COVIP

Commissione di Vigilanza

sui Fondi Pensione

POLICY ISSUES RELATED TO THE REFORM OF DIRECTING THE TFR IN THE PENSION FUNDS

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TRATTAMENTO DI FINE RAPPORTO - TFR

• TFR is a sort of severance pay scheme, or deferred salary, imposed by law and applied to all employed workers in the private sector

• TFR has to to be paid by the employers to the employees at termination of the labor contract

• Every month, for each employee, the employer sets aside as a book reserve in the balance sheet:

Gross salary x 7,41% = gross salary/ 13,5

7,41% of which:

6,91% set aside for the employees

0,5% contribution to social security

TRATTAMENTO DI FINE RAPPORTO - TFR

Every year the accumulated stock of the TFR is appreciated according to a CPI-linked formula:

(1,5+75% X CPI)

The accumulated stock is accounted as a book reserve in the balance sheet of the employer.

In case of employers default the TFR is paid by a Public guaranteed fund

THE TFR KEPT FOR THE EMPLOYEE

Accruing TFR	6,91% of gross salary
Return	a pre-defined income inflation linked (accrual rate: 1.5 + 75% of inflation) is guaranteed on the TFR set aside
Benefits	Lump – sum at termination of employment contract
Withdrawals *(for specific and proved needs)*	after 8 years of work in the same company; max. 70 % of TFR accrued ; only 1 withdrawal is allowed; max 10 % of entitled employees, and max 4% of total employees every year (better conditions could be set by collective bargaining)
Tax treatment	separate taxation (average rate of the last 5 years). Min 23% of the gross income revenue
Other	Public guaranteed fund in case of employer failure

Precautionary and retirement saving function

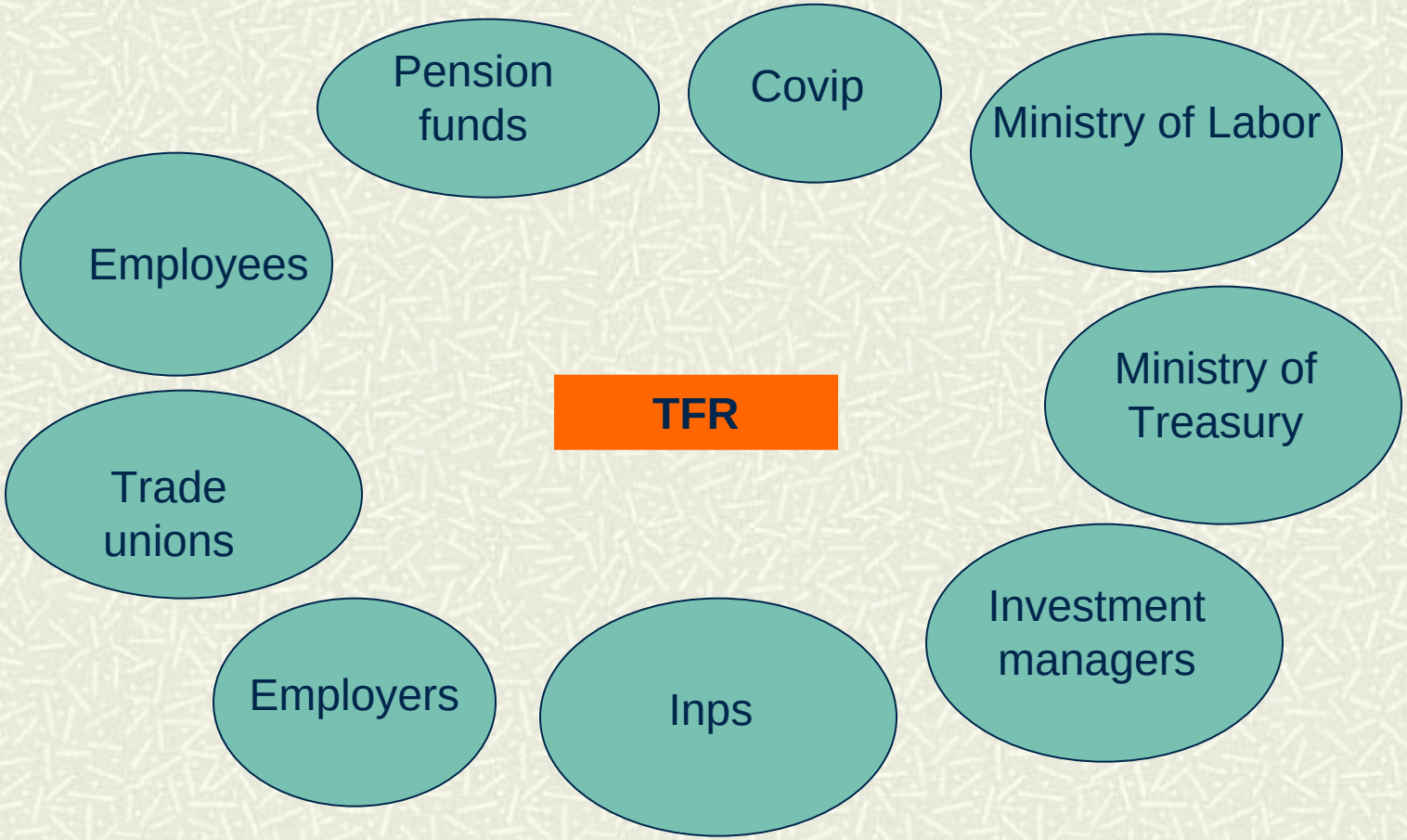
THE TFR FOR THE EMPLOYER

Source of financing	The TFR is kept as book reserve until the end of the contract of employment TFR is an easy source of financing: - in the last twenty years the revaluation of the TFR is less than the average interest rate in the banking system - restrictions on employee withdrawals on the TFR already accrued

MAIN POLICY ISSUES

- Adhesion to pension funds: voluntary vs mandatory vs automatic enrolment mechanism
- Design of the default option
- How to incentive employees to invest thier TFR in the pension funds
- How to compensate companies to “free” the TFR
- Competition between different pension funds
- Portability of the employer contributions

INSTITUTIONS INVOLVED IN THE REFORM PROCESS



ADHESION IN OTHER COUNTRIES

Countries	Occupational pension plans		Personal pension plans	
	Mandatory or quasi-mandatory	Voluntary	Mandatory	Voluntary
EU countries				
Austria		x		x
Belgium		x		x
Bulgaria		x	x	x
Czech Republic		x		x
Denmark	x		x	x
Finland		x		x
France	x	x		x
Germany		x		x
Greece		x		x
Holland	x			x
Hungary			x	x
Ireland		x		x
Luxemburg		x		x
Poland		x		x
Portugal		x		x
Spain		x		x
Sweden	x			x
United Kingdom		x (AE coming)		x

ADHESION IN OTHER COUNTRIES

Countries	Occupational pension plans		Personal pension plans	
	Mandatory or quasi-mandatory	Voluntary	Mandatory	Voluntary
Other OECD countries				
Australia	× ((AE)		×	×
Canada		X		×
Island	×			×
Japan		X		×
Korea		X		×
Mexico			×	×
New Zeeland		X		× ((AE)
Norway	X	X		×
Switzerland	X			×
Turkey		X		×
United States		X (AE)		×
Other countries				
Chile			X	X
Costa Rica		X	X	X
Jamaica		X		X
Kenya	X	X		X
Chile			X	X

EMPLOYEE CHOICE

From the 1 of January 2007 all private employee workers have to choose whether

- To **invest** of the whole accruing annual severance pay provision in a pension fund

Once an employee decides (expressly or tacitly) to transfer his or her TFR flow to a pension fund, he becomes member of a pension fund. The decision is irrevocable.

- Or to **keep** the severance pay provision within the employer (companies with less than 50 workers) or Fondotesoreria (companies with more than 50 workers)

Employee that decides to leave their TFR within the employer/Fondotesoreria may decide to transfer the future TFR flows to a pension fund at any time

AUTOMATIC ENROLMENT

If the employee does not explicitly make a choice, over a 6 month period (for a new worker from his hire date), TFR will be **automatically paid into an occupational pension fund:**

- to the contractual fund (if any), or to the open pension fund indicated by the contractual agreements;
- In presence of a plurality of contractual pension funds, the TFR is automatically diverted to the pension fund to which adhere the majority of company's employees;
- If there is not a contractual fund or an open pension fund foreseen by the collective agreements the TFR is devoted to a "residual" **pension fund instituted by INPS (the National Social Insurance Institute).**

DESIGN OF THE AUTOMATIC ENROLMENT

	ITALY	USA
1 step		Automatic enrolment in a 401k plan and automatic payment of the employee contribution (+ maching contribution)
2 step	Employee decision about the TFR within 180 days	Decision to opt out within 90 days
3 step	If any decision: Automatic enrolment in a pension fund and automatic payment of the TFR	
4 step	Irreversible choice	Opting out after 90 days – penalty of 10%

Investment options and default option

Country	Multiple Investment Options	Default Option	Default option: selected features
Australia	very frequent	very frequent	
Austria	no		
Belgium	no		
Bulgaria	no		
Chile	required	required	life-cycle
Hong Kong	very frequent	very frequent	usually low risk
Hungary	very frequent	*required from 2009*	life cycle
Ireland	very frequent	required	life cycle required for PPP
Italy	generalized	required (OPP)	guaranteed return
Jamaica	no (OPP) , very frequent (PPP)		
Mexico	required	required	life cycle
Netherlands	very frequent	required	life cycle
Poland	no (PPP)		
Slovakia	required (PPPM)	required (PPPM)	life cycle
Spain	very frequent	recommended	life cycle
Turkey	very frequent	recommended	life-cycle recommended
UK	very frequent	required (stakeholder pensions) very frequent (OPP)	life-cycle recommended
USA	required	required	life-cycle od data target

THE TFR KEPT FOR THE EMPLOYEE

Precautionary and retirement saving function

Accruing TFR	6,91% of gross salary
Return	a pre-defined income inflation linked (accrual rate: 1.5 + 75% of inflation) is guaranteed on the TFR set aside
Benefits	Lump – sum at termination of employment contract
Withdrawals *(for specific and proved needs)*	after 8 years of work in the same company; max. 70 % of TFR accrued ; only 1 withdrawal is allowed; max 10 % of entitled employees, and max 4% of total employees every year (better conditions could be set by collective bargaining)
Tax treatment	separate taxation (average rate of the last 5 years). Min 23% of the gross income revenue
Other	Public guaranteed fund in case of employer failure

THE TFR TO PENSION FUNDS (EMPLOYEE)

Retirement function

Return	the return depends on financial markets performance. It is not necessarily guaranteed
Benefits	Annuity or lump sum (max 50%) at retirement
Withdrawals *(for specific and proved needs)*	In general: after 8 years of participation; max. 75% of TFR accrued; more than 1 withdrawal is allowed; at any moment, up to a maximum of 75% of the individual account, for health expenses
Tax treatment	Benefits: from 15 to 9% (with 15 years of participation); Withdrawals: 15% for health expenditures, 23% in other cases. Employee contributions are tax-deductible
Other	Contribution from the employer (if applicable) Segregated assets

COMPENSATION TO COMPANIES

1 Tentative solution (2005)

1) Setting up of a public fund to guarantee companies that are not able to pay back the loans they borrow in order to divert the TFR to pension funds

2) Compensation measures:

   - Exemption from the payment of the contribution to the TFR Guarantee Fund

   - exemption from some social security taxes (family, maternity, unemployment)

COMPENSATION TO COMPANIES

Public guarantee fund (for loans)

- companies covered: all that are compliant with specific criteria (capital and economic requirements + not risk of failure)
- limited period for the guarantee: 5 years
- interest rate: euribor+ max 200 bp
- max duration of loans: 10 years
- loans according to a chronological criteria

Issues:

- Compliance with European regulation in relation to aid to companies
- The guarantee fund could be accounted as debt in national accounting
- Interest rate to high with respect the lack of risk for banks
- Large amount involved & private management of fund
- Definition of more effective criteria to select companies

COMPENSATION TO COMPANIES

2 Tentative solution (2006)

1) Setting up of the **FondoTesoreria**: companies have to pay to that Fund 50% of future TFR not diverted to pension funds

2) Compensation measures:

- **Exemption** from the payment of the contribution to the TFR Guarantee Fund in relation to TFR paid to **FondoTesoreria** and to pension funds;
- Increasing in **tax deductibility** for contributions paid to Pension funds and to FondoTesoreria;
- exemption from some social security taxes (family, maternity, unemployment).

COMPENSATION TO COMPANIES

Final solution adopeted with the anticipation of the reform (2006)

1) Setting up of the FondoTesoreria: companies, with at least 50 employees, have to pay to that Fund 100% of future TFR (not diverted to pension funds)

2) **Exemption of companies with less than 50 employees to mandatory pay future TFR to FondoTesoreria**

3) Compensation measures for contributions paid to Pension funds and FondoTesoreria

- Exemption from the payment of the contribution to the TFR Guarantee Fund
- Increasing in tax deductability (higher percentage for companies with less than 50 employee);
- exemption from some social security taxes (family, maternity, unemployment)

THE TFR IN THE COMPANY OR PAID TO PENSION FUNDS/FONDO TESORERIA (EMPLOYER)

	Tfr kept in the company	**Tfr to pension funds/**
Source of financing	The TFR is kept as book reserve until the end of the contract of employment TFR is an easy source of financing:	Loss of the main source of financing (also in the case of the payment of the TFR to the **Fondo Tesoreria (for companies with more than 50 employees))**
Other		Contribution to be paid according to collective agreement (if applicable) Increasing in tax deductability Exemption from the payment of the contribution to the TFR Guarantee Fund Exemption from some social security taxes

PENSION FUNDS

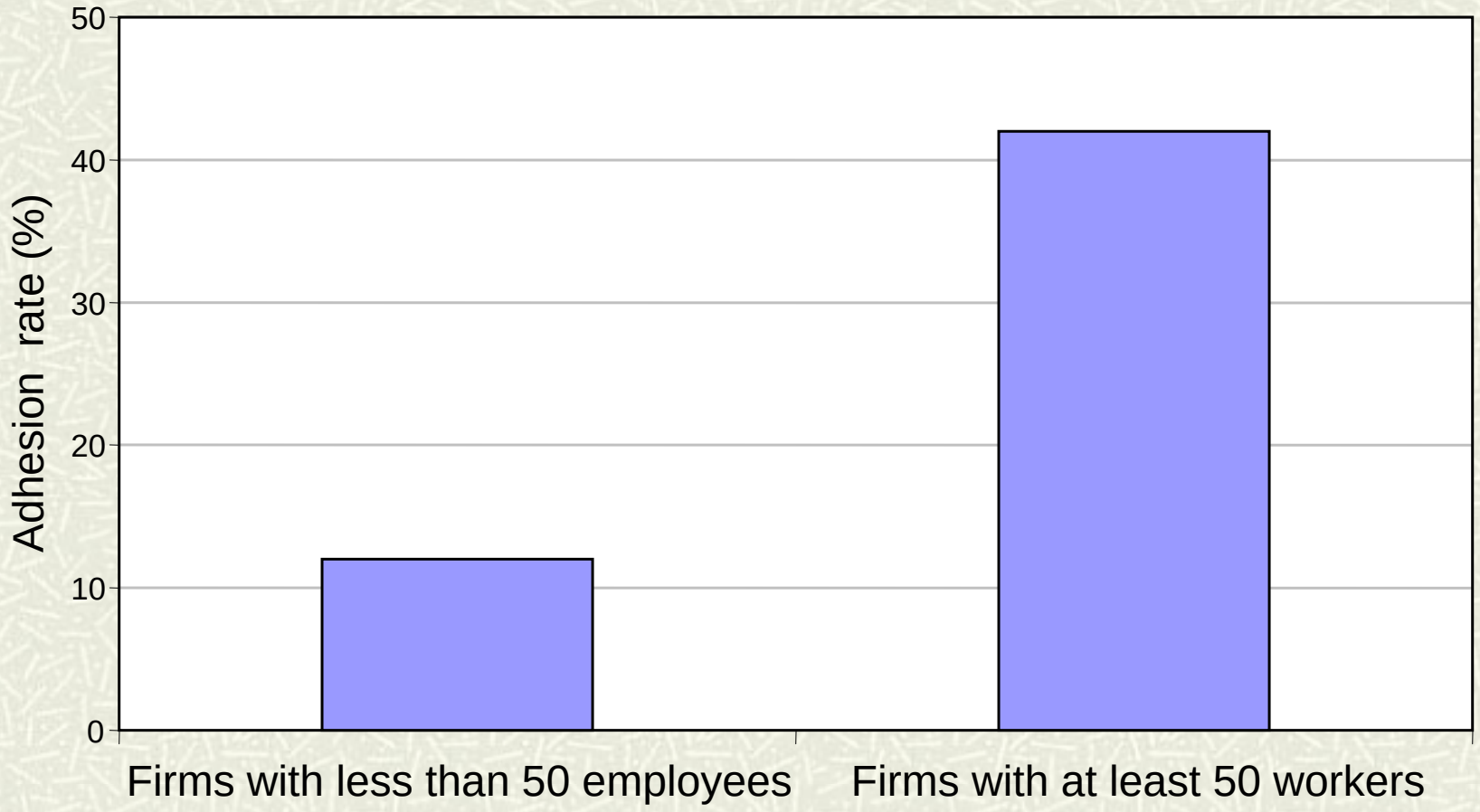
- Introduce a default option for silent members
- More competition between PF

STATE

- Increase of tax incentives for employees
- Compensation measures for companies
- Use of money accumulated with the Fondo Tesoreria for infrastructure expenditures
- Target of adhesion set by the government
- Information campaign

COVERAGE RATIO OF CONTRACTUAL PENSION FUNDS

Private employee workers adhesion (2007)



COVERAGE RATE OF CONTRACTUAL PENSION FUNDS

	Members		Coverage rate	
	2007	2006	2007	2006
Funds limited to the employees of a company or a group of companies	304.000	215.000	58,6%	43,34%
Industry wide sector pension funds	1.414.000	816.000	21,6%	12,5%
Territorial pension funds	115.000	60.000	-	-
TOTAL	**1.833.000**	**1.091.000**	**26,0%**	**15,5%**

FUTURE ISSUES TO FACE

- Results of automatic enrolment: coverage rate across firms of different size…
- New measures to increase the adhesion rate mainly within small companies
- Very conservative investment default option. Different design (e.g. life cycle)?
- The effects of the recent crisis on new adhesion
- Better design of fiscal incentives (for young workers)
- Major efforts devoted to information campaign and to financial education
- Further efforts to improve the portability of employer contribution
- Discussion around the possibility to opt –out
- Diffusion of a culture that fully accepts: an increased role of 2nd and 3rd pillar in the Italian pension system, with increased direct responsibility of workers at group and individual level

Information efforts are crucial for the good functioning of the reform, development of financial literacy and of pension planning skills in the public at large is a major concern