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Retirement: understanding how much, when, how

The three pillars, the replacement rate, the weight of time and costs, and the documents to read before deciding.

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IN THIS GUIDE

Retirement is the financial subject on which time weighs most, and also the one people tend to put off. This guide explains how a pension system is built and which information to look for. Rules differ from country to country and change over time: for the figures and rules in force, official sources always prevail.

01 Three pillars

02 How much the pension will be: the replacement rate

03 The weight of time

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05 Where to begin

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01

CHAPTER 1

Three pillars

State, workplace, personal: three sources of income for the same stage of life.

In many countries the pension system is described with the image of three pillars. The first is the compulsory state pension: contributions paid during working life give entitlement to a pension calculated according to the law.

The second pillar is collective supplementary provision linked to employment: workplace or occupational schemes set up by employers or by collective agreements. The third is individual supplementary provision, which anyone can join by personal choice.

Pillar	Who funds it	Membership	What it is for
First: state	Compulsory contributions from workers and employers	Compulsory	The basic pension
Second: workplace	The worker, often with an employer contribution	Voluntary or automatic enrolment, depending on the country	Topping up the state pension
Third: personal	The individual	Voluntary	Topping up further, independently

THE FIRST THING TO CHECK

For employees, joining the workplace scheme often brings an employer contribution that is otherwise lost. It is the first piece of information to ask your employer for.

02

CHAPTER 2

How much the pension will be: the replacement rate

The ratio between your first pension and your last salary.

The replacement rate says how much of your income from work will be replaced by your pension. With a rate of 60%, someone earning 2,000 a month will receive about 1,200. The difference is the gap to be filled from other sources if you want to keep the same standard of living.

In several countries, population ageing and the reforms of recent decades lead to estimates of lower future replacement rates than those of previous generations, especially for people with interrupted careers or irregular incomes. It is not a certain forecast: it depends on your career, retirement age and the rules that will be in force.

Where to find your own estimate

In many countries the public pension body offers a forecast service which, starting from contributions already paid and some assumptions about the future, calculates an estimate of your pension. It is the starting point of any reasoning: without this number, the discussion is about impressions.

> **AN ESTIMATE, NOT A PROMISE**
>
> Forecasts rest on assumptions (income growth, continuous employment, the economy, unchanged rules). It is worth repeating them every two or three years and whenever your working situation changes significantly.

03

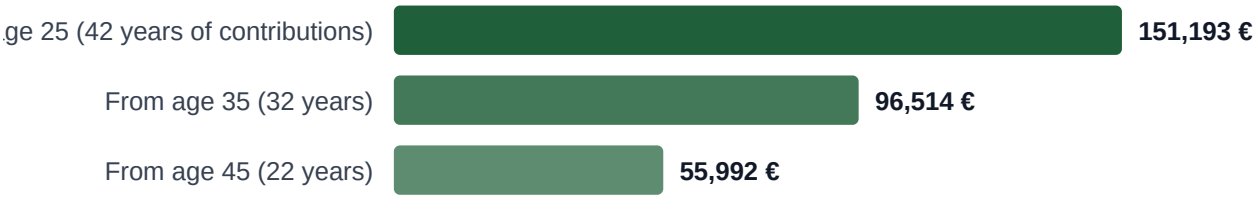
CHAPTER 3

The weight of time

Starting ten years earlier counts for more than paying in much more later.

In a plan lasting decades, time is the variable that weighs most, because returns earned generate returns in turn. A hypothetical example shows it clearly: the same amount paid in every month, starting at three different ages, until age 67.

Hypothetical example: 150 euros a month until age 67, constant net return of 3%



Total paid in: 75,600, 57,600 and 39,600 euros. Constant return only to show the mechanism: real returns vary and can be negative.

Someone starting at 25 pays in 75,600 euros in total; someone starting at 45 pays in 39,600. The first person's contributions are less than double the second's, yet in the example their final result is about 2.7 times larger: time makes the difference. This is a constant-return calculation, which does not exist in reality; it shows the mechanism, it does not forecast a result.

And inflation: purchasing power of 10,000 euros with prices rising 2% a year



Assumes constant inflation. Over long horizons, figures should always be read in terms of purchasing power.

04

CHAPTER 4

Investment options, costs, restrictions

Three things to understand before joining a supplementary scheme.

The investment option

Every pension scheme offers several options with different levels of risk: guaranteed, bond, balanced, equity. The choice depends mainly on how many years remain before retirement. With a long horizon, fluctuations have more time to be absorbed; closer to retirement, stability matters more. Many schemes offer paths that reduce risk automatically with age.

Costs

On an investment lasting thirty or forty years, a one percentage point difference in annual costs can translate into a very large difference in the final pot. Supervisory authorities and public services publish cost indicators and comparison tools: using them takes a few minutes.

Restrictions

Supplementary pensions generally enjoy tax advantages, within limits set by law. In return the money is meant for retirement: before then it can be withdrawn only in the cases provided for, with limits and conditions. It is not a tool for short-term goals, and it does not replace the emergency reserve.

What	Where to find it	What to look at
Features and costs of each option	The scheme's information document	Cost indicator by length of membership
Past results	Information document	Several years, and the comparison with the benchmark, knowing they do not tell the future
Your own position	Annual statement sent to members	Amount paid in, amount accrued, estimate of the supplementary pension

05

CHAPTER 5

Where to begin

Five steps, none of which requires signing anything.

1. Ask the public pension body for your state pension forecast.
2. Work out the gap from the income you would like to have: that is your target.
3. Find out about the workplace scheme available to you and any employer contribution.
4. Compare the costs of the schemes you could join, using the tools provided by your country's authority.
5. Read the information document of the scheme you are interested in and, for a personal assessment, talk to an authorised adviser.

- [ ] I know my state pension forecast
- [ ] I know which workplace scheme I can join and whether there is an employer contribution
- [ ] I have compared the costs of at least two schemes
- [ ] I know in which cases I could withdraw the money early
- [ ] I have an emergency reserve separate from my pension

> *With pensions, the most expensive decision is usually not finding out.*

TO CONTINUE

All courses, the glossary and the calculators are freely available at getinfofree.co, with no registration.

Institutional sources for further reading

- Financial Conduct Authority (UK) — Consumers — https://www.fca.org.uk/consumers
- ESMA — Investor Corner — https://www.esma.europa.eu/investor-corner
- European Central Bank — Explainers — https://www.ecb.europa.eu/ecb-and-you/explainers/html/index.en.html

Sources consulted for this guide

- ESMA — Investor Corner — https://www.esma.europa.eu/investor-corner
- COVIP — «Guida introduttiva alla previdenza complementare» — https://www.covip.it/per-il-cittadino/educazione-previdenziale/guida-introduttiva-alla-previdenza-complementare

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