COUNTRY SPOTLIGHT | ITALY

Heading in a new direction

David Adams considers the efforts so far to make the Italian pensions system more sustainable, and the work that still needs to be done

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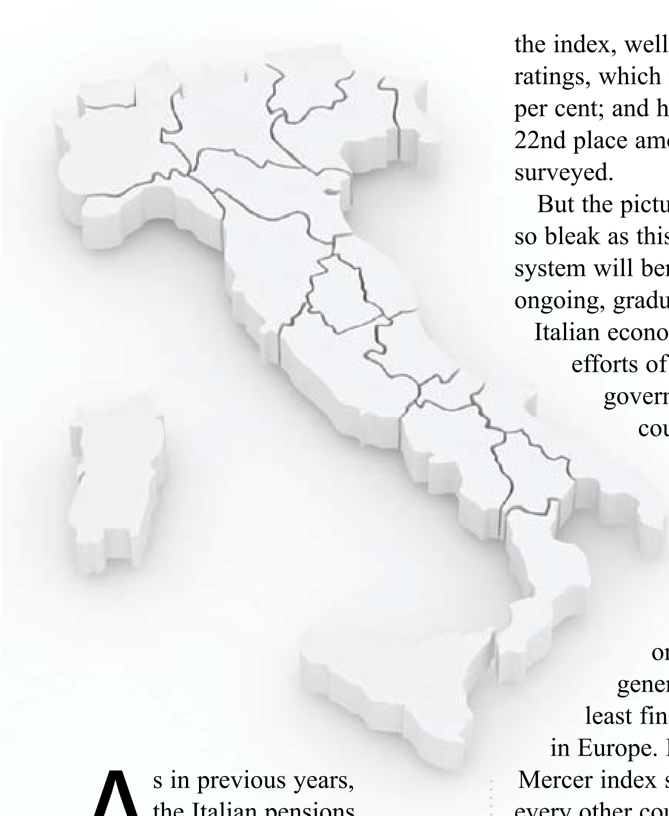

As in previous years, the Italian pensions system was given a mediocre review in the 2017 Melbourne Mercer Global Pension Index (MMGPI), published in October. It scores 50.8 per cent in the index, well below the top ten ratings, which range from 67 to 78 per cent; and has fallen from 19th to 22nd place among the 30 countries surveyed.

But the picture is not necessarily so bleak as this might suggest. The system will benefit from the ongoing, gradual recovery in the Italian economy and also from the efforts of successive governments to reduce the country's dependence on the system's creaking first pillar. Before reforms completed in 2011, the state pension in Italy was one of the most generous – and one of the least financially sustainable – in Europe. Even today, the Mercer index still puts Italy below every other country in Europe in terms of pensions system sustainability; and Italy still spends about 15 per cent of GDP on the first pillar system, almost double the OECD average.

Making changes

The first pillar is based on a contribution-based scheme, previously a defined benefit (DB) final salary scheme, now operating on a pay-as-you-go basis. The state retirement age has increased and will be 67 for men and women by 2021, but the full state pension is payable after 42.5 years of contributions for men and 41.5 years for women.

Mercer Italy CEO Marcio Valerio Morelli highlights the country's ageing population and low investment returns as the most important reasons why the system still receives such a low score for sustainability in the MMGPI. "If left unchanged these issues will create societal pressures where pension benefits are not distributed equally between generations," he warns.

Indeed, the 2011 reforms mean younger workers will end up receiving lower benefits than older people, while paying higher contributions. Yet they still have the chance to live on a reasonable income in retirement, if they supplement the state system

with additional savings in second or third pillar pensions. But at present most Italian workers do not do this.

In 2017, in an attempt to soften the blow of an increased retirement age, the government introduced the Anticipo finanziario a garanzia pensionsistica (APE), a mechanism that effectively allows early access (up to three years and seven months) to the state pension for some workers with the use of a bank loan; and the APE Sociale, an additional pension payment for unemployed workers aged 63 or older with 30 years of first pillar contributions.

They complement measures introduced in 2016, including the Temporary Anticipated Complementary Annuity (Rendita Integrativa Temporanea Anticipata, or RITA), which allows early access to second pillar pension savings for those who choose to take early retirement under the APE scheme, paid as a monthly income for three years. As things stand, this initiative will only run until the end of December 2018.

But matters are complicated further by the existence of the trattamento di fine rapporto (TFR), a statutory severance pay scheme. If accumulated throughout a whole career the TFR can provide the equivalent of a pension worth about 15 per cent of final salary.

At present the TFR is either held by an employer for the long term or transferred to a second pillar pension scheme, but at the time of writing there are discussions underway in parliament about the possibility of allowing a greater degree of flexibility around how this money can be used. The outcome of these discussions may also undermine take up of second or third pillar pensions.

Second pillar demand

One important reason why take up of occupational pensions has always been sluggish is the very high contributions workers need to pay for first pillar pensions, which can account for up to 30 per cent of gross salary. This is unlikely to change in the context of the financial demands of the first pillar, but other government policies aim to encourage greater take up of second pillar pensions.

In September 2017 the government increased tax relief on pension savings and offered tax incentives for employees who transfer performance bonuses into second pillar pensions. Up to €3,000 can be transferred tax-free this way, with the pensions tax relief continuing to apply during decumulation. At present the annual limit for tax-free pension contributions is €5,164, a figure many would like to see increased.

The government has also encouraged pension funds to invest in Italian companies, with those that maintain such investments for at least five years allowed to pay tax-free dividends on them.

Membership of workplace pensions increased by 7.6 per cent in the year to mid-2017, according to figures from the Italian pensions regulator Covip. Nearly eight million workers, just over 25 per cent of the country's total workforce, are now members of a second pillar scheme – but that is still only 34 per cent of workers aged 55 or older and just 19 per cent of those aged under 34.

The occupational schemes that have seen the most growth in recent times have been industry-wide schemes (fondi negoziali), which acquired another 251,000 members and now cover about 2.6 million workers. This is due in large part to several funds using a form of auto-enrolment. At the time of writing, these schemes are the construction industry fund Prevedi; Astri

(road transport); Byblos (paper and publishing); Eurofer (railway workers); Solidarieta Veneto (a regional fund for north-east Italy); Cooperlavo (for workers in cooperatives); and Fondapi (a scheme for employees of small and medium-sized companies). Many in the pensions industry advocate use of auto-enrolment for other second pillar schemes.

Aon Hewitt Italy head of consulting Claudio Pinna believes common assumptions about retirement will need to be challenged if the second pillar is ever to acquire critical mass. "There is a cultural problem, because most employees start from the point that their pension is going to be paid by social security," he says. He wonders if it may become necessary to introduce some form of compulsory participation in the second pillar,

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including compulsory payment of part of the TFR into these funds.

Whether or not auto-enrolment and/or compulsion play a role, more user-friendly, digitally-enabled methods for interaction with pension schemes could also help, suggests Previnet Outsourcing senior manager Martino Braico. "Online portals are becoming the main communication and interaction channel," he says. "Interactive functionalities, such as change of investment options and pension projections, are crucial to allow members to actively manage pension savings."

Investment strategies

Meanwhile, there is some evidence that pension schemes are developing more sophisticated and effective investment strategies. Candriam global head of European client relations, Renato Guerriero highlights a shift away from what were often very conservative portfolios towards more sophisticated strategies, incorporating adoption of diversified-growth strategies and use of a broader range of asset classes.

The hope must be that more sophisticated investment strategies help pension funds manage future operational and financial challenges, such as the proposal for stress tests for occupational pension schemes based in the EU, to be introduced under the IORP II Directive from 2019. Covip is currently seeking clarity on the requirements relating to pension schemes' investment, cross-border activity, governance and risk.

More work to do

Those charged with managing the state system and workplace pensions still have much more work to do as they seek to improve the effectiveness and sustainability of pensions in Italy. But for individual workers the calculation is simple: saving in the second and third pillars can be an effective complement to first pillar provision. Covip is launching new financial education programmes for schools and workplaces, with one key aim being to improve the understanding and use of second pillar pensions.

"Public and private sectors need to work together to engage individuals in saving for the long term," says Morelli. "A supplementary pension, *[using]* the second and third pillar, is needed to ensure financial wellbeing in a social and demographic scenario that is very different from the past."

"Service providers and pension schemes should make members feel involved in building up their pension savings," says Braico. "If more members *[understand]* the advantage of having a second pillar pension, other workers will consider to become affiliated and start contributing." Slow progress made so far towards this goal is welcome, but much more work will be needed by public and private sector organisations – and by Italian workers – in the years ahead. ■