2nd pillar Pension Plan - Funding

Past – Present - Future

Context

The goals of this presentation are

Goal 1

Awareness of the changes on the Belgian pension scene that may affect
- The employer liability (underfunding)
- The retirement lump sum of the employee (purchasing power protection)

Goal 2

Suggest possible alternatives

Goal 3

Provide all information to be able to make the right decision regarding the funding of the 2nd pillar pension scheme for your employees

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Agenda

1	2004-2022: Evolution investment returns, returns insurers and pension funds, return to be guaranteed by the employer (WAP/LPC)
2	2022-2037: Estimate of future investment returns and guarantees
3	Branch 21-23 comparison and different forms of branch 23
4	Questions & Answers

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2004-2022: Evolution investment returns, returns insurers and pension funds, return to be guaranteed by the employer (WAP/LPC)

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Branch 21 Returns insurers decreased sharply but WAP/LPC interest rate remains at 1,75% since 2016

Law on complementary pensions (2004 WAP/LPC)

Article 24: legal obligation to provide a minimum interest rate on a DC plan by the employer

- Before 2004 no minimum guarantee to be provided by the employer
- As from 2004 a minimum return of 3,25% on employers' premiums and 3,75% on employee's premiums to be provided by the employer
- As from 1/1/2016 minimum return on all premiums: Variable with OLO 10 years, minimum **1,75%**

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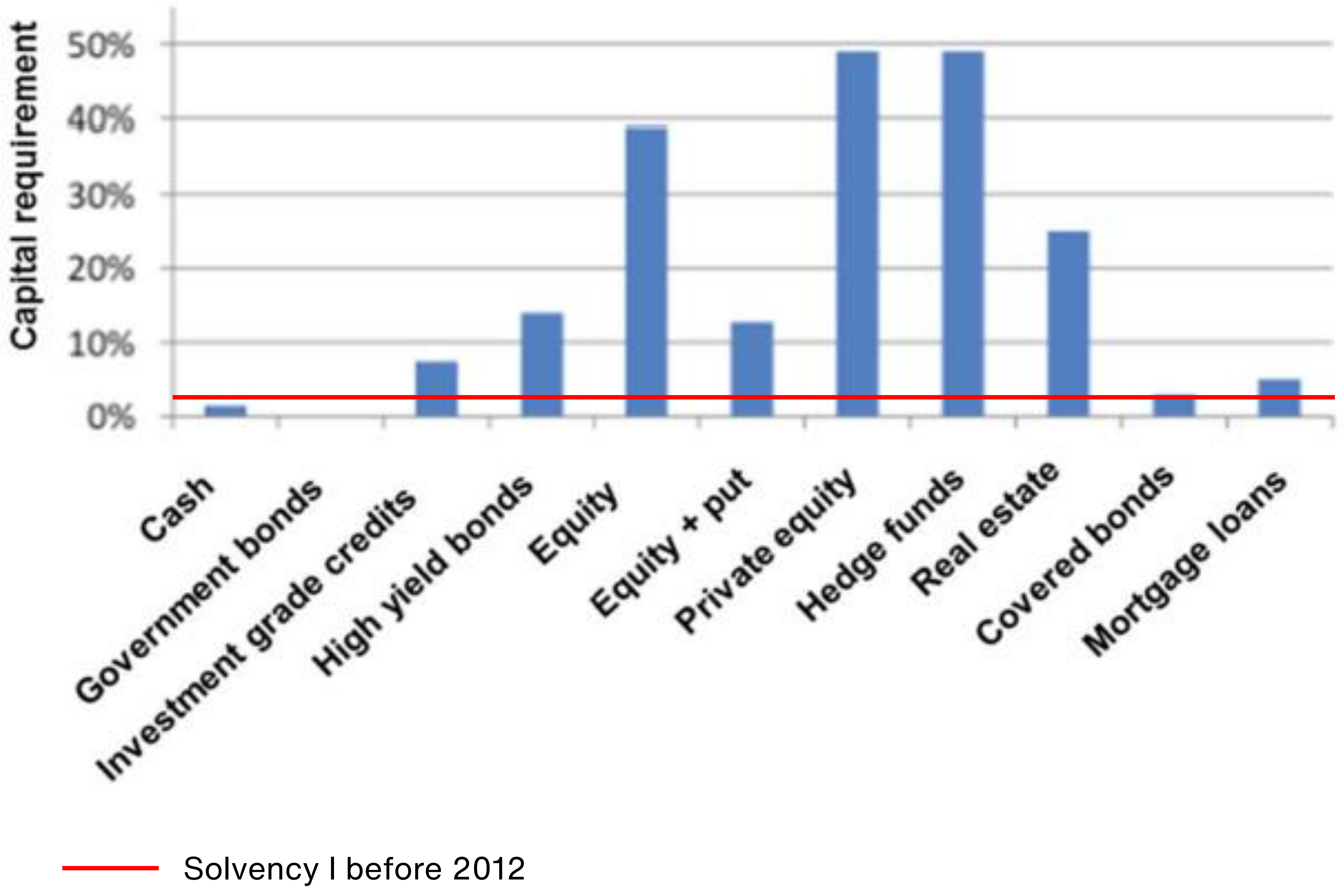
Low market interest rates (OLO) since the Financial crisis of 2008

WAP/LPC guarantee employer 1,75%

Average guaranteed return insurers, current 0%-0,25%

OLO 10 years on 6/2/2023 = 2,88%
OLO 15 years on 6/2/2023 = 3,10% (30 years 3,16%)

Solvency II Directive 2009-2016 effective as from 2016



(*) Solvency margin is the own capital that the insurer has to provide as buffer to meet its commitments (+/- 12% return on capital)

Solvency II Directive (2009/138/EG)
On January 17th, 2015, the European Commission published the Delegated Regulation Solvency II (Delegated Acts)
Applicable as from 1/1/2016

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Observations

- If an insurer in Branch 21 wants to invest in more risky investments with higher potential return, the capital requirements are much higher.
- Current main fund portfolio (Branch 21) mainly invested in (government) Bonds

Historical returns 2nd pillar

<u>Branch 21</u> average returns Belgian insurers (AXA, AG, Allianz, Vivium, Baloise, NN, Athora, Ethias)

	Premiums (with FG)	Premiums (without FG)
1 year (2022 – estimated)	1%	1,4%
1 year (2021)	1,07%	1,48%
3 years	1,19%	1,58%
5 years	1,28%	1,70%
10 years	2,00%	2,30%

PensioPlus OFP	
0,5 year (06/2022)	-12,99% (estimated end 2022 -15%)
3,5 years	3,93%
5,5 years	2,86%
10,5 years	5,20%

Current minimum guarantee by employer: 1,75% quid Branch 21

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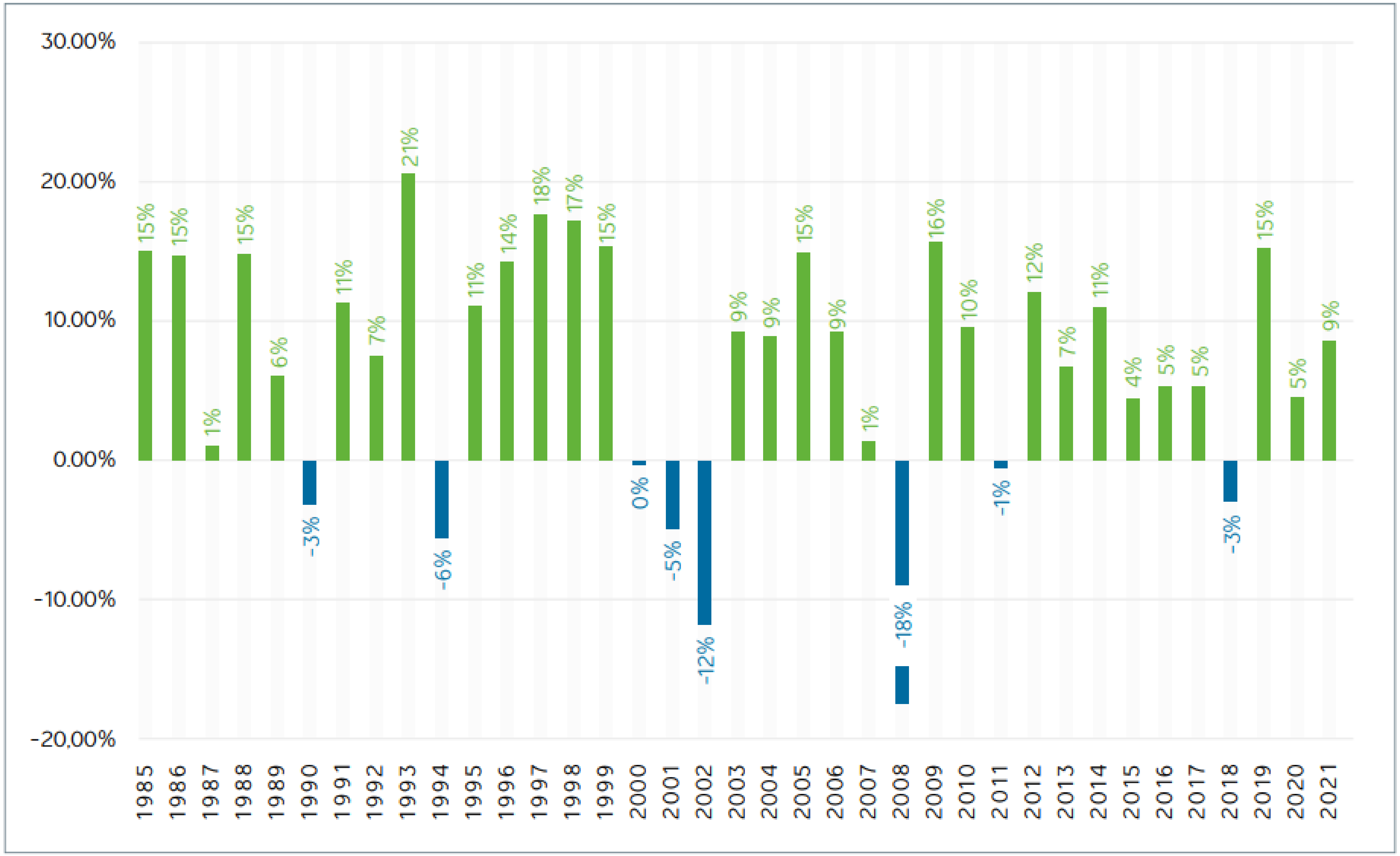
Pensioplus report 2022

Yearly average returns Belgian pension funds (1985-2022)



Observations

- Average annual return of > 6,22% over 37,5 years
- Only 9 negative years compared with 28 positive years (24%)
- Maximum drop down of 18% in 2008

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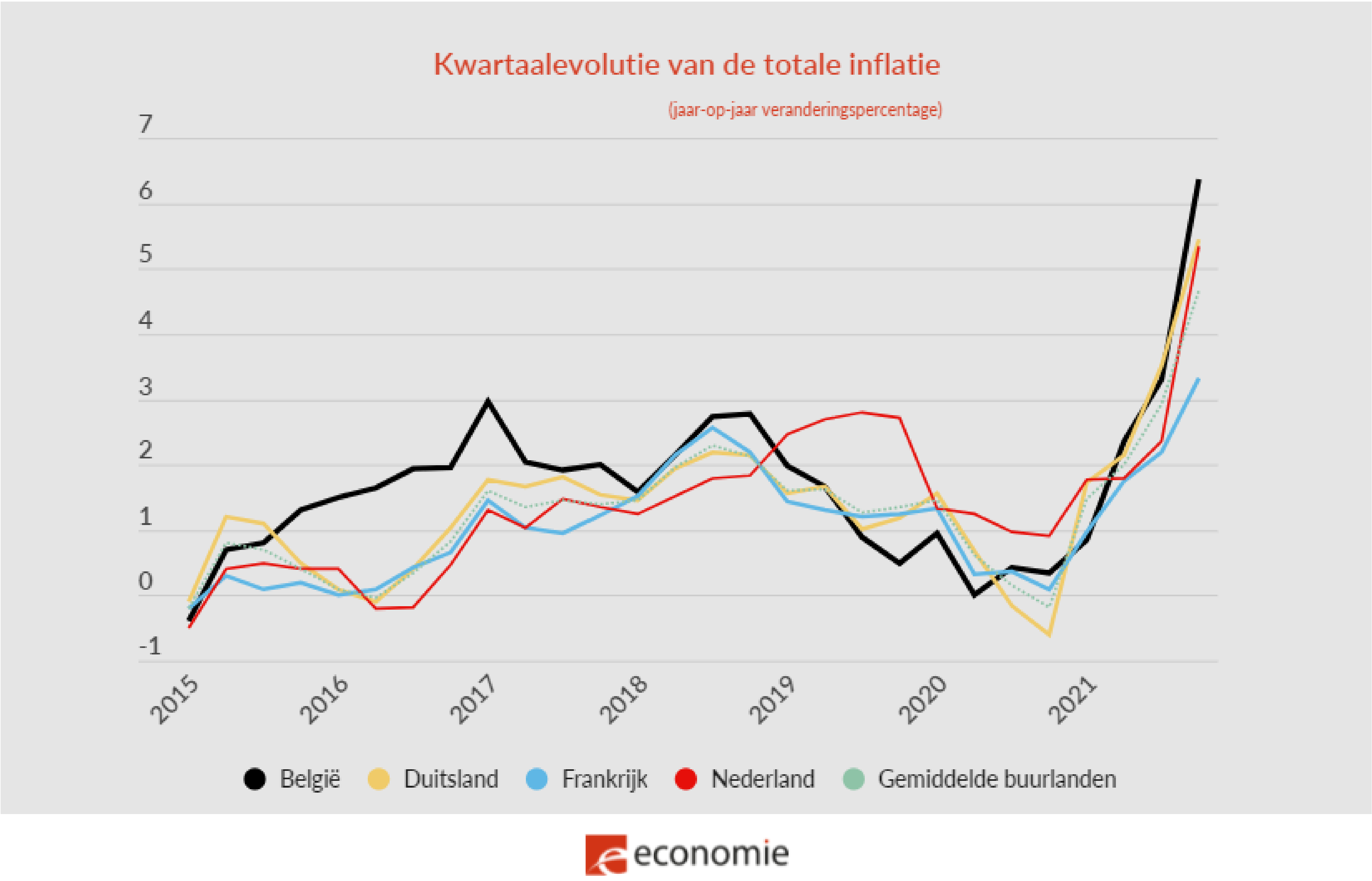
Inflation data

Average inflation over the past years	
2022	10,35%
2021	3,20%
2020	0,70%
2019	1,40%
2018	2,34%
2018-2022	3,6%



- In order to **maintain the purchasing power** of the retirement lump sum, companies need to achieve a higher return than the inflation (Quid Branch 21?)
- Future inflation
  - ECB wants price stability, i.e. inflation below, but **close to 2%**

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Estimate of future investments and guarantees

2022-2037

Future return expectations

Insurer XX	Expected higher return (horizon: 15 years)		
	0,10%	1,75% (*)	3,14%
Branch 21 (**)	100% (***)	20%	2%
Branch 23 (**) 50% FI / 50% EQ	86%	68%	50%

Insurer YY	Expected higher return (horizon: 15 years)		
	0,10%	1,75% (*)	3,14%
Branch 21 (**)	100% (***)	8%	0%
Branch 23 (**) 50% FI / 50% EQ	86%	68%	50%

(*) *1,75% to be guaranteed by EMPLOYER (WAP/LPC)*
(**) *Depending of the cost on assets (asset manager and insurer) and the simulations of the plan and existing portfolio*
(***) *Attention based on the actual guaranteed interest rate (? Negative returns) dd. 06/2022*

Observations

- Average return 50/50 asset allocation = 3,64% (Pension Fund), 3,14% (Group insurance)
- After 15 years
  - 86% probability to have a return > 0,01%
  - 68% probability to have a return > 1,75% (return to be guaranteed in DC by Employer)
  - 50% probability to have a return ≥ 3,14%

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Example: End lump sums with different returns

- Minimum return (WAP/LPC) of 1,75% to be borne by the employer
- Time horizon: 35 years
- Annual premium: 4.950 EUR

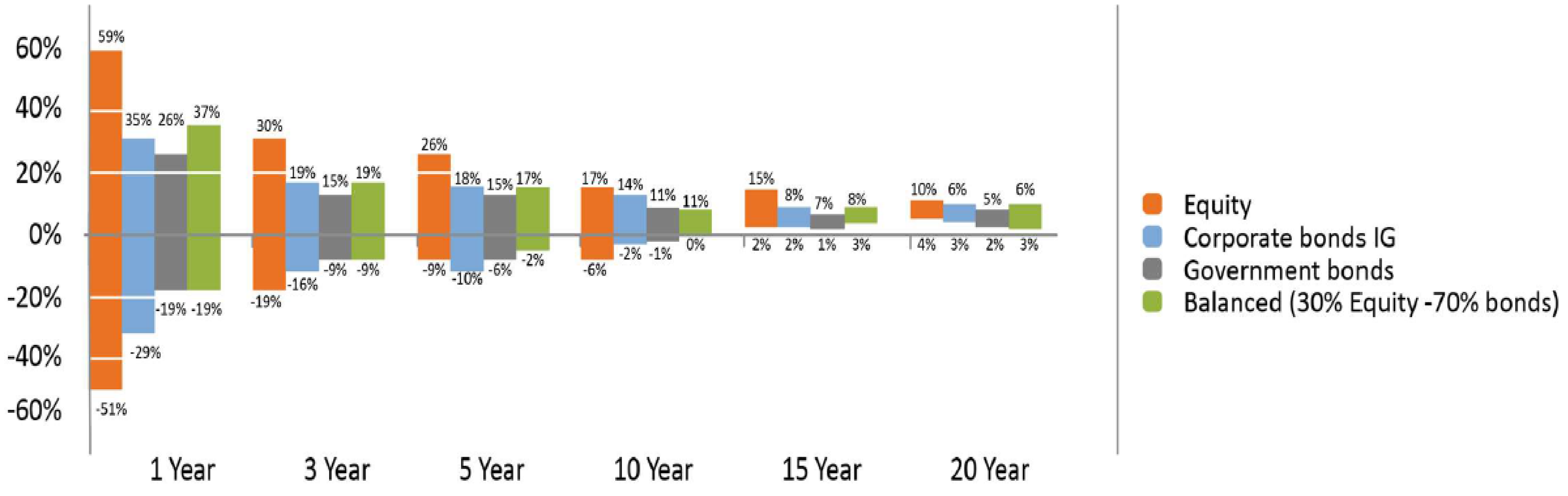
	Expected net return	End lump sum	% relative to LPC/WAP
Branch 21 guaranteed	0,01%	173.653 EUR	-27%
Branch 21 estimated	1,33%(*)	220.638 EUR	-7,6%
WAP/LPC guarantee	**1,75%**	**238.792 EUR**	**=**
Inflation objective	2%	250.613 EUR	+5%
Branch 23 50% FI / 50% EQ	3,14%	314.791 EUR	+32%
Historical return pension fund (**)	6,22%	619.322 EUR	+ 160%

(*) Based on Aon's market assumption model and actual asset mix average insurers
(**) Average Belgian pension fund return over the last 36 years
The employer pays the difference in case of underfunding
End lump sum at 0,01% equals 173.653 EUR (underfunding – 65.139 EUR = extra premium of 38%)
End lump sum at 1,33% equals 220.638 EUR (underfunding – 18.154 EUR = extra premium of 10%)

Volatility Branch 21, Branch 23 and Pension Fund

- Duration is key to lower the volatility

Range of real returns on major US assets for different time horizons



High short-term equity volatility is reduced largely by a long term approach

Source: Source: Amundi, Bloomberg. Analysis on monthly data from January 1973 to December 2018. Equity =S&P500, Corporate bonds IG = ICE BofAML US Corporate, Government bonds = ICE BofAML US Treasury &Agency, Balanced = 30% Equity + 35% Corporate IG + 35% Government bonds. Annualised real returns=annualised nominal returns less US CPI Inflation. **Past performance is no guarantee of future results.**

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Observations

- At short time volatility is much higher for equities vs. bonds
- At 20 years volatility of equities and bonds are similar
- Monthly investments lower the volatility

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Branch 21-23 comparison and different forms of branch 23

Difference Branch 21 – Branch 23

	Branch 21	Branch 23
Administration	• 100% insurer	• 100% insurer
Choice asset mix	• Black-box Main fund • No transparency	• Choice asset mix employer via investment funds • Transparent
Guarantee	• Yes	• No
Return	• Low	• Potentially high
Risk underfunding	• High	• Low
Maximum underfunding	• Limited	• Unlimited

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Possible funding solutions - Estimated return Branch 23 3%, Branch 21 0.75%

(*) Up to 1.75% return 100% employee, above 1.75% 20% in free reserve for employee and % for employee (% can be adjusted)

(**) 1.75% can be chosen freely, can also be a variable return. Attention deferred same return.

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Questions & Answers

Contacts

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