general, occupational pension plans are designed for employees with preferably long affiliations to the company since the charges on initial contributions can be high." (p. 181)

- Generally, it is one of the biggest differences between second and third pillar pensions that that the former does not incur any distribution costs. While there might be some second pillar insurance products which incur costs at the beginning (known in Germany as Zillmerung), this is prohibited e.g. for regulated Pensionskassen.[8] It is possible to transfer occupational pension assets accumulated in a Pensionskasse, Pensionsfonds or Direktversicherung to an equivalent vehicle of a new employer.

"In general, there are no taxes on dividends, income or capital gains, to take into account during the accumulation phase of the real return calculations. However, the calculations are considerably complicated by the fact that EET and TEE taxation formulas (or intermixtures) can still be found. This should be kept in mind when interpreting real return results."(p. 188)

- We would like to point out that the tax framework applied depends on when the pension promise was made as well as on the type of vehicle. Until 2005 it was possible for members of Pensionskassen and Direktversicherungen to use the tax framework set out in Art. 40b EStG (TEE taxation, flat rate tax of 20%, which leads to very attractive returns). It is not possible to use this framework for a new pension promise anymore, but the existing contracts continue. It would therefore be important to clearly state what type of vehicle the data refers to. Footnote 126 for example refers to Direktversicherungen, but we did not find where and how they are included in the analysis.

Annex to Country-specific comments from PensionsEurope's German Member Association:

Draft law to strengthen occupational pensions

On December 21st the Cabinet approved a draft law to strengthen occupational pensions (Kabinettsentwurf Betriebsrentenstärkungsgesetz).[9] It contains the following provisions:

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[7] Alterssicherungsbericht 2016

[8] Versicherungsaufsichtsgesetz (VAG)

[9] Previous version and developments: On November 4th 2016 the Federal Ministry for Labour and Social Affairs and the Federal Ministry of Finance published a Draft law to strengthen occupational pensions (Referentenentwurf für ein Betriebs-retenstärkungsgesetz). The draft was preceded in the spring by two reports on occupational pensions: one commissioned by the Federal Ministry of Finance addressing the financial framework for occupational pensions, both in terms of tax and social insurance contributions (Gutachten zu Optimierungsmöglichkeiten bei den Förderregelungen der betrieblichen Altersversorgung); the other commissioned by the Federal Ministry for Labour and Social Affairs developing the proposals to strengthen occupational pensions through collective agreements /

- **Defined Contribution:** the new law makes it possible for the first time to give a Defined Contribution promise in Germany. However, in order to be able to choose this option, the tariff partners have to be involved.
- **Auto-enrolment:** The new law makes it legally watertight for employers / social partners to automatically enrol employees in a pension plan with the option to opt out of the system within a certain time frame.
- **Extending the EET system** (§ 3 Nr. 63 EStG): The maximum tax free contributions are increased slightly to 8% of the income ceiling of the statutory pension (the assessment ceiling – Beitragsbemessungsgrenze - in 2017 this is 76.200 EUR EUR per year).[10] The current limit is 4% with an additional 1.800 EUR which is tax free but on which social insurance contribution have to be paid. That means that currently the annual limit is 4.848 EUR, this would be increased to 5.343 EUR). However, as under the previous system, only 4% remain free from social insurance contributions. In the pay-out phase of the occupational pension, statutory health and long-term care insurance contributions are levied. **Making EET more flexible** (also § 3 Nr. 63 EStG) – while currently the relief in the accumulation phase is granted annually and lost at the end of the year if not used up, the draft includes a provision allowing a partial or full top up in case the employment relationship was suspended as is the case e.g. when being posted abroad or when taking parental leave.
- Support for **low income workers**: employers of those with a gross income of up to 2.000 EUR (regardless of whether this is earned through full-time or part-time work) will be offered a tax incentive of 30% of employer contributions (max. 144 Euro per year) to contribute to their employees' occupational pensions.
- **Incentives to save for those on low incomes**: the law will introduce an allowance so that low income pensioners can receive their occupational pension without having it deducted from the minimum income provided by the state.
- **Next steps:** In the spring of 2017 the proposal will be discussed in Parliament, if everything goes to plan, it is likely to be adopted in June 2017. This way the reform could become operative January 1st 2018. Both the Minister of Finance and the Minister for Labour and Social Affairs have made clear it is crucial to them to conclude the reform before the general elections in September 2017.

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with the support of the social partners (Rechtsgutachten zu dem ‚Sozialpartnermodell Betriebsrente' des Bundesministeriums für Arbeit und Soziales).

[10] Bundesgesetzblatt

Annex III

Country-specific comments from Italian AIPE on Better Finance report

Like the 2014 edition, also the last release of the Better Finance report: *Pension Savings The Real Returns* shows some inconsistencies that undermine its achievements and give a misleading picture of the Italian supplementary pension schemes.

The 2014 edition was marked by mistakes in the interpretation of the inputs that conducted the author to a double computation of charges (both administrative and financial) and taxation.

The 2016 edition of the report shows a correct interpretation of the inputs, however the computations are extremely confused, partially omitted and, in our opinion, ends up with mistakes yet.

The concerns are related to the findings of Tables IT 5 (Closed pension funds), Tables IT 6 (Open pension funds), Tables IT 7 (Pip with profits) and Tables IT 8 (Pip unit linked). They come up with the following Real return net of inflation, charges and taxes on benefits for the time horizon 2000-2015: Closed PFs 0.61%, Open PFs -0.44%. As regard Insurance contracts (PIP) in the text it is not clearly specified whether taxation on benefits is taken into account but in line with other schemes we presume so (is there an editing/printing type?). Real return net of inflation, charges and taxes on benefits for the time horizon 2008-2015 are: Pip with profits 0.88%, Pip unit linked -0.01%.

First of all the text is cryptic and does not provide a clear specification of the way in which taxation on benefits is estimated. Moreover, tables did not provide the real returns net of inflation, charges and taxes on benefits for every year but only the mean value for every type of scheme.

Another concern is related to the computation of taxation of benefits. When computing the calculations the author made a conceptual mistake as he only focuses on pay out phase and did not take into account the munificent exemption of contributions during the accumulation. If the overall effect of the taxation has to be computed in such a way, huge tax relief of contributions has to be take into account otherwise computations end up with misleading findings.

Computations refer to different time horizons since for Closed and Open PFs they take into account the period 2000-2015 while for insurance contracts (PIP) they only refers to the period 2008-2015. This is due to the fact that new insurance contracts entered into force only between 2007 and 2008. Taking into account that the legislative framework of Italian Pension funds has been overhauled in 2007, using different time horizons did not seems to us the best way to compare returns. Conceptually, a homogeneous time horizon like 2008-2015 is more suitable to perform the analysis as from 2008 on, Closed PFs, Open PFs and Insurance contract share a common level playing field and compete for membership.

A final concern is related to the estimate of nominal return before charges. The author uses as proxy of charges the Indicatore Sintetico di Costo (ISC) for a time span of 35 years of contribution. The ISC is a forecast of how the balance of a "sample member" will be affected by the costs of the scheme and it is computed, based on the assumptions released by Covip (Italian watchdog of PFs), on a money weighted basis. Instead, nominal returns used by the author, are computed on a time weighted basis. For this reason, do not seems appropriate, both conceptually and practically, to combine values computed on a different basis to measure the cost of the plan.

Based on previous assumptions, and taking into account that Italian watchdog already provide nominal return net of charges (both financial and administrative) and tax on investments, the **only correct way** to compute the real return is to net these return of inflation rate.

We made the computations and we provide the measures of correct real returns. The reference period is 2008-2015

	Nominal return after charges and tax on investments	**Real return after charges and tax on investments**
Closed PFs	3.5%	1.9%
Open PFs	3.0%	1.5%
Pip with profits	3.1%	1.5%
Pip Unit Linked	2.0%	0.4%

To compare our achievements with those of Better Finance we also provide calculations for the period 2000-2015 only for Closed PFs and Open PFs. Our findings hugely differ from those of Better Finance.

	Nominal return after charges and tax on investments	**Real return after charges and tax on investments**	**Real return Better Finance**
Closed PFs	3.1%	1.2%	0.61%
Open PFs	1.9%	-0.1%	-0.44%

Annex IV

Country-specific comments from Spanish INVERCO on Better Finance report

I. PRELIMINARY REMARKS

INVERCO (Spanish Association of Collective Investment Schemes and Pension Funds) represents more than six thousand Collective Investment Schemes and more than 1,300 Pension Funds, with assets under management over EUR 450 billion.

As the report mentions, in Spain there are diverse instruments for retirement savings. The comments made in this document by INVERCO, as Spanish representative Association of Pension Funds refer only to Pension Plans, notwithstanding many of the observations, particularly regarding the inaccuracies in tax matters, can be extrapolated to other products that share tax treatment with Pension Plans.

INVERCO congratulates Better Finance for its 4th edition of the report about the real return of pension funds, which compares pension saving systems across fifteen European countries. INVERCO really appreciates the effort applied on it and recognizes the difficulties to match all the collected information considering the diversity of the European landscape for pensions.

Likewise, INVERCO thanks Better Finance for requesting quantitative information prior to the publication of the report, which has allowed several of the deficiencies detected in the previous edition to be remedied in this new version.

Notwithstanding, **INVERCO has still found a number of inconsistencies and mistakes offering a distorted vision of the Spanish Pension Funds industry. Therefore the aim of this document is to take under consideration some remarks that should be corrected on the report on Pension Savings dedicated to Spain (pages 327-352) since they are crucial to reach an accurate understanding of the Spanish Pensions Funds regime.**

INVERCO´s main concern is the deliberate omission of tax impact in Spain when comparing Spanish pension funds with those from other Member States. This comparison, although theoretically based on annualized real return after charges, inflation and taxes for the period 2000-2015, <u>in the case of Spain has been carried out without considering the tax impact</u>, despite the information is not only available, but also provided by the report itself. As a consequence, <u>Spain is ranked in the 14th position when it should be the first, considering that return after inflation and taxes in Spain amounts +10.09%, and not -0.11%</u>.

Besides this important issue, **there is a number of inaccuracies, mistakes and inconsistencies related to the calculation of returns,** the lack of a clear rule **in selecting a uniform method**

and time periods to compare data, the information on commissions and the lack of clarity about the instruments under comparison, among others, that are detailed in Part II of this document

II. Main findings

1. Deliberate omission of tax impact on Spanish pension funds

The main concern from INVERCO is the deliberate omission of tax impact in Spain when comparing Spanish pension funds with those from other Member States.

The variable voluntarily chosen by Better Finance to compare across Member States is the annualized real return after charges, inflation and taxes for the period 2000-2015. The fifteen countries included in the survey are therefore listed in a graph on page 20, where only those countries where it is not possible to take into consideration the tax effect should have been included with an asterisk.

This is not the case with Spain, which unlike the rest of the countries[11], has surprisingly been included in the graph without considering the positive tax effect on net returns (showing a return of -0.11%), when this effect is not only available but also provided by the report itself on its page 343 and increases the net return to +10.09%.

In other words, **whether Better Finance had followed its own methodology and applied to Spain the same variable of comparison than to the rest of European countries, the relevant return to consider would have amount to +10.09% and not to -0.11%, moving up to the first place in the ranking, instead of the current 14th position.**

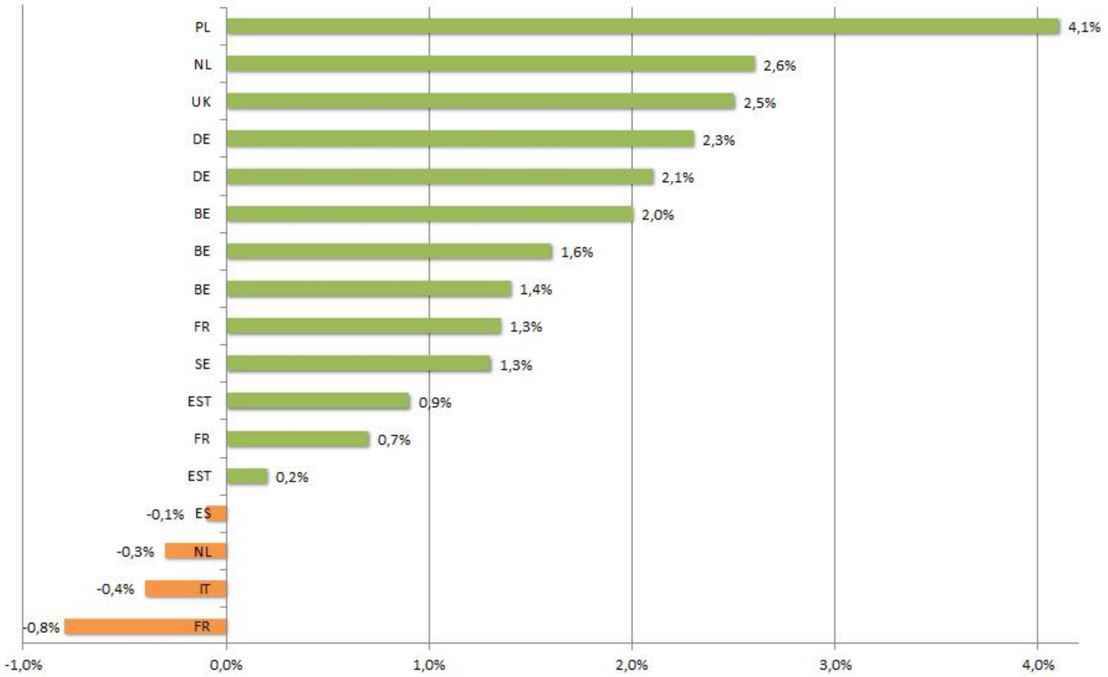
This omission of the relevant variable of comparison is especially disconcerting considering that:

1. **Previous editions of the report did include Spanish returns after taxes,** although wrongly calculated as a consequence of a misunderstanding on the functioning of the Spanish tax system that caused Spanish Pension Funds showed a poor performance after taxes. **Surprisingly, now that these assumptions have been corrected and that, applying the same methodology defined by Better Finance but with a right consideration of the Spanish tax system impact, Spanish pension funds show a good performance after inflation and taxes (+10.09%), Better Finance has decided not to include, for the Spanish case, this figure in the comparison, using the return before taxes instead (-0.11%).**

2. **When presenting the findings of this report to the relevant stakeholders, Better Finance has focused its message on the comparison across countries, as shown in the**

[11] Please note that there are other countries where the impact of tax has not been considered because it was not possible to calculate it, being Spain the only country where, despite having the figure, it has not been used for the comparison.

following slide of the presentation made by Better Finance that summarizes the report (available on its website).



2. The figure for financial returns after inflation and taxes is miscalculated

The main variable that the report uses to compare among countries is incorrectly calculated. When accumulating the returns (after inflation and after taxes) for the period 2000-2015 (Table ES 6 page 343) the result is wrong. If correctly calculated, accumulated return after inflation and after taxes would be 373% instead of 10.09%, and therefore being annual average return 10.2%. The recalculation of Table ES 6 is provided in **Annex I**.

However, unlike previous editions, in this edition Better finance has decided not to include the column with annual average return for the period 2000-2015.

3. The time period chosen for the comparison is not homogeneous across countries and is detrimental to Spain

According to the table "annualized real returns of pension savings" (page 20), the report is aimed at showing and comparing among EU countries **the real returns of pension savings after charges, inflation and taxes**. This comparison requires homogeneity, not only in the variable analyzed, but also in the length of the time period.

It is inconsistent to analyze and compare returns from different countries that have been calculated over different time periods, especially when some of them do not cover the

WorldCom bankruptcy in 2002, year where the equity markets felt almost 30% and as a result the returns on private savings were negative until 2005. Therefore the comparative on the Better Finance report cannot be reliable nor be it comparable.

In addition, the time period chosen is especially negative for Spain returns, considering that:

a) **As shown in the table below, annualized return after charges and inflation is considerably higher in all the periods, except for 15 years, which is precisely the one chosen for the comparison.**

Period	Annualized real return after charges and inflation
25 years	2,31%
20 years	1,65%
15 years	0,02%
10 years	0,90%
5 years	3,49%
3 years	5,84%
1 year	1,76%

(data to dec-2015)

Please note that the table above does not include tax impact which, if considered, would significantly increase the results.

b) **OECD, on its report "Pension Markets 2016"[12] compares the 5 year average on real** and nominal **returns of Pension Funds across OECD and non OECD countries** that have been calculated over the period June 2010 - June 2015, as shown in table below. It must be highlighted that, Spanish Pensions Funds are amongst the best runners.

[12] The report is available here: https://www.oecd.org/daf/fin/private-pensions/Pension-Markets-in-Focus-2016.pdf

A. Selected OECD countries

Country	5-year average	
	Real	Nominal
Canada	6,4	8,0
Australia	6,2	8,7
United Kingdom	6,1	8,2
Netherlands	6,1	7,9
Denmark	5,8	7,1
Iceland	5,7	9,1
Belgium	4,6	6,2
Israel	4,2	5,1
Norway	4,1	5,8
Spain	3,8	4,7
Greece	3,5	3,3
United States	2,9	4,4
Slovenia	2,8	3,9
Luxembourg	2,8	4,4
Mexico	2,6	6,2
Italy	2,5	3,8
Portugal	2,4	3,5
Chile	2,3	6,0
Latvia	1,9	3,1
Korea	1,9	3,7
Austria	1,9	3,9
Estonia	0,9	2,3
Czech Republic	0,6	1,9
Slovak Republic	0,4	1,9
Turkey	-2,0	6,0

B. Selected non-OECD countries

Country	5-year average	
	Real	Nominal
Pakistan	8,7	16,2
Uruguay	5,6	14,6
Dominican Republic	7,4	11,6
Serbia	5,7	10,8
Costa Rica	6,4	10,1
Nigeria	-0,5	9,0
India	0,6	8,2
Romania	5,3	7,3
Colombia	2,1	5,9
FYR of Macedonia	4,3	5,9
Panama	2,1	5,3
Albania	3,5	5,3
Lithuania	3,1	4,4
Thailand	2,1	3,8
Bulgaria	2,9	3,7
El Salvador	1,7	3,3
Liechtenstein	2,7	2,7
Peru	-1,1	2,5
Hong Kong, China	-3,1	0,9
Malta	-1,3	0,1

Source: OECD

In any case, it is not the purpose of these comments to compare Spain with other countries, but to illustrate that, depending on the period taken into consideration, the results differ notably.

4. Information on Commissions should be improved

The first consideration that must be highlighted regards Better Finance statement, according with transparency on commissions is inadequate and the supported charges on Spanish Pensions Funds are high (page 334).

Commissions and charges borne by the pension plan must be included both in the pre-contractual documentation to be subscribed by the participant and in the quarterly and semi-annual reports that entities must send to participants in the pension plan. In this sense, investors know beforehand commissions and fees that the pension plan charges before making their investment decision and once invested, they will have recurrent information on the effective fees and charges paid by the plan and their impact on its performance.

In addition to the information disclosed to the participants, the information about charges and commissions is sent to DGSFP (The General Directorate of Insurance and Pensions is the Spanish government financial regulatory agency that supervises and controls Spain's Insurance and pension fund sector) and to INVERCO. Both entities make public this information, not only in an individually form (for each existent Pension Plan) but also in aggregate form (sectorial averages).

For all of these reasons it is disappointing that, far for recognizing the high effort made on transparency by the sector, the report simply states that the transparency has only been achieved recently (pg**.** 334 – Paragraph 4 "*Spanish savers have greatly benefited from the regulator's recent intervention in fees and commissions. Until this moment, the transparency of these key aspects was insufficient and inadequate."*)

In the same line, the report contains numerous wrong statements about the level of fees and the lack of transparency of Spanish pension plans. All of them have been duly confronted, by providing numerous data and specific regulatory references, which can be summarized as follows:

a) Firstly, **transparency duties in Spain are embodied since the first regulation on these vehicles (1987), and not from the reform carried out by the Royal Decree 304/2014,** as Better Finance maintains.

b) Likewise, **there are limits on management and depositary commissions from 2004, and not from 2014, as the report holds**. Those limits were established in 2% and in 0.50% respectively, although the effective levels applied in practice were much lower, as had already been shown in our comments to last year´s report.

The reform carried out by Royal Decree 304/2004 reduced those maximum limits to 1.50% and 0.25%, respectively, although again the practice shows that the effective levels are significantly lower, as Better Finance shows in table ES 4 and ES 5.

c) **These limits apply also on a cumulative basis** to management/depositary fees of the underlying funds invested by the pension fund irrespective of them being paid to entities of the group or third entities.

d) **Differences between 3rd pillar and 2nd pillar fees are miscalculated. Regarding management fee, the proportion between 3rd pillar and 2nd pillar is 5 to 1 (not 7 to 1, as indicated in the report) and for depositary fee, the proportion is 5 to 1 (and not 6 to 1).**

The reason why the 2nd pillar management fee is lower than 3rd pillar is due to the fact that in the occupational system there is no distribution and commercialization.

e) In order to avoid confusion for the reader, as a recommendation it would be a plus to rename each table ES 4 and ES 5 with a different title (such us Management Fee for ES 4 table and Depositary Fee for Table ES 5), because currently both tables are wrongly named with the same title (administration fees and commissions).

f) To end with, **Better Finance considers that fees and commissions on pension products are very high in Spain (page 344). However, this conclusion is not supported by the management fees for the second and third pillar provided by Better Finance** in the report itself, that have been tabled below.

Country	CHARGES - Managment Fee	
	2nd Pillar	3rd Pillar
Spain (1)	0.24%	1.18%
Belgium (2)	0.16%	1.29%
Bulgaria (3)	1%	10%
Denmark (4)		0,6% -1,4%
Estonia (5)	1.23%	1% - 1.55%
France (6)		1.8%
Latvia (7)	1,5%-2%	1,25%-2%
Poland (8)	0.5% - 4%	0,8% - 4%
Sweden (9)		0.65 %
The netherlands (10)		0.19%
UK		1%

[13]

5. A RELEVANT NUMBER OF MISTAKES, INACCURACIES AND INCONSISTENCIES ARE DETECTED IN THE REPORT

Besides those already mentions before, there are many other inaccuracies, mistakes and inconsistencies. Some of them are described as follows:

- **Page 20 - Table "annualized real returns of pension savings".** As explained above, according to this table the main purpose is to show and compare among EU countries **the real returns of pension savings after charges, inflation and taxes**. Even though they are not comparable at all, as they contain:

  - ✓ 13 different time periods
  - ✓ Different kind of returns

- **Page 44**- The Report states that *"In Spain**, the promotion of occupational and personal pension schemes has only recently been established**. Personal pension provisions and pension funds are taxed according to the beneficial EET formula; however, pension disclosures to individuals are broadly inadequate. The 16-year period states zero returns in real terms. "*.

Regarding this statement **it must be noted that although the current legislation stems from 2002, the first legislation on pension funds and pension plans was issued in 1987**[14] Therefore,

[13] (1)Management Fee 2015 (2) average and TER (total expense ratio) (3) Management Fee 2015 (4) Yearly charges (5) Average Fee in 2015 and for the 3rd pillar depend on the type of the fund (6) management fees for equity funds in France were 1.8% on assets in 2013(7) 2nd Pillar limits 2015 and 3rd Pillar management fee 2015 (8) management fee varies depend on the investment profile of funds chosen. (9)The average fee is 0.65 % of managed capital in 2015 (10) pension fund charges 2015 (% of total assets).

this statement is not accurate, as it cannot be said that the market for professional and individual schemes in Spain is a recently established market.

- **Page 339 – Footnote 163 – "***BOE number 288 of the 28th of November 2014*".

  This statement is not accurate since BOE (Boletín Oficial del Estado) is the official gazette of the Government of Spain, and therefore the Act that reformed the tax regime was approved by the Parliament in the Act Parliament in 26/2014, of 27 December, amending among others, both the Personal Income Tax Act and the Pension Plans and Pension Funds Act, with consequences from 2015 onwards.

- **Page 42-43 – Use of the term "unit link"-** The report uses the term of "pension fund" for different types of institutions, such us the terminology of "unit-link" in the case of Spain according to the Table GR 10- Yearly Real Returns of Private Pensions Products (page 42-43).

  As an example, all the countries included on this table are detailed and compared with various products and types of institutions, being Spain the only country whose results are concluded just with unit-link providing as result -0.11%, paradoxically the same result given on table page 20, but referring on it as Pension Funds.

- **Page 44 – paragraph 4 "***Personal pension provisions and pension funds are taxed according to the beneficial EET formula;* ***however, pension disclosures to individuals are broadly inadequate. The 16-year period states zero returns in real terms****."*

  This statement seems to be the conclusion of the wrong calculations made in table ES 6, which is firmly refuted by figures on returns provided in this document.

- **Page 117- paragraph 2 -**The report states that "*it is interesting* ***to note that cash and deposit holdings are extremely low, contrary to other countries such as Spain****, Greece and Estonia,* ***which tends to be a worse investment strategy in the long run.****"*

  Better Finance considers investing cash and deposits a worse strategy selecting three countries (Spain, Greece and Estonia) as examples of this bad strategy. However:

a) On the one hand, the countries selected are not comparable at all, considering that Greece has not section and data about "Pension's funds 'asset allocation" on Better Finance Report, and Estonia has a period of 5 years (see page 30), when the statement keeps that in the long rung holding a high investment on cash and deposit is a bad strategy.

[14] Law 8/1987, of June 8, on Pension plans and Pension Funds, in force until 14th December 2002.

b) On the other hand, other countries appearing on the report, which have a considerable investment strategy on cash and deposits and with a time period comparable with the Spanish one are not mentioned at all (see table below):

		Currency and deposits			Currency and deposits			Currency and deposits
	2000	60%		2004	35%		2000	13%
	2001	62%		2005	28%		2001	13%
	2002	62%		2006	29%		2002	15%
	2003	63%		2007	40%		2003	15%
	2004	57%		2008	44%		2004	17%
	2005	45%		2009	39%		2005	14%
	2006	43%		2010	39%		2006	16%
Germany	2007	43%	Latvia	2011	25%	Spain	2007	16%
	2008	45%		2012	20%		2008	20%
	2009	43%		2013	16%		2009	16%
	2010	39%		2014	14%		2010	17%
	2011	37%		2015	19%		2011	13%
	2012	31%					2012	14%
	2013	32%					2013	12%
	2014	25%					2014	12%
	2015	23%					2015	13%

Again, it's not the goal of INVERCO comments to compare between countries, but to highlight the lack of rigor of Better Finance when stating conclusions and making comparisons.

c) Finally, **the high level of liquidity in Spanish pension Funds is a consequence of switches.** Under Spanish legislation, personal pension plan participants have the right to change from one pension plan to another (included those managed by different management companies) without any financial cost, fee or commission, without tax consequences and within a brief period for the management company to implement said change (7 business days).

This right is actively exercised by participants, as shown in the table below, and leads to enhance competition among management companies and is an incentive for them to keep fees and charges lower and create value for the pension plan participants, but also demand a higher level of liquidity on Pension Funds portfolios.

	MOVILIZACIONES (millones €)	PATRIMONIO SIST. INDIVIDUAL	
		Patrimonio medio *(millones €)*	% s/ Pat.medio
2000	6.235,5	20.136,3	31,0%
2001	2.961,5	22.175,6	13,4%
2002	5.306,4	24.496,6	21,7%
2003	4.846,1	28.408,4	17,1%
2004	5.609,0	33.821,5	16,6%
2005	6.069,6	40.096,9	15,1%
2006	9.112,4	45.976,2	19,8%
2007	8.660,7	51.922,3	16,7%
2008	13.331,5	50.502,3	26,4%
2009	9.768,8	50.172,1	19,5%
2010	9.735,5	52.469,1	18,6%
2011	9.025,6	51.286,2	17,6%
2012	9.430,0	51.421,3	18,3%
2013	9.761,4	55.398,0	17,6%
2014	13.592,1	61.621,3	22,1%
2015	**15.844,7**	**66.944,5**	**23,7%**

Fuente: DGSFP, INVERCO

- **Page 331-333** Table ES 2: Pension Funds – 2015 Distribution, Graph ES 1 and Table ES 3 – Life insurance asset allocation.

  These tables are not made by INVERCO, the source is DGSFP (The General Directorate of Insurance and Pensions).

- **Page 336-** *"This system allows for savers that invest in pension products to receive fiscal stimuli, leaving the invested capital exempt from taxation.* ***Moreover, the revenue generated by the capital investments is only taxed if it has generated profits.*** *This illustrates the underlying political strategy that the government has taken to encourage savings through taxation measures when the pension system is in question".*

  This is not the Spanish income tax formula since the benefits generated by the pension plans are not treated as capital gains since they are considered labour income and are taxed according to the pertinent personal income tax rate. Likewise the Spanish tax regulation allows the participant to deduct the full amount contributed.

- **Page 344- paragraph 1 – "***The annual average return of Spanish pension funds is practically flat (****0% after tax and inflation are deducted****)."*
  This statement is incorrect, according to the Table ES 6- Return on Spanish Private Pension Funds (%), as shown in the report: the annual average return of Spanish Pension Funds **after tax and inflation is 10.2%.**

  - **Page 349- paragraph 3 – "***The foreseeable accumulation of capital by the contributor throughout the years of investment in* ***the pension fund could lead the saver to be in a higher tax rate bracket by the time of retirement"***

This statement is inaccurate since the only the case that the saver could be in a high tax rate would be under the sum-lump option. Also, it is important to remember that this statement still being not accurate, since the reform by Law 35/2006, retirement age in pension plans does not automatically ends the accumulation phase. Namely, once retired the participant of a pension plan can remain in the plan making contributions and therefore the accumulation phase lasts until the participant decides to end the plan.

- **Page 350- paragraph 2** *"it could be stated that the fiscal system in Spain is* ***more favorable for the providers of saving/pension instruments than for savers themselves****"*

  This statement seem to be the conclusion of the wrong calculations made in table ES 6, which are refuted above. When the own report shows that after taxes and after inflation the real return of Spanish Private Pensions is 10.2%.

- **Page 351- paragraph 3** ***"****For this reason, it has been especially controversial* ***that in the new DGSFP*** *resolution draft, on the information obligations of insurers that commercialize PPA's it was stipulated that the new term should be complimented by the old guaranteed technical interest****. This could lead into misunderstanding due to the parallelism with pension plans"***

  In our view, the above statement, lacks of specific regulatory references, such as the DGSFP resolution where this is rather unclear on its purpose and it does not explain in a sufficient manner the point that it is trying to make.

- **Page 351- paragraph 4** *"****~~Conversely~~,*** *Order ECC 2316 from November 4th, relating to information obligations and financial product classification, is based on a colour "traffic light" system and numeric scale that express the risk of the products****. "***

  We note in this regard that while Order ECC/2329/2014 refers to the obligation to inform on the expected returns **<u>on life insurance operations</u>**, the main objective of Order ECC/2316/2015 is related to information obligations and classification of **<u>financial products</u>**, so "Conversely" does not seem the appropriate transition word since it is not expressing opposite ideas.

- **Page 352- paragraph 2** *"On the other hand, entities can choose whether to use the colour coding "traffic lights" or* ***a number on a scale from one to six in order to define the risk*** *(which could also be colour coded).."*

  This statement is inaccurate since Order 2316/2015 on classification of financial products and disclosure requirements, establishes standardized information and classification of financial products to warn customers or potential customers about the level of risk, liquidity and complexity of the products that fall under its scope. It incorporates a risk indicator, which classifies financial products in six categories.

However, for private pension plans, on an exceptional basis, this risk indicator will be calculated following the methodology established for Investment funds according to CESR guidelines on synthetic risk, and, therefore, **will be allowed to classify their products in seven categories instead of six**. Whenever necessary, specific warnings about possible liquidity constraints, risks of early redemptions or complexity of the product, should be added to the information given to investors.

Annex to Country-specific comments from PensionsEurope's Spanish Member Association

Table ES 6- Return on Spanish Private Pension Funds (%), as shown in the report.

Table ES 6 - Return on Spanish Private Pension Funds (%)																
2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2000 – 2015
Non-mandatory 2nd Pillar Pension Fund from associations or worker unions to members																
-	-0,1	-3,84	5,61	6,56	9,49	8,16	3,05	-11,1	9,23	0,95	-1,11	6,94	9,51	6,88	2,57	64,20%
Non-mandatory 2nd Pillar Pension Funds from firms to employees																
-	-0,64	-3,72	6,73	5,52	8,39	5,36	2,44	-10,5	9,28	2,01	0	8,04	7,7	7,14	2,88	61,28%
3rd Pillar Pension Funds – Fixed returns (short term)																
3,83	3,64	3,83	1,95	1,77	1,04	1,26	1,94	2,13	1,8	-0,64	1,38	3,47	2,08	1,37	-0,2	35,31%
3rd Pillar Pension Funds – Fixed returns (long term)																
0,68	0,62	-0,73	2,62	1,92	1,78	0,34	0,75	2,03	3,96	-0,47	1,39	4,79	4,66	8,93	-0,46	37,76%
3rd Pillar Pension Funds – Fixed returns (mixed)3rd Pillar Pension Funds – Fixed returns (mixed)																
-2,2	-2,41	-5,16	3,92	3,16	5,33	3,58	1,32	-8,79	6,05	-1,54	-2,21	5,41	6,11	3,61	0,78	16,68%
3rd Pillar Pension Funds – Variable Returns - mixed3rd Pillar Pension Funds – Variable Returns - mixed																
-4,97	-7,73	-17,2	8,7	5,6	12,16	10,09	2,96	-23,8	14,21	-0,82	-7,01	8,62	12,51	4,77	2,5	11,60%
3rd Pillar Pension Funds – Variable Returns3rd Pillar Pension Funds – Variable Returns																
-10,6	-16,3	-30,1	16,18	8,88	18,73	18,3	3,93	-38,4	27,2	1,63	-10,4	10,43	22,19	7,63	5,58	5,67%
3rd Pillar Pension Funds – Guaranteed Capital Pension Funds																
-	-	-	-	4,66	4,64	1,44	1,48	-0,68	3,77	-3,96	1,16	5,48	9,41	11,37	0,27	45,48%
WEIGHTED AVERAGED ANNUAL RETURNS, BEFORE INFLATION AND TAXES																
-1,85	-1,64	-4,4	5,42	4,46	7,22	5,23	2,08	-8,07	7,7	-0,13	-0,76	6,59	8,36	6,92	1,78	44,38%
Inflation – CPI Spain, Eurostat																
4	2,7	3,94	2,65	3,22	3,66	2,71	4,16	1,49	0,84	2,82	2,34	2,9	0,3	-1	0	43,54%
ANNUAL RETURNS, AFTER INFLATION AND BEFORE TAXES																
-5,85	-4,34	-8,34	2,77	1,24	3,56	2,52	-2,07	-9,56	6,86	-2,95	-3,1	3,69	8,06	7,92	1,78	-0,11%
ANNUAL RETURNS, AFTER INFLATION AND AFTER TAXES																
4,35	5,86	1,85	12,97	11,44	13,76	12,72	8,13	0,64	17,06	7,25	7,1	13,89	18,26	18,12	11,98	**10,09%**

Table ES 6- Return on Spanish Private Pension Funds (%), recalculated and adding columns with average returns.

Table ES 6 - Return on Spanish Private Pension Funds (%)																	
2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2000 – 2015	2000 – 2015 average
Non-mandatory 2nd Pillar Pension Fund from associations or worker unions to members																	
-	-0,1	-3,84	5,61	6,56	9,49	8,16	3,05	-11,1	9,23	0,95	-1,11	6,94	9,51	6,88	2,57	64,20%	3,36%
Non-mandatory 2nd Pillar Pension Funds from firms to employees																	
-	-0,64	-3,72	6,73	5,52	8,39	5,36	2,44	-10,5	9,28	2,01	0	8,04	7,7	7,14	2,88	61,28%	3,24%
3rd Pillar Pension Funds – Fixed returns (short term)																	
3,83	3,64	3,83	1,95	1,77	1,04	1,26	1,94	2,13	1,8	-0,64	1,38	3,47	2,08	1,37	-0,2	35,31%	1,91%
3rd Pillar Pension Funds – Fixed returns (long term)																	
0,68	0,62	-0,73	2,62	1,92	1,78	0,34	0,75	2,03	3,96	-0,47	1,39	4,79	4,66	8,93	-0,46	37,76%	2,02%
3rd Pillar Pension Funds – Fixed returns (mixed)3rd Pillar Pension Funds – Fixed returns (mixed)																	
-2,2	-2,41	-5,16	3,92	3,16	5,33	3,58	1,32	-8,79	6,05	-1,54	-2,21	5,41	6,11	3,61	0,78	16,68%	0,97%
3rd Pillar Pension Funds – Variable Returns - mixed3rd Pillar Pension Funds – Variable Returns - mixed																	
-4,97	-7,73	-17,2	8,7	5,6	12,16	10,09	2,96	-23,8	14,21	-0,82	-7,01	8,62	12,51	4,77	2,5	11,60%	0,69%
3rd Pillar Pension Funds – Variable Returns3rd Pillar Pension Funds – Variable Returns																	
-10,6	-16,3	-30,1	16,18	8,88	18,73	18,3	3,93	-38,4	27,2	1,63	-10,4	10,43	22,19	7,63	5,58	5,67%	0,35%
3rd Pillar Pension Funds – Guaranteed Capital Pension Funds																	
-	-	-	-	4,66	4,64	1,44	1,48	-0,68	3,77	-3,96	1,16	5,48	9,41	11,37	0,27	45,48%	3,17%
WEIGHTED AVERAGED ANNUAL RETURNS, BEFORE INFLATION AND TAXES																	
-1,85	-1,64	-4,4	5,42	4,46	7,22	5,23	2,08	-8,07	7,7	-0,13	-0,76	6,59	8,36	6,92	1,78	44,38%	2,32%
Inflation – CPI Spain, Eurostat																	
4	2,7	3,94	2,65	3,22	3,66	2,71	4,16	1,49	0,84	2,82	2,34	2,9	0,3	-1	0	43,54%	2,28%
ANNUAL RETURNS, AFTER INFLATION AND BEFORE TAXES																	
-5,85	-4,34	-8,34	2,77	1,24	3,56	2,52	-2,07	-9,56	6,86	-2,95	-3,1	3,69	8,06	7,92	1,78	-0,11%	-0,01%
ANNUAL RETURNS, AFTER INFLATION AND AFTER TAXES																	
4,35	5,86	1,85	12,97	11,44	13,76	12,72	8,13	0,64	17,06	7,25	7,1	13,89	18,26	18,12	11,98	373%	10,20%