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Italian pension schemes eye emerging markets

A new law could relax investment restrictions on Italian pension funds, paving the way for a slew of emerging market and alternative asset class mandates.

Italian pension schemes may consider investing in emerging markets, private equity, real estate and commodities once a ministerial law currently being drafted by the Italian Ministry of Finance and the pension fund regulator Covip comes into force.

The new bill is aimed at replacing ministerial law 703, which currently regulates pension fund investments and which many industry practitioners consider obsolete, although effective.

Introduced in 1996, the 703 ministerial law compels pension funds to use a benchmark and fixed quantitative limits in terms of exposure to property, pooled funds and investments outside OECD countries. Thanks to its highly conservative approach, the law allowed Italian pension schemes to limit their losses during the financial crisis. Many people in the industry hope this focus on prudence will remain in the new bill, while wishing for fewer restrictions in terms of asset classes.

“We expect that the system will be simplified and that there will be more freedom in the way we can invest,” Flavio Casetti, secretary of Assofondipensione, the Italian pension fund association, told MandateWire. “On the other hand, we don’t want a total liberalisation. I wouldn’t like pension funds to be allowed to invest 100 per cent in emerging market equities,” he added.

Many pension funds hope that in the future they will be able to invest in emerging market securities, considered the best way to diversify their portfolios at a time when western economies are hampered by low growth and the sovereign debt crisis.

“We definitely have an interest in emerging markets, especially Asian markets,” Simona Farrotti, Investment Officer at the €5.8bn (GBP5.04bn) Previndai told MandateWire.

Her view is shared by Andrea Nanni, advisor at Prometeia Advisor, who considers that “Italian pension schemes must have the possibility to invest in emerging market economies, even though according to quantitative limits.”

Davide Cipparrone, CEO at MangustaRisk, reckons that Italian pension funds are not looking at emerging market only for equities but also for government and corporate bonds.

Nevertheless, Italian pension schemes seem also to be looking at alternative asset classes. Raffaele Bruni, Partner at Bruni, Marino & C., considers his clients are “very interested in the possibility of investing in alternatives, especially in private equity.” According to Mr Bruni, pension funds, regardless of size, are very keen on investing in venture capital vehicles because of the benefits they might bring to the country.

Mr Cipparrone also thinks private equity will be one of the next big topics in Italy, although he reckons the country lacks good private equity funds.

“Italian pension funds look with interest at private equity, especially considering the problems that our companies are facing because of the crisis,” he told MandateWire. “They would prefer to invest in Italian private equity and would be reluctant to fund the infrastructure of other countries while we still struggle to recover. The real problem is the lack of good private equity funds in Italy,” he concluded.

Pension funds have also shown an unwillingness to invest in assets such as commodities, private equity and infrastructure, which although not expressively forbidden, have appeared to be frowned upon by Covip. The expectation is that the regulator will clearly state these kind of investments are not forbidden, so that pension funds can consider these asset classes without fear of being censored.

Although the review is seen positively by the pensions industry, not everybody is sure of its outcomes. Covip recently prepared the draft of a white paper on pension fund investments currently in circulation among pension funds. The paper, if approved in its current form, will force pension funds with more than 1,000 members to write an equivalent of the statement of investment principles and a report that describes the internal control instruments.

According to Davide Cipparrone, this will lead to a more formal control by the regulator and will hand more responsibilities to pension funds’ trustees.

“Board of directors are often formed by teachers, chemistries, factory workers and other categories of workers that are not necessarily experts in finance. This means that they always relied on what the investment consultant said, but always without taking too much risk and without the will of investing in internal governance,” Mr Cipparrone said. “It will take a long time before Italian trustees will have the necessary understanding for investing in sophisticated financial products and improve the governance structure. This might take years.”