

# The Italian pension system

Meeting with Sozialbeirat

*Rome, 13<sup>th</sup> June 2019*



# Agenda

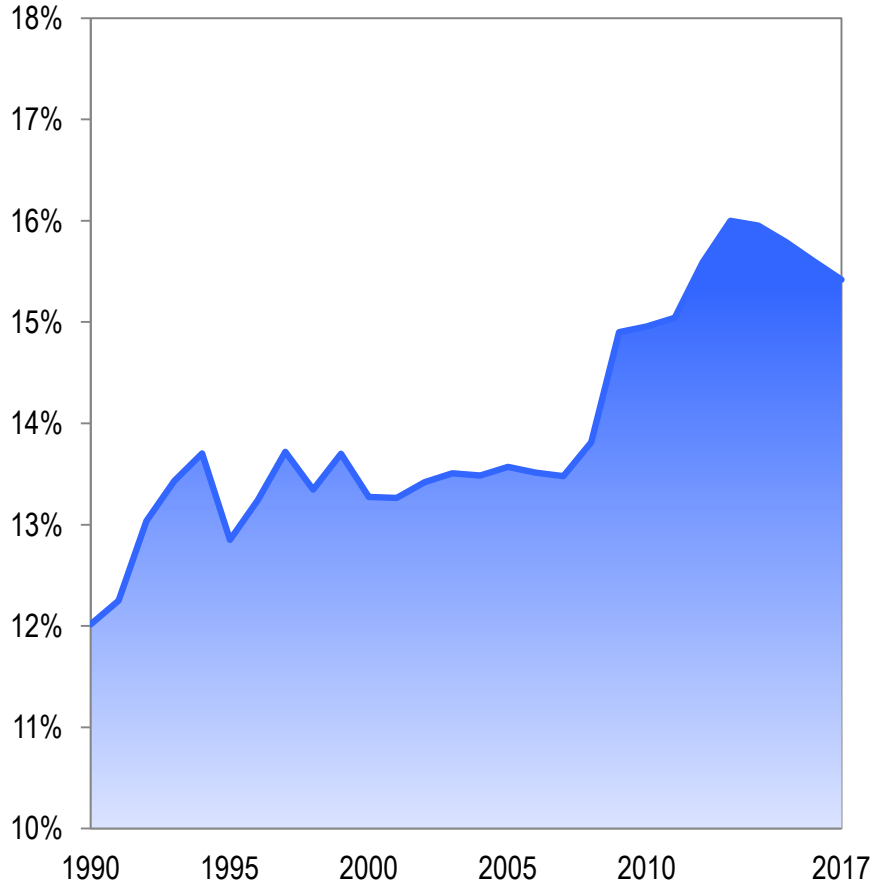
- Part I – **An introduction to the Italian pension system**
- Part II – **Focus: the first pillar of the Italian pension system**
- Part III – **Focus: The Second pillar of the Italian pension system**

# Part I

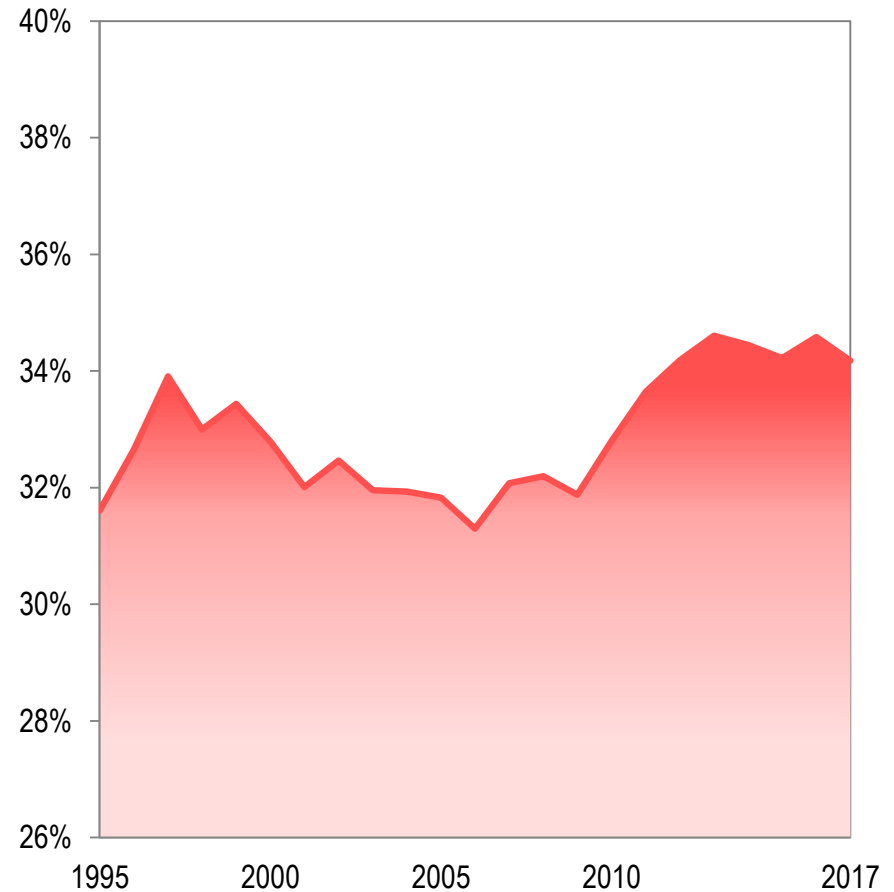
## *An introduction to the Italian pension system*

# Pension expenditure in Italy: high compared to the past (1/2)

Pensions 1990-2017, % of GDP



Pensions 1995-2017, % of current primary expenditure

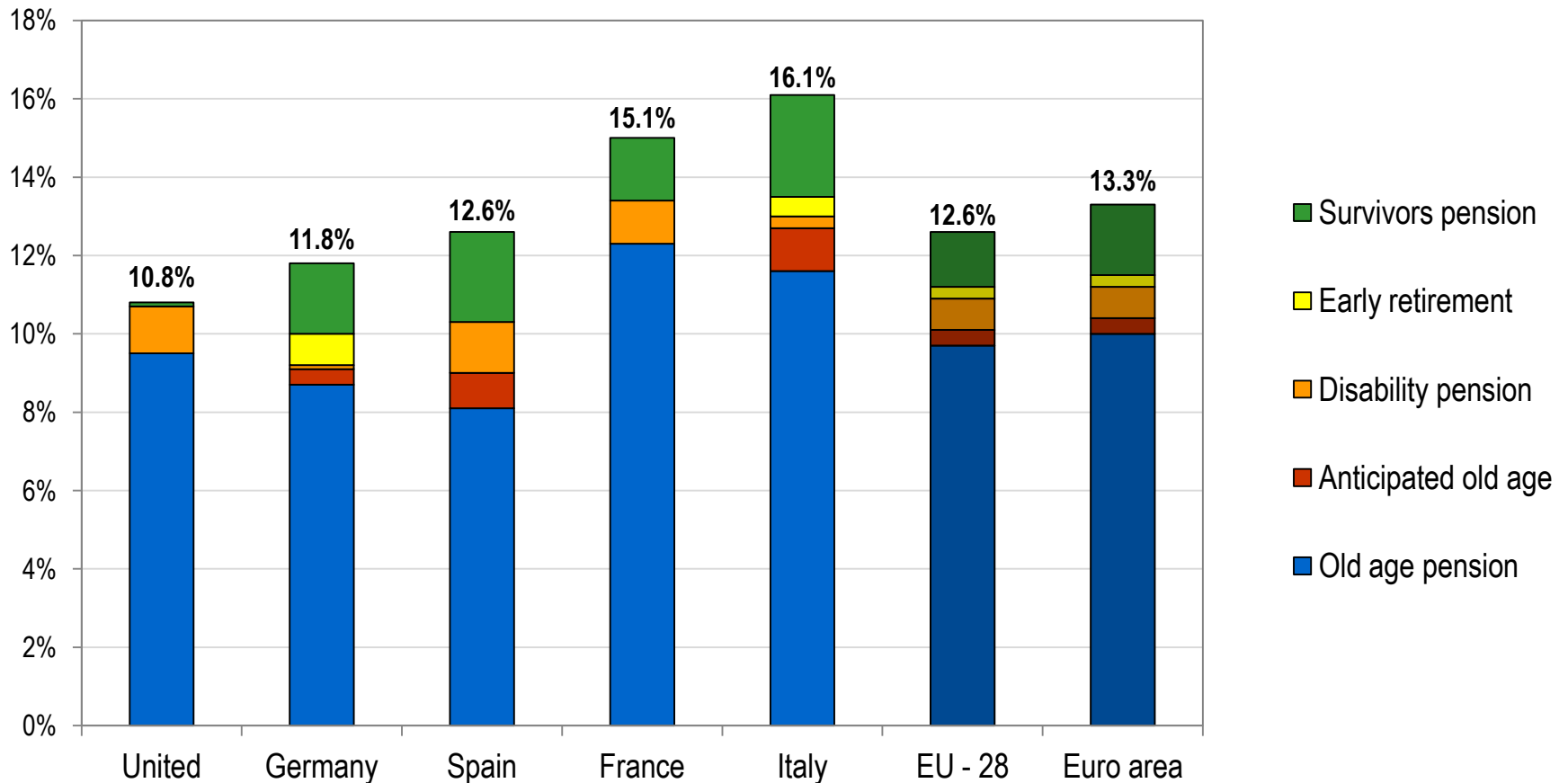


# Pension expenditure in Italy: high compared to the past (2/2)

- The share of pension expenditure in GDP has increased significantly over time. From values of about **8 per cent** in the 80's, the expenditure grew up to **12 per cent** in 1990 and to **15.4 per cent** in 2017.
- Pension expenditure accounts for a significant part of the Italian public expenditure. In terms of current primary expenditure (i.e. public expenditure excluding investments and interests on public debt), from **31.6 per cent** in 1995, the pension expenditure increased to **34.2 per cent** in 2017.

# Pension expenditure in Italy: high compared to other European countries (1/2)

Pensions (2016), % of GDP

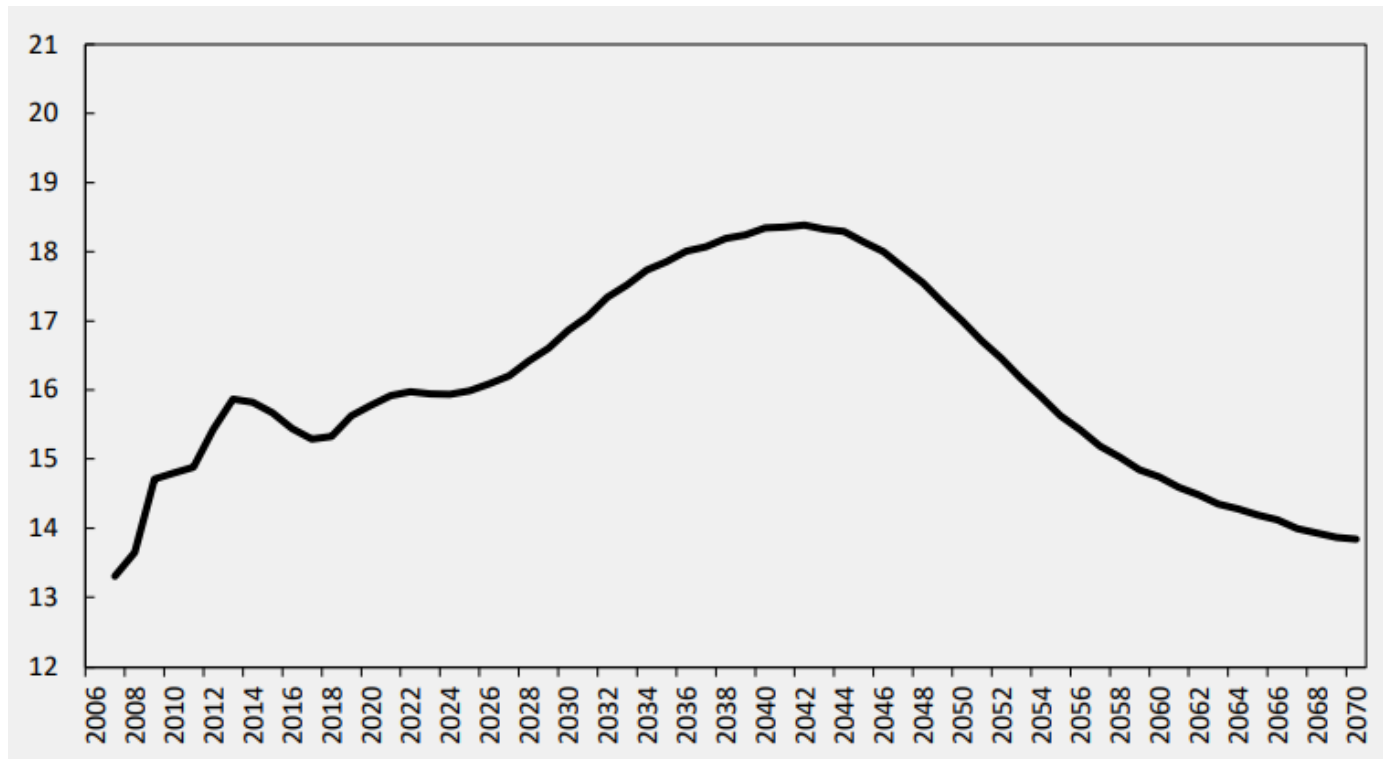


# Pension expenditure in Italy: high compared to other European countries (2/2)

- Italy has the highest expenditure on pensions compared to the other principal European countries.
- Italy's expenditure on GDP exceeded the euro area average by 2.8 per cent and the EU-28 average by 3.5 per cent.
- As a matter of fact, Italy has the second highest pension expenditure in the European Union, second only to Greece (17.5 per cent). Germany is at 11.8 per cent in 2016.
- The predominance of expenditure for old-age pensions is common in every country. Compared to other EU countries, Italy presents a larger share for survivors pensions.

# The Italian pension system: still expensive in the future (but sustainable) (1/3)

- Official projections by the Italian Government indicates that the ratio of pension expenditure to GDP will start to rise between 2019 and 2020.
- In 2040/2045 the ratio is expected to peak. After that, over the period 2040/2070, the expenditure will decline rapidly.





# The Italian pension system: still expensive in the future (but sustainable) (2/3)

## 1. Demography

- The projections reveal a deterioration in demographic prospects, with a decreasing population and a larger share of elder people (+65 y.) on total population (22.1% in 2016 → 33.8% in 2050).

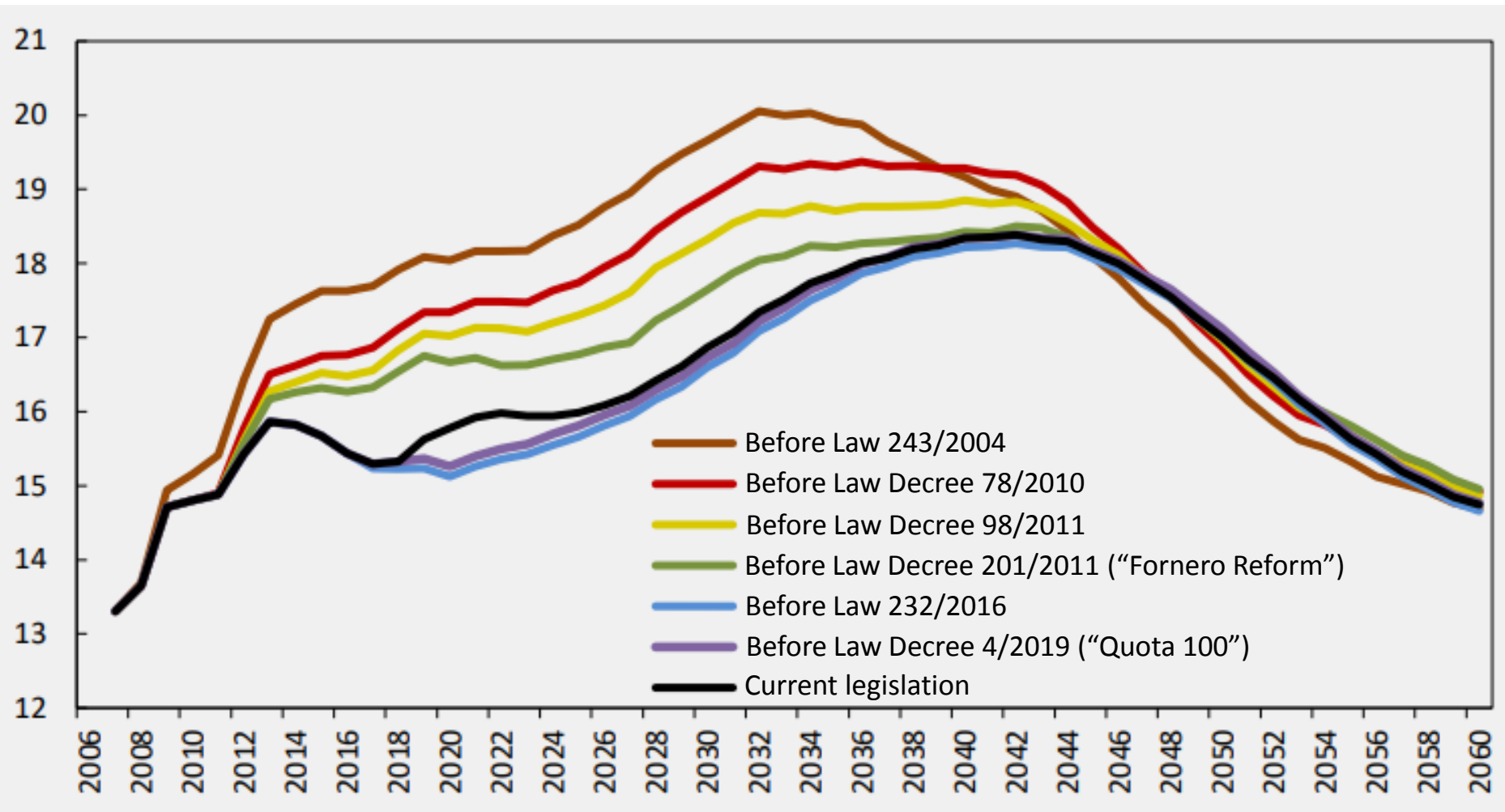
## 2. Economic growth

- Together with demographic trends, low economic growth prospect worsens the expenditure to GDP ratio. The EPC-AWG scenario indicates an average growth of productivity of 0.7% per year in 2016-2070 period.

## 3. Rules

- The curve has actually lowered after the interventions put in place starting from the 1995 (in particular, the “Fornero reform” in 2011).
- The rise between 2019 and 2026 is due to the latest intervention on pension system, the introduction of “Quota 100”. This is a new, temporary option of early retirement, accessible only in 2019, 2020 and 2021, representing an exception to the general rules.

# The Italian pension system: still expensive in the future (but sustainable) (3/3)



# The adequacy of pensions: current and future replacement rates

	2020	2030	2040	2050	2060	2070
<i>Public statutory pension (replacement rates in %)</i>						
<b>Gross</b> Replacement Rates	71.0	68.1	60.2	60.7	60.8	60.8
<b>Net</b> Replacement Rates	80.3	77.5	69.9	70.3	70.4	70.4

Source: Italian Department of General Accounting (2018).

The decrease in replacement rates (both gross and net) over time reflects the completion of the gradual shift from a Defined Benefit (DB) to a Notional Defined Contribution (NDC) scheme.

# The merits of the “Fornero Reform”

1. The Reform aimed at medium- to long-term **financial sustainability** of the pension system.
  - A sustainable pension system in the long run is able to absorb the impact of population ageing without destabilising public finances.
2. The Reform aimed at **social sustainability** of the pension system, because in a **NDC** plan, each pension benefit is directly linked to the contribution paid.
  - **Intergenerational equity** means that younger and future generations are not forced to bear burdens which they are not responsible for, arising from decisions made by the preceding generations.

**At the same time, the financial sustainability of the system must not undermine the provision of an adequate income for pensioners in the retirement phase.**

# Policy levers to address the challenges

In every pension system, the adequacy of benefits and the financial sustainability are two side of the same coin, two aims that must be achieved simultaneously. This is the challenge ahead.

**The policy levers we have refers to:**

- 1. Postponing retirement actively, through life-long learning;**
- 2. Introducing exceptions only when driven by solidarity issue, assuring transparency and uniformity of the rules;**
- 3. Complementary retirement savings, which will be useful to secure adequate replacement rates in the future.**

# The adequacy of pensions: current and future replacement rates **with the second pillar**

	2020	2030	2040	2050	2060	2070
<i>Public statutory pension (replacement rates in %)</i>						
<b>Gross</b> Replacement Rates	71.0	68.1	60.2	60.7	60.8	60.8
<b>Net</b> Replacement Rates	80.3	77.5	69.9	70.3	70.4	70.4
<i>Public statutory pension + <b>private funded pillar</b> (replacement rates in %)</i>						
<b>Gross</b> Replacement Rates	76.3	75.5	69.0	69.1	68.1	68.7
<b>Net</b> Replacement Rates	87.1	87.4	81.9	82.0	80.4	80.5

Source: Italian Department of General Accounting (2018).

# Part II

*Focus:*

*The first pillar of the Italian pension system*



# The two pillars of the Italian pension system

## Social Security is a complex issue

It affects the sustainability of public accounts and it addresses the social issue of inter-generational solidarity

### First pillar:

- Public pensions (including other statutory social security bodies, e.g. autonomous workers/professionals, etc.)

### Second pillar:

- Supplementary pension schemes, integrating public pensions



# The Italian pension system

Keeping under control the public pension expenditure is important for the main following reasons:

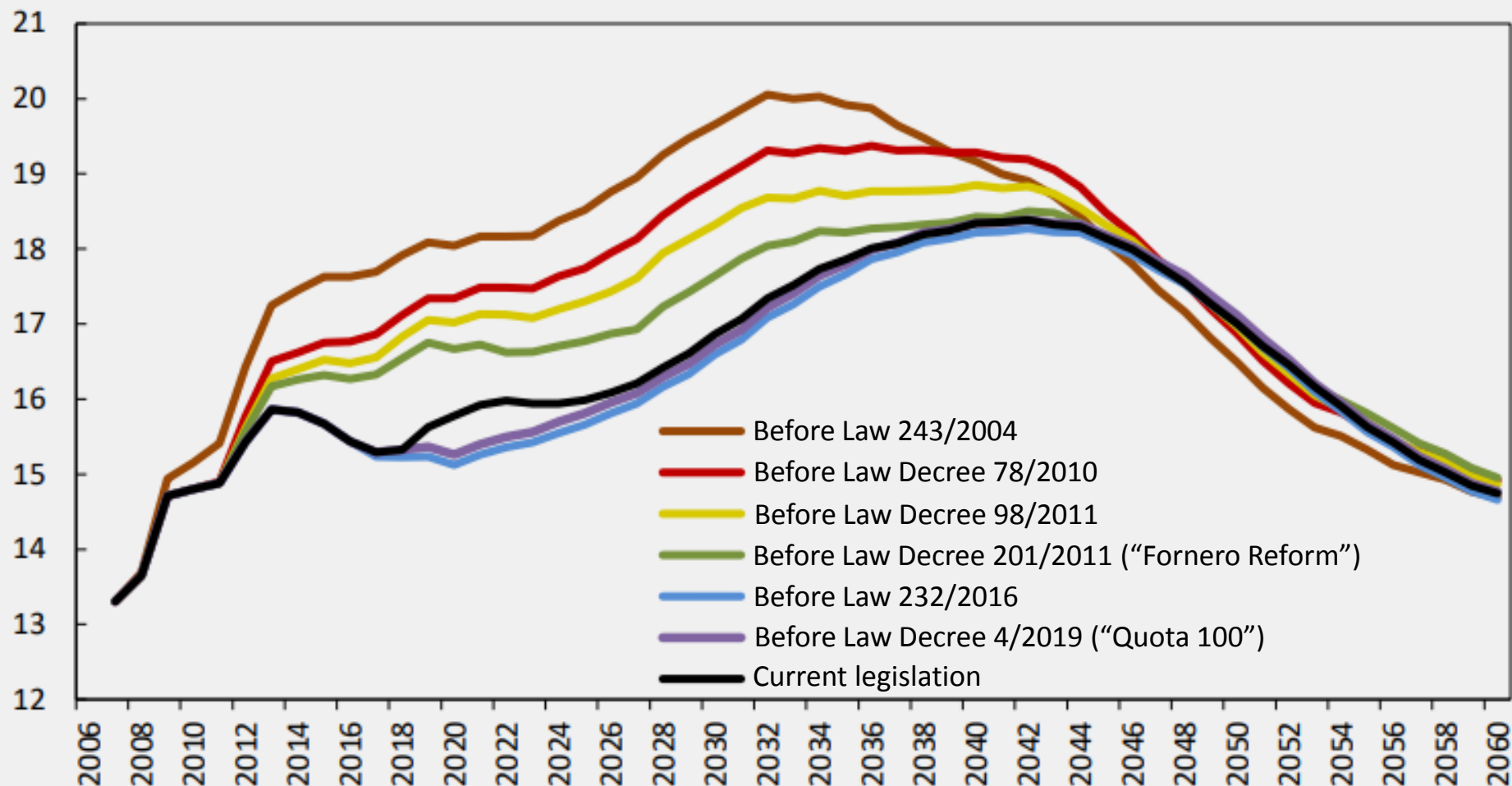
- It has positive effects on other expenditure invoices
- It allows to formulate new proposals to reduce labour costs, therefore reducing the high level of social security contributions
- It has positive effects on the employment rate and on competitiveness

# The Italian pension system

The pension reforms enacted in the last years have been aimed at:

- Keeping under control the public expenditure and the financial sustainability of the pension system
- Establishing inter-generational solidarity
- Ensuring adequacy of pension benefits
- Promoting and boosting supplementary pension schemes

# The Italian pension system



Pensions expenditure in Italy 2006-2070, % of GDP

Source: Italian Government, Economic and Financial Document (DEF) 2019.

# The Pension Reform of 2011

The Reform of the Italian pension system enacted in 2011 (Law n. 214/2011 – “Fornero Reform”) has involved two main **positive effects**:

- Focussing on the medium-long economic sustainability of the pension system
- Through the increase of the legal retirement age:



it has improved the replacement rates between pension and labour incomes, which would have - in the long term - negatively affected the social sustainability of the system.

# The Pension Reform of 2011

The 2011 Reform was based on the following 4 lines of action:

- Inter/Intra- generational solidarity
- Flexibility paths for the access to retirement
- Adequacy of pension requirements to life expectancy
- Simplification, harmonization and efficiency of operational rules governing the different social security management funds

# The Pension Reform of 2011

**As from January 1, 2012: the Defined-Contribution Scheme is applied to all workers**

This scheme is applied also to workers who - at 31 December 1995 - had accrued at least 18 years of social security contributions. Their pensions will be calculated by applying the pro-rata system. This means that:



the Defined-Benefit Scheme is applied to the working periods accrued by the worker up to 31 December 2011, whilst



the Defined-Contribution Scheme is applied to the working periods accrued after 31 December 2011.

# The Pension Reform of 2011

## Re-definition of the different types of pensions provided by the public system:

- As from 1 January 2012 the so called “**anticipated pension**” enters into force, replacing the former seniority pension. This pension is only linked to the contribution seniority accrued by the worker and is addressed to workers who have accrued a significant contribution seniority, willing to retire, despite not having reached the necessary requirements for the old-age pension.
- The **old-age pension** is confirmed – Mainly linked to the age requirement (for a minimum part, also to social security contributions: at least 20 years).

# The Pension Reform of 2011

As from January 1, 2019, the **old-age pension** requires **67 years of age** for all workers (private + public sectors)

+

progressive age increase in relation to life expectancy evolution.



# The Pension Reform of 2011

- **It promotes the postponement of the working activity up to 70 years of age**, with new indexes to be applied to the Contribution-Defined Scheme, so that the worker who continues to work after 40 years of contribution, will obtain a higher pension
- **It reinforces the mechanism of pension adequacy to life expectancy** . How?

By linking the age requirements for retirement to indexations on life expectancy issued by ISTAT (Central Statistics Institute).

The adjustment has started on January 1, 2013, with an anticipation in respect to the scheduled date of January 1, 2015, and it applies to all pension benefits. **For old-age pensions, the next adjustment will take place on 2021.**

# The position of Confindustria on the 2011 Pension Reform

**Italian companies** have accepted the consequences of the political choice made with the enactment of the 2011 Reform.

The Reform was aimed at ensuring the long-term sustainability of the pension system and, thus, the more general sustainability of the public expenditure.

The general rules established by the 2011 Reform must be kept as they are. At most, it would be advisable to provide some flexibility so to allow limited, but useful, possibilities for anticipated retirement and the necessary turnover to allow companies to hire younger people.

# The position of Confindustria on the 2011 Pension Reform

- This reform was enacted simultaneously with the social safety nets (SSN) reform.

The total costs for the companies were high. Corporate restructuring became more complicated due to the increase of the retirement age and the reduction of the periods of income support at dismissal.

- Confindustria has shared this political approach, supporting the proposals to enhance and improve the efficiency of the active labour market policies that the Government was implementing.

The SSN reform was also aimed at renewing active labour market policies, making them more efficient and effective, adapting them to the changed conditions of the economic context and giving them a stronger role to increase the employability of people. This aim was to be attained through continuous training/ professional retraining, with specific regard to dismissed workers, for their more effective and timely relocation.

# How to explain the position of Confindustria

- The Defined- Contribution Scheme ensures the balance between social security contributions and pension benefits. This system pays back what the workers have virtually saved (by law obligation).
- The progressive increase of retirement age improves the amount of pension benefits, with positive effects on people's income.
- When the older generations will retire and the Defined- Contribution Scheme will fully apply to all workers, we will have an important simplification for our complex pension system and it will be easier to maintain/fine-tune it according to future conditions.

# Exceptions to the 2011 rules: **Quota 100**

- Art. 14 Law Decree n. 4/2019 – Experimental measure for workers accruing the pension requirements between 2019 and 2021
- Entitlement to anticipated pension with 62 years of age + 38 years of social security contributions
- The age requirement is not linked to the increase of life expectancy
- No cumulation with income from subordinate employment
- The pension benefit is consequently lower than the one that would be paid in case of retirement at the ordinary, legal age.

# Quota 100 and its exceptions

- ***Anticipated pension:***  
the adequacy to life expectancy is freezed from 2019 to 2026
- Access to pension for ***“early” workers:***  
the adequacy to life expectancy is freezed from 2019 to 2026
- Extension of specific exceptions to age/social security contribution requirements, for certain groups of workers (e.g: women + hard/strenuous work)

# Quota 100 – Confindustria's remarks

## An exception from the general rules

The demographic perspectives and the economic long-term forecasts that motivated the 2012 reform of the Italian pension system, **did not change**. Actually, the risk is to negatively affect the financial sustainability of the pension system.

- Moreover, Quota 100 is an exception to the general rule which is presently not guaranteeing the generational turn-over expected by the Government. In the Government expectations, Quota 100 should have involved the following scheme: **3 newly hired workers per each pensioner**. According to other official sources, the ratio is **1 newly hired worker per 3 pensioners**.

# Part III

*Focus:*

*The second pillar of the Italian pension system*





# The need for a second pillar in Italy

Complementary pension schemes have been operating in Italy since 25 years, e.g. with voluntary schemes.

In 2005 the Italian legislation provided an organic regulation of complementary pension plans.

Considering the limits – in terms of adequacy of pension benefits - of the public pension system, the promotion of the second pillar in Italy is essential **to ensure** to today's and future generations of workers :

- **adequate pension benefits**
- A possible, **higher flexibility** in determining the exit age from the labour market

# Complementary pension schemes in Italy – Some data

- **Accrued resources** at the end of 2018: 166.9 bln (**3.8% of the financial wealth** of Italian households), of which more than 50.4 bln in occupational pension funds
- **8.74 mln of enrolled workers**, of whom, approximately, 75% of active contributors to the funds and 3 mln workers enrolled in occupational pension funds
- **Enrollment rate** (enrolled workers in % of the workforce) average of **30.2%**

(Source: Covip - General Assembly, 12/6/2019)

# Enrollment to complementary pension schemes in Italy

The way to reach a full coverage of Italian workers with an average enrollment rate of **30.2%** is still far from us.

## **The diversification is quite significant:**

- From 16% referred to 25-34years old up to 31% among *over 45*
- Higher than 30% in Valle d'Aosta, Lombardy, Veneto, Trentino Alto Adige and Friuli Venezia Giulia; lower than 20% in Southern Italy + Islands.

In an international benchmark perspective, the second pillar in Italy is under developed, but it must be considered that its provision is much more recent than in other EU countries: 25 years since its establishment.

Today, with the transposition of the EU Directive on IORP 2, ruling on governance, transparency and cross-border activity, there is an important chance to boost the sector.

# Occupational pension plans vs open funds and Insurance Products (PIP)

**Occupational pension plans, established by agreement between companies and trade unions:**

- These schemes absorb every year approx. **one third of all the enrolled workers/financial resources** destined to complementary pension schemes
- They are particularly competitive in terms of low management costs and they offer – on the long-term – good net revenues (except for 2018).

**But there are difficulties in finding new adherents**, who are mainly attracted by open funds, especially by insurance products, that can rely on a well organized sales network .

# Occupational pension plans - Significant effect on revenues

On a 35-year period, considering as hypothesis that an occupational pension plan ensures an yearly revenue of 5,000 euros, the major costs **of other pension schemes (open funds, insurance products)** can be expressed - on the same terms - **in revenues of 20% less, by year (1,000 euro less)**

# Purpose: the development of the second pillar – Why and how

The **complementary pension schemes** are, today and on the average, **relatively underdeveloped**.

The **increase of their size** is functional to:

- **cost reduction**
- the improvement of the **management quality** (administrative and financial), also in terms of investments **diversification**.

To attain the purpose of their development, it is advisable to act in two directions:

- to promote the **increase of the enrollment rate**
- to promote their aggregation, at least between smaller funds.

# The Severance Pay (TFR) and the complementary pension schemes

As from 1<sup>o</sup> Jan 2007, Italy has in force a mechanism of adhesion to complementary pension schemes addressed to subordinate workers of the private sector, operating through the **transfer of the so called “TFR” (Severance Pay)**, in addition to the contribution paid by the worker and by the employer.

In case the worker chooses to keep its TFR by the company:

- The TFR is allocated by the company, if the company employees < 50 workers
- The TFR is transferred to the Treasury Office Fund at INPS (National Social Security) if the company employees > 50 workers.

- More than 5 bln euros per year are transferred to the **Treasury Fund** by INPS. More than **34 bln** euros from 2007 al 2018. The State Audit Court in several occasions has reproved the forced withdrawal of TFR by the Treasury Office, as intended to be destined to the “current expenses”.
- These are amounts of money that should be transferred to complementary pension schemes.



In addition, there are **13 bln euros of TFR** that **remain every year allocated by companies** employing less than 50 workers.

In order to promote the disinvestment of this share of TFR towards complementary pension schemes, it would be necessary – among other aspects, including a better information/education of the public on social security issues – to:

- Improve the compensating measures for the benefit of companies
- Reduce the solidarity contribution applied to the contributions paid on complementary pension schemes
- Facilitate the access to bank credit for SMEs (e.g. Guarantee Fund, compensating the loss of liquidity by companies).

# How to increase the number of enrollments to complementary pension schemes (1/2)

## Sensibilization and financial education

- **Italy lacks of a national strategy dedicated to the financial education**, which is instead already established in the majority of industrialised countries.
- According to data available, Italians are among the less informed on (social security) saving issues
- It is necessary to develop initiatives/campaigns of financial education

# How to increase the number of enrollments to complementary pension schemes (2/2)

## Compulsory enrollment to the scheme on the basis of an agreement between company and trade unions, with the contribution paid by the employer

- In our Confederation, this is an hypothesis implemented by certain pension Funds as from 2015
- The mechanism encourages the effective increase of the enrollments to the pension fund, when followed by the transfer of TFR and by the worker's contribution.
- Also for this case, it is **necessary to promote information and sensibilisation** of the enrolled persons. Differently, this measure would not be very effective.

# Promoting the aggregation between pension funds, also for the diversification of the portfolio structure

- Promoting aggregations between minor funds in order to create adequate structures in terms of assets and enrolled workers.
- Investments of complementary pension schemes **concentrated in bonds**, also in years with low interest rates
- They can play a role in supporting the Italian real economy: **2.9% of assets** at the end of 2017 , invested in securities issued by **Italian companies** (3.2 bln), but almost all referred to **listed securities**.

# The development and the diversification of the portfolio structure

Without prejudice of the first purpose to be attained (ensuring complementary pensions), it is important to create the conditions **to enhance** the investment activity also towards the local development, the infrastructures and the SMEs financing.

To this purpose, the following elements are also necessary:

- The development of **adequate financial instruments**
- The improvement of tax benefits (in respect to the ones provided by Budget Law 2017).