COVIP

COMMISSIONE DI VIGILANZA SUI FONDI PENSIONE

PENSION PROJECTIONS IN ITALY
experience and current issues

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- 2015-> : the Italian social security agency (INPS) launches a service offering PPs to members of the main public, PAYG pension schemes
- 2016 : in the EU, the IORP 2 Directive introduces rules for PPs at European level (to be implemented by January 2019)
- Current issues in Italy regarding PPs
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The Italian context on pensions

- Universal coverage of mandatory pension schemes – mostly public and PAYG
  - **a large PAYG, mandatory system covers most workers; transformed in NDC in mid'90s –with a long transition**
  - contributions are 33% of salary
  - public expenditure for pensions is around 16% of GDP
  - substitution ratio (pension/last salary) lower than for current retirees, but still around 70% for «full» careers (net of taxes)
- Private, funded pension plans for all workers introduced from mid/end-90's
  - voluntary membership; significant tax allowances are in place (but system is still «ETT» - or rather «ETt»)
  - main source of contributions is the severance pay (so-called TFR), set at 7% of annual salary; total contributions often reach 9-10 % of salary but may also be much lower (if the TFR is not diverted to pension funds)
  - **in 2007, nation-wide auto-enrolment was introduced but with limited success**
  - **as of 2018, still only 25/30% of work force is enrolled**
  - occupational, industry-wide, non-profit pension funds are the main component of the system
  - in practice, market-based open pension funds and insurance-based personal plans are important as well
  - **new pension schemes are only DC**
  - strong emphasis on **comparability, rich and standardized information to members** and competition between plans
- From 2004 and especially in 2009-2011, the reform of the public pension system was pushed ahead
  - **retirement age was raised and indexed to life expectancy ; currently is set at 67, expected to reach 70 in 2050;**
  - women's retirement age is set equal to men's
- In 2018, the new Gvt is heading for some reform reversal of public pensions
  - retirement age for public pensions is brought back – **«quota 100» is the new rule** (sum of age + years of contributions)
  - private pension funds should not be touched

PPs for private, funded pension schemes

2008: a comprehensive regulation is introduced by COVIP

- paper-based PPs are made mandatory
    - to actual members, personalized PPs are sent annually
    - to potential members at joining, generic PPs for representative individuals
- macro-economic/financial scenario is standardized
    - different expected returns are set for bonds / equity
    - uncertainty is not taken into account, except than in a written caveat
- actual costs of the plan are included in the calculations
- format is standardized
- all monetary figures are shown in real terms
- specific rules are set for pension calculators
    - wage growth can be chosen by members , with a cap at 3% real
    - multiple scenarios must be symmetric wrt standard, central scenario
    - may include PPs for PAYG, public pensions

PPs: COVIP rules for setting the parameters

Parameters & assumptions	standardized	fund-specific	member-specific
Gender			✓
Current age			✓
Current wage			✓
Current contribution rate			✓
Age of retirement	✓		
Rates of return bonds/equity	✓ (2%-4%)		
Inflation rate	✓ (2%)		
Wage growth rate	✓ (1%)		
Conversion in annuities	mortality tables, charges, technical rate		
Costs		✓	
Bond/Equity asset allocation		✓	✓ investment option

Format example: PPs for representative individuals

additional assumptions: retirement age 67, annual contribution 2.500 euro/year; male

Entry age	Years of contribution	Investment option	Contributions paid into the plan	Account balance at retirement	First annuity
30	37	Guaranteed	111,269	114,960	6,643
		Bond		161,588	7,405
		Equity		178,944	8,201
40	27	Guaranteed	77,052	93,521	4,286
		Bond		101,259	4,639
		Equity		108,965	4,994
50	17	Guaranteed	46,076	52,058	2,485
		Bond		54,742	2,613
		Equity		57,345	2,738

Example: web-based pension calculator

Summary of projected values

SUMMARY

	Early retirement	Old-age pension
Retirement age	66 years and 9 months	69 years and 9 months
Life-long annuity	8.425,47 €	10.744,48 €
Pension Benefit amount	23.754,68 €	27.846,41 €
Last Annual Gross Salary amount	43.352,29 €	44.665,91 €
Substitution Rate	54,79 %	62,34 %
Supplementary pension substitution rate	18,86 %	24,06 %
Total substitution rate	73,66 %	86,40 %

Benefits' performance over time

GRAPH TABLE (DETAILED AMOUNTS)

PPs for PAYG, public pensions

- the Italian public, PAYG pension system for all employed workers was converted from wage-based to NDC in 1995, with a long transition
- from 2004 to 2010, several changes aimed at easing the burden for the public deficit, but transition remained long
- at end-2011 a major reform made transition much quicker
    - retirement age raised to 66 and indexed to life expectancy
    - earlier retirement for women to be cancelled by 2018
- public pension rules seemed to have reached a certain stability and predictability → to offer official PPs became easier
- From 2015, major initiative by INPS: «La mia pensione»
    - millions of letters sent, with the Swedish «orange envelope» as a model
    - pension calculator was set up on the INPS web-site

PPs in the EU Directive «IORP 2»

- With respect to the original IORP Directive of 2003, the new «IORP 2» Directive approved in 2016 is much more detailed in terms of information to members

- Art.39: PPs are made mandatory, to be sent annually by IORPs to members together with the PBS (Pension Benefit Statement)

- If economic scenarios are used for PPs, they should include:
    - a «best estimate» scenario
    - an unfavourable scenario

→ some doubts on the interpretation, but mutiple scenarios may become the standard fo DC pension plans

Current issues for PPs in Italy

- Reviewing macro-economic & financial assumptions
  - Global low-yield context and its persistence
  - Specific issue for Italy: sovereign risk premium

- How to deal with uncertainty
  - Multiple scenarios
  - Stocastic models

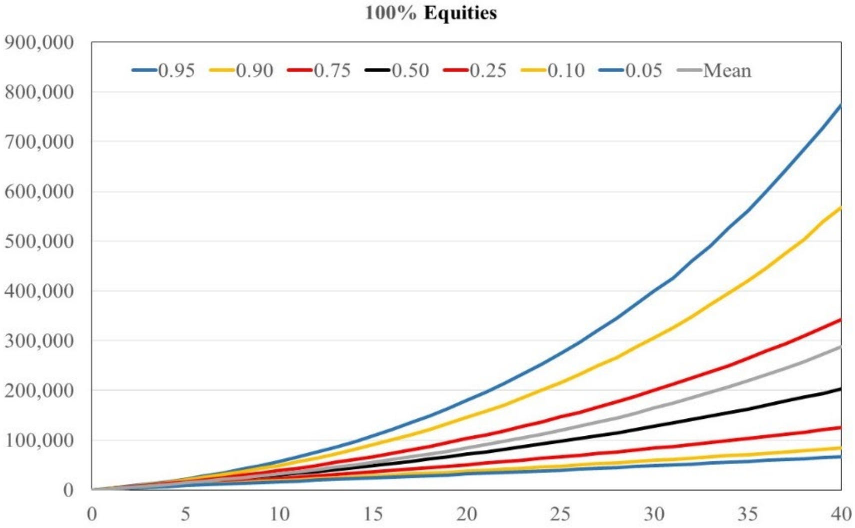
- Stocastic models may be used in two ways:
  - to obtain & show the complete distribution of outcomes
  - even in the context of a deterministic approach, to help choose the distance from the central, best estimate scenario of one, two or more alternative scenarios

➢ Stocastic models look promising but specification for PPs may be difficult

➢ Main issue is to distinguish long-term risk from short volatility. Only the first matters for PPs

An example: a PP projecting short-term volatility in the long term

Figure 4. Stochastic projected assets for multiple probabilistic scenarios *(in €)*



Take-aways from the Italian experience

- PPs are increasingly relevant in the context of DC-based pension systems
- Macro-economic & financial assumptions are a delicate task, especially in the context of a low-yield environment
- Multiple scenarios are likely to quickly become the standard
- The appropriate use of stochastic models fo PPs directed to members is challenging. More work & experience are needed, especially to distinguish long-term from short-term volatility. Only the second is relevant for PPs
- For public pensions, a pre-requisite for reliable PPs is the stability/ predictability of the rules

Thank you for the attention !

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