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Italian Pension Funds Set for Greater Diversification

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Many Italian pension funds will be able to invest in a much wider range of assets for the first time, including emerging markets and alternative assets, under regulations currently being finalised in Italy.

Key points:

- **Italian complementary pension funds created since 1993 have operated under investment rules that have restricted them to listed equities and bonds in the major developed markets. Under a new law, they will be able to invest in emerging markets and alternative assets for the first time.**
- **Rather than setting limits on where pension funds can invest, the new regulations are expected to give risk-based principles on investing. The details have yet to be finalized, but it is expected pension funds will need better risk monitoring systems to take advantage of the new rules.**

According to Andrea Canavesio, partner at Italian investment advisory firm MangustaRisk, a 16 year restriction on the investment freedom of many Italian pension funds could soon end, giving funds the opportunity to invest in emerging markets, private equity, real estate and high yield debt for the first time. "There is a lot of speculation on how the new regulations will come out, as the final draft is not ready yet, but the Ministry of Labor and Covip, the Italian pensions regulator, are talking to advisers, pension funds and asset managers about how the new system will work", he said.

> *Under current rules, many Italian pension funds can only invest in listed stocks and bonds in OECD countries, but this looks set to change*

Canavesio said the old law, which was implemented in 1996, set rigid limits on where and how pension funds set up since 1993 could invest. "It meant that fund could not have more than 10 percent of a portfolio in a single stock or bond, not more than 20 percent of total investments in a mutual fund and you could not invest in companies listed outside the OECD. That excluded all of the BRIC countries and most other emerging markets, apart from some countries such as Turkey and South Africa".

Now these restrictions are set to be overturned, opening up a new era of investment for many Italian pension funds. Canavesio said the change would apply to funds with total assets of €40 billion, which have been set up as complementary pension funds since 1993 in an effort to tackle Italy's ageing demographics. Another €30-€40 billion is estimated to be in pension funds predating the 1993 regime and another €50 billion is in industry wide pension funds set up for professionals.

One expected result from the greater investment freedom is increased competition for pension fund assets from banks and other institutions with expertise in emerging market investing. "The unions opposed the changes, because they felt that the pension funds would be under pressure to invest in new asset classes even though they are not as prepared as should be and that is understandable. But I think that the pension funds have managed their investments very well. They have been through two major crises and there were no defaults and no collapses. There were some losses of course but nothing major", Canavesio commented.

The experience that pension funds have gained in managing their assets is seen as one reason for the changes. Greater diversification is also seen a good thing. Explaining why the new rules are expected to principles-based, Canavesio said: "Setting limits on each asset class would not work; you end up trying to follow a market that is always ahead of you. The idea is to have information, such as value at risk, concentration ratios and volatility, that helps investors evaluate how much risk they are taking in each asset class. But if pension funds are not ready for this, they can still use the old rules; but they cannot mix and match between the two".

He said the new regulations are expected to raise demand for risk management systems and software among pension funds. "Sixteen years ago knowledge of financial markets among the pension funds was not that great, but the market is now ready for this and Covip has more resources to control what pension funds are doing". Canavesio gave the example of Fondo Cometa, the steel workers pension funds with 500,000 members and €6 billion in assets, which mainly invested in Italian government bonds and large cap European equities. It then moved into large cap global equities and European government bonds, then world government bonds. "It has now moved into corporate bonds and the next moves will be into real estate, private equity and commodities".

Editor's comment: If you are an Italian investor, what is your view on the prospect of greater investment freedom? Are you keen to invest in new assets, such as emerging markets or alternative assets? And how do you expect the risk-based regulations on investing to work in practice? Please add your comments below or email me at mcraig@iilondon.com.