Italian reform

Andrea Canavesio provides an overview of the changes occurring in the Italian pension market

MangustaRisk is an Anglo-Italian risk management firm with €55 billion of assets under advice. Around €43 billion come from pension funds and roughly €38 billion are from Italian pension funds.

As the total pension fund market in Italy is around €140 billion, we cover around 30 per cent of it directly. This makes us the largest risk management firm in Italy and we therefore have very good observation of the market.

The pension funds created after the Italian 1993 law, which introduced the private second pillar, manage around €40 billion. They are all voluntary, second pillar DC schemes and are regulated and controlled by the Covip (the regulatory body for Italian pension funds). They are 100 per cent concentrated in listed world equities and euro bonds (due to rigid regulation), with bonds being around 80 per cent of global assets under management.

The funds created before 1993 are usually very old funds, mainly created at the beginning of the 1900s or shortly after World War II. They are second pillar schemes and manage around €50 billion. They mix both DB and DC schemes and are invested in most asset classes.

The first pillar professional bodies' funds (the Casse) are mostly DB and manage around €50 billion. They are still growing in assets but face an aging population problem and might turn to DC systems. They have been historically biased towards Italian real estate and bonds, leaving little to equities (well below 10 per cent!).

Due to their different backgrounds, all three types of funds have different regulations on investments and different regulators although from May 2012 all post and ante 1993 pension funds will fall under the same regulation and from January 2012 the Casse is also under the control of Covip.

Investment performance

A recent study performed by MangustaRisk showed that the new Italian pension funds have been the best investment any Italian has made in the past 10 years. They have out-performed most international and national peers thanks to asset allocations biased towards liquidity and bonds leaving much less than 20 per cent of their portfolio to equities (the underperforming class of the decade). Only emerging market, German and US treasuries euro hedged would have performed better.

There are three reasons for this good performance:

1) Liquid and unbiased asset allocations towards equity,
2) Lack of short-termism and focus on low turnovers;
3) Management of costs.

But risks have been too high due to very concentrated portfolios into Italian bonds and developed equity.

Where to improve

Better monitoring of strategic asset allocation (SAA) and of risk measures.

Even though it is good practice not to change the SAA frequently, today most pension funds only look at it once every five years and this is clearly wrong.

Better diversification of SAA.

The concentration on euro bonds and world equity is obviously a risk that has to be dealt with. Some forward-looking pension funds such as Cometa or Fondenergia have started looking into real estate, private equity and commodities but the market is still too 'shy'.

More efficient management of costs.

Today the only strategy on costs is that they have to be low, as funds have almost 100 per cent in passive or semi-passive mandates. When new asset classes are invested the costs will rise but this should not be a reason to fly away from these new diversifying investments. There should also be more investment in the human and technological structure of the funds.

Better regulation.

Current regulation is old and has been widely criticised. It is now undergoing a total change, shifting from percentage based limits on classes to risk objectives on portfolios.

Retirement funds in Italy have largely been well managed and performing well. With the new regulation coming for all form of private pension systems they have the chance to become a model for Europe, but this shift will be challenging and the transition will have to be 'handled with care'.

WRITTEN BY MANGUSTARISK
DIRECTOR ANDREA CANAVESIO