

Building funded pension systems



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Private Pensions Day 2009

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About EFRP



- 28 national associations
 - 15 EU MS: (AT, BE, DE, ES, FI, FR, HU, IE, IT, NL, PT, RO, SK, SE, UK)
 - 5 non-EU MS: (CH, HR, NO, Iceland, Guernsey)
- CEEC Forum
 - 9 countries (BG, CZ, EE, HU, HR, LT, LV, SK, RO)

Key messages

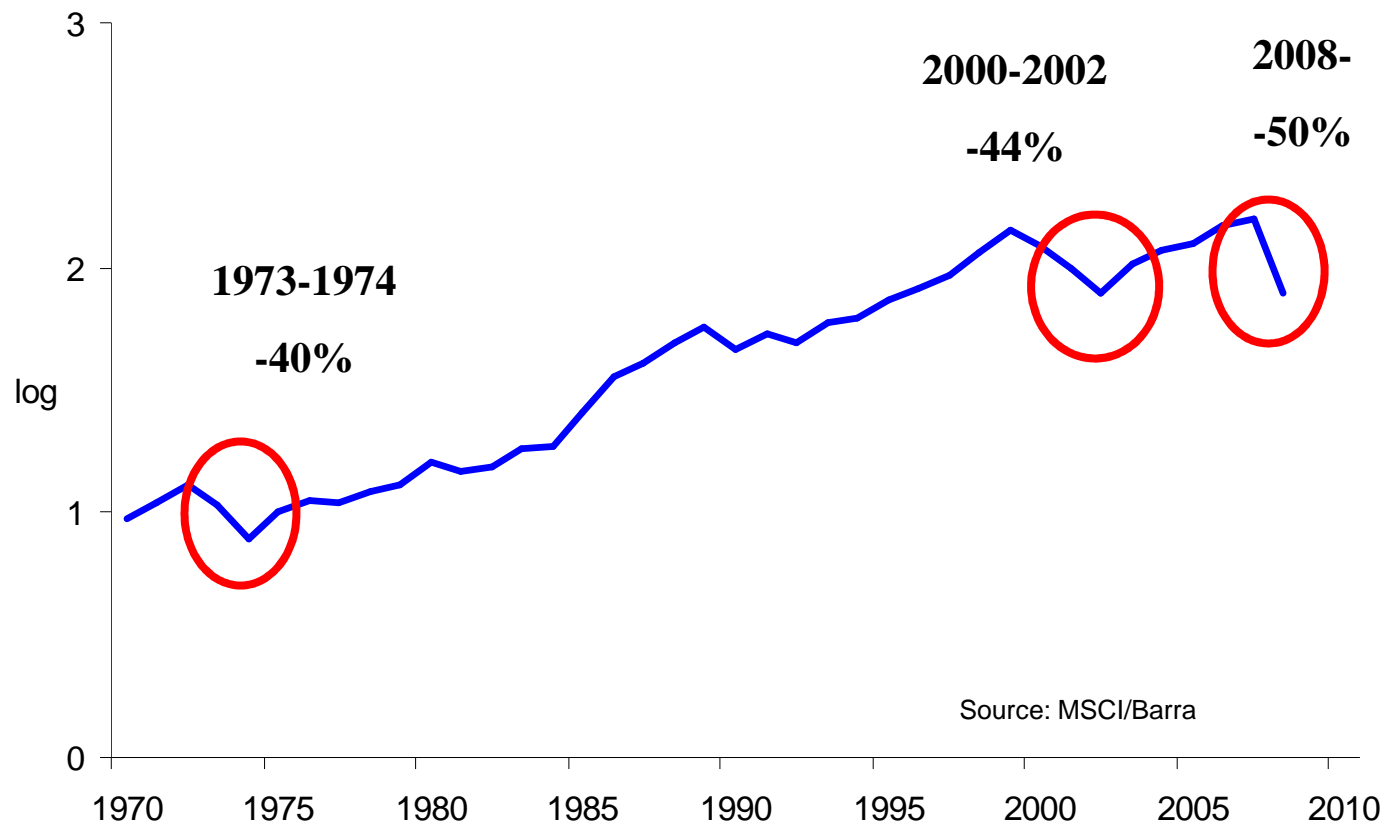


- Impact of financial and economic crisis on pension institutions was milder than on other type of financial institutions
- Development of multi-pillar pension systems is a prerequisite to deliver sustainable pensions
- There is an important role for funded pensions organised through the workplace
- Pension systems are about the long term and need stability

This time is not really different



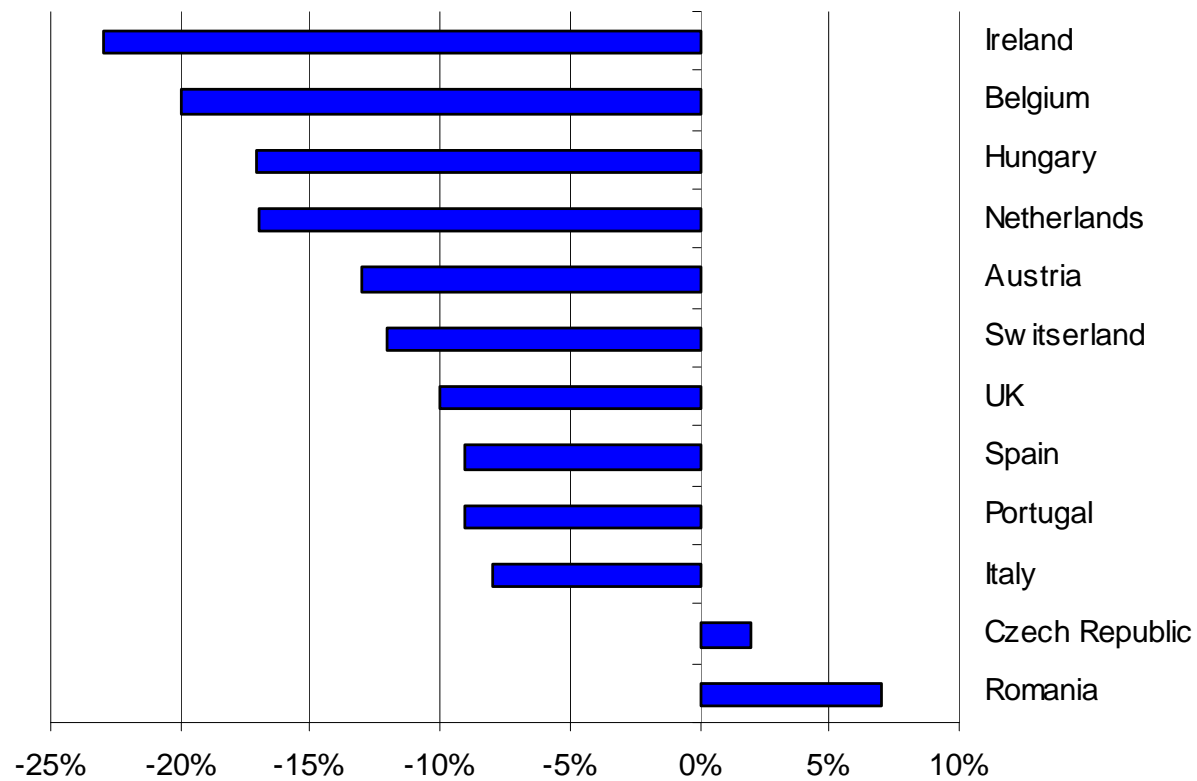
MSCI World Price Index (US\$), 1970 – November 2008



Pension fund performance in 2008



Investment returns/fall in assets 2008



Source: EFRP

Financial & Economic turmoil (1)



- no liquidity problems: pensions continue to be paid out
 - deterioration of the financial position of **DB schemes** due to:
 - falling equity markets
 - low interest rate environment
- BUT recovery can be achieved by:
- pension cut collectively shared
 - sponsor contribution
 - recovery plans
 - financial market upturn

Financial & Economic turmoil (2)



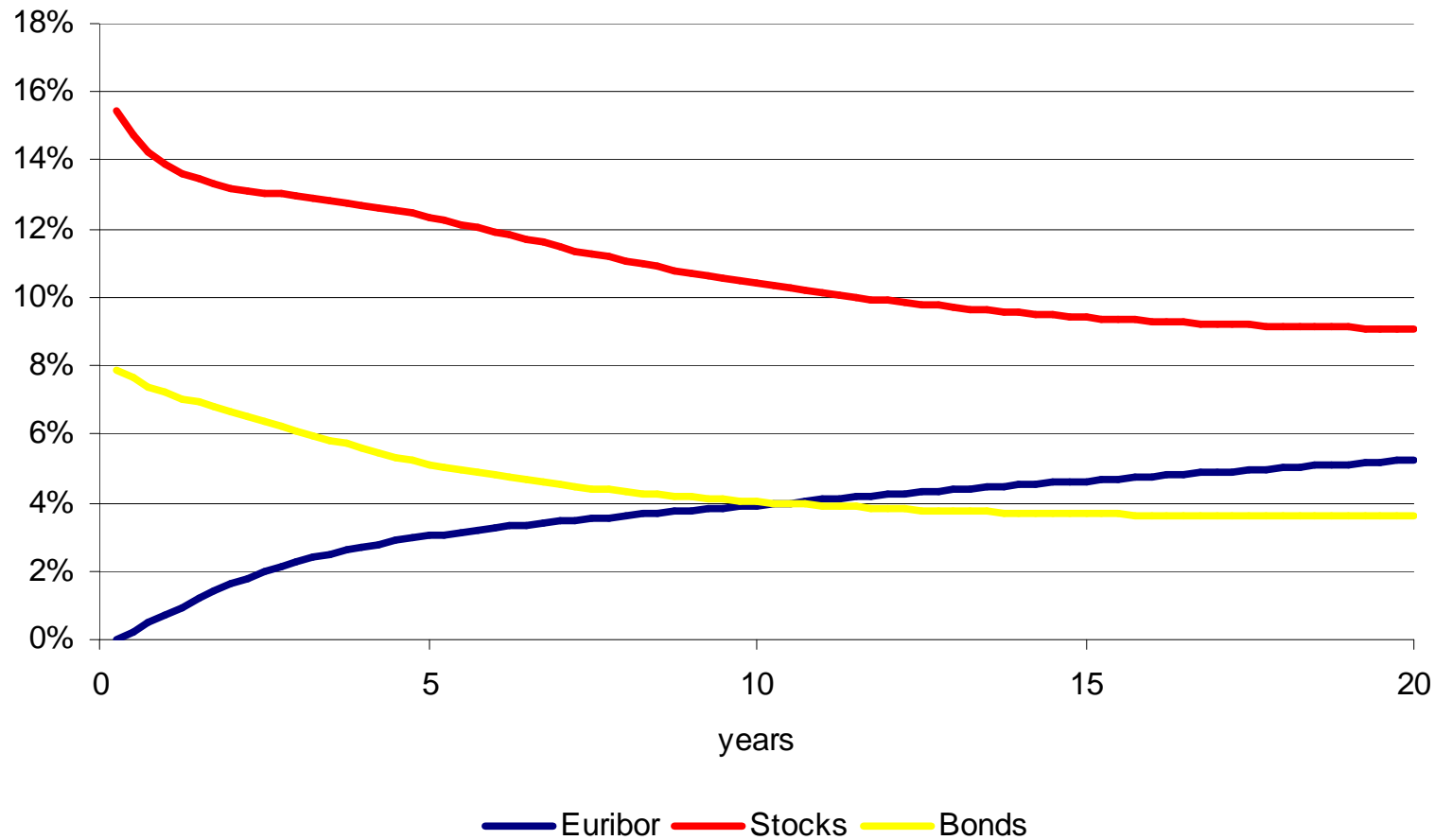
- **DC schemes** face different risks: employees
 - *far away from retirement*: business as usual
 - *close to retirement*: adverse annuitisation of severely downsized pension savings pot
 - *just after retirement*: devaluation of assets portfolio if paid out as a lump sum
- BUT improvement can be achieved by
- lifecycle funds (90% in the UK)
 - collective DC (NL)
- and
- financial market upturn
 - Deferral of annuitisation

Financial & economic turmoil (3)

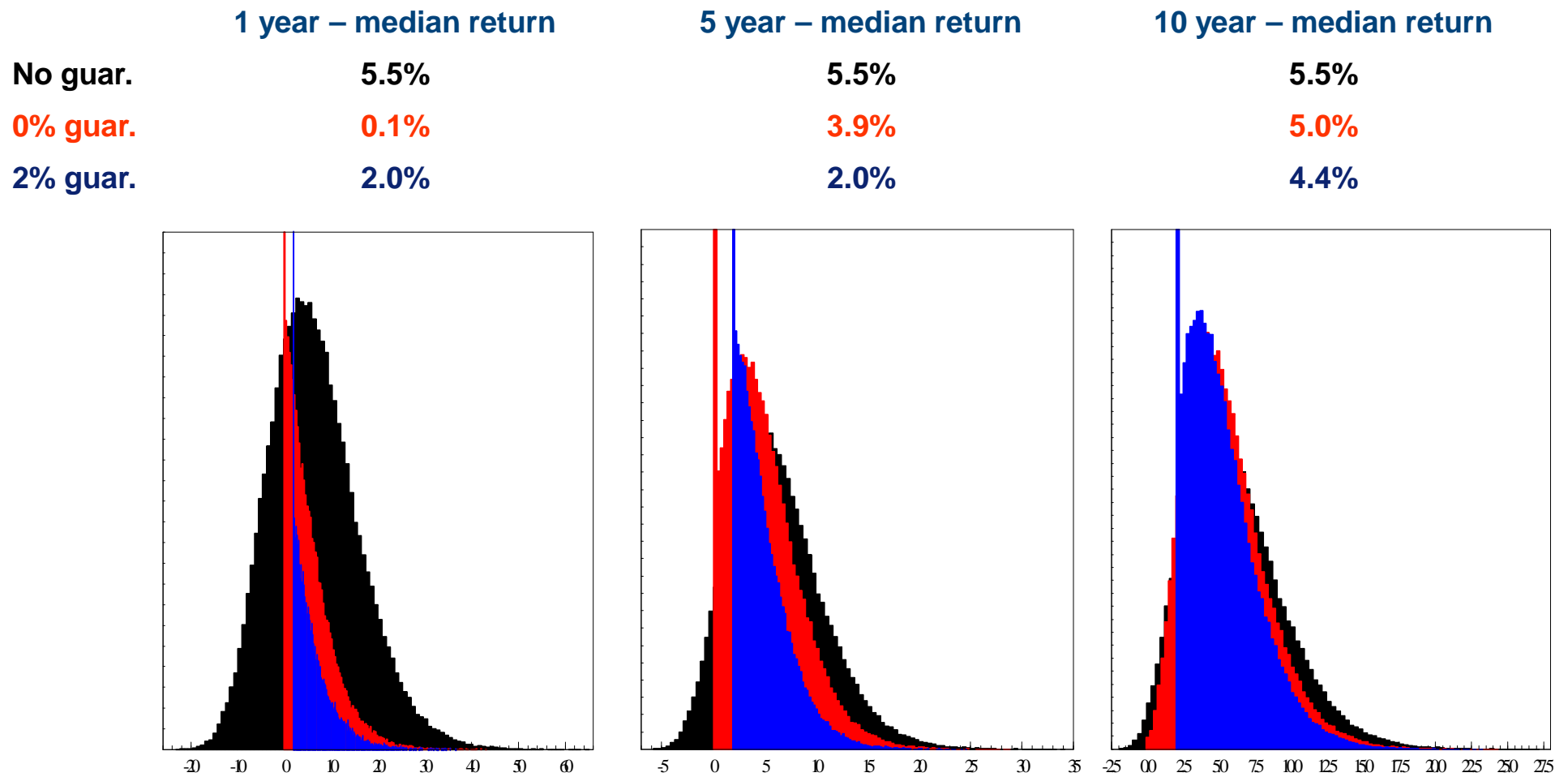


- Financial and economic crisis:
 - is illustrative for paramount need of **a supportive**
 - **macro-economic**
 - **regulatory**
 - **supervisory**
 - environment fostering the development of funded private pensions
 - has reminded us the fundamentals of funded pension systems

Equity risk declines with investment horizon



Guarantees



Fundamentals of funded pension provision (1)



- **Essential external requirements**
 - Sound macro-economic environment with steady growth
 - Stable financial markets with correct pricing of assets
- **Long term perspective of pension systems**
 - Stable and regular inflow of contributions as early as possible in career
 - Adequate supervisory mechanism
 - Sound governance structures
 - Financial education of members / citizens
 - Legislative stability

Fundamentals of funded pension provision (2)



- **Stable and regular inflow of contributions**
 - 1 % additional contribution during 40-year pension savings = 30 % higher pension
 - Instability of contributions is detrimental for building a pension
- **Adequate supervisory mechanisms**
 - IORP Dir. = EU supervisory standard for private and funded pensions
 - CEEC region: regulatory and supervisory regime inspired by international principles coming from EU, OECD, IOPS
 - Prudential regime framed to statistical 99,5% or even 100% certainty level does not translate into 100% certainty in reality and in a crisis situation

Fundamentals of funded pension provision (3)



- **Private institutions with sound governance structures**
 - Invest contributions in the best interest of scheme members and beneficiaries
 - No system is free of costs
- **Financial education of citizens**
 - To understand economics of long-term savings and dynamics of financial markets
 - 3% haircut a year if individuals are left to their own devices
 - 3% haircut a year implies half pensions or double contributions

Fundamentals of funded pension provision (4)



- **Legislative stability**
 - Crucial for all pension systems
 - Financial crisis does not provide license to **scale back pension reform**
 - EFRP is concerned about issues in the CEE region:
 - Freezing contributions
 - Re-opening 2nd pillar
 - Returning to single pillar PAYG pension is no valid alternative

A three pillar model



- EU is in need of a balanced three-pillar pension model
 - PAYG State
 - Private system accessed through paid work
 - Mandatory or voluntary – competence of MS
 - Main policy objective: “to ensure that citizens save for retirement” = diversification of retirement income
 - Private systems for individual retirement savings

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