

# Building funded pension systems

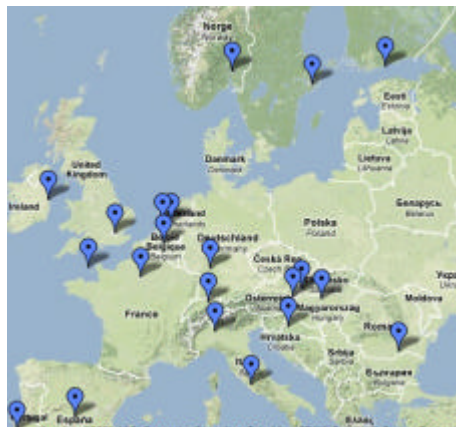


**Jaap MAASSEN, Vice Chairman EFRP**

Private Pensions Day 2009

27 May 2009, Sinaia

## 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)

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## Key messages



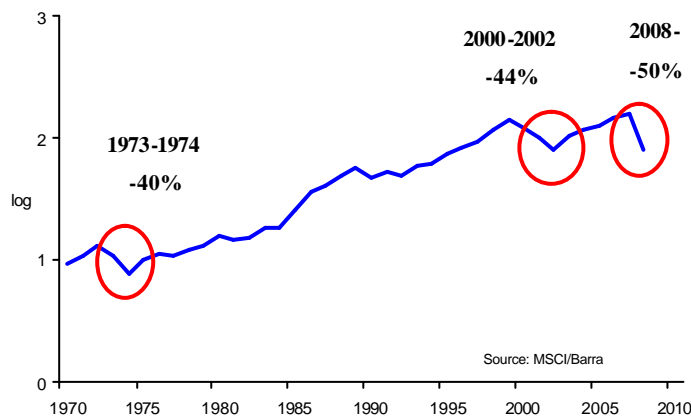
- Impact of financial and economic crisis on pension institutions was milder than on other type of financial institutions
- Development of multi-pillar pension systems is a prerequisite to deliver sustainable pensions
- There is an important role for funded pensions organised through the workplace
-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

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## This time is not really different



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

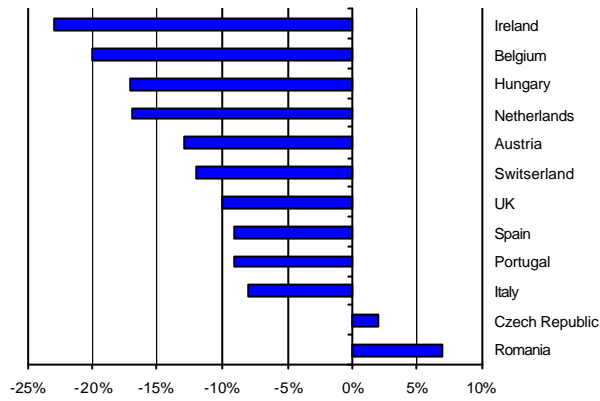


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## Pension fund performance in 2008



### Investment returns/fall in assets 2008



Source: EFRP

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## 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

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## 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

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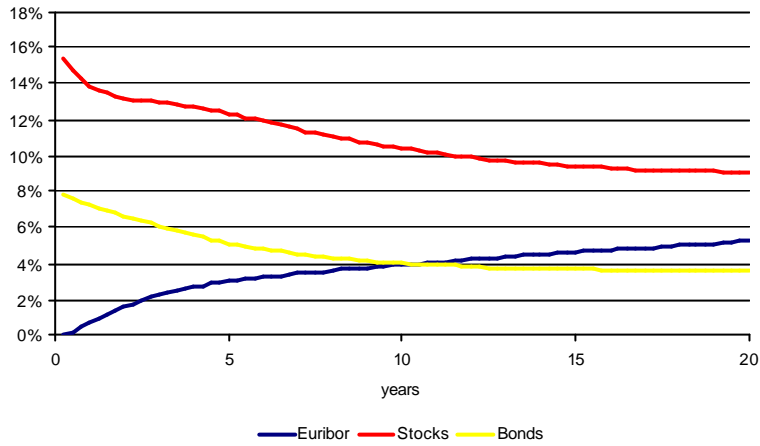
## Financial & economic turmoil (3)



- 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

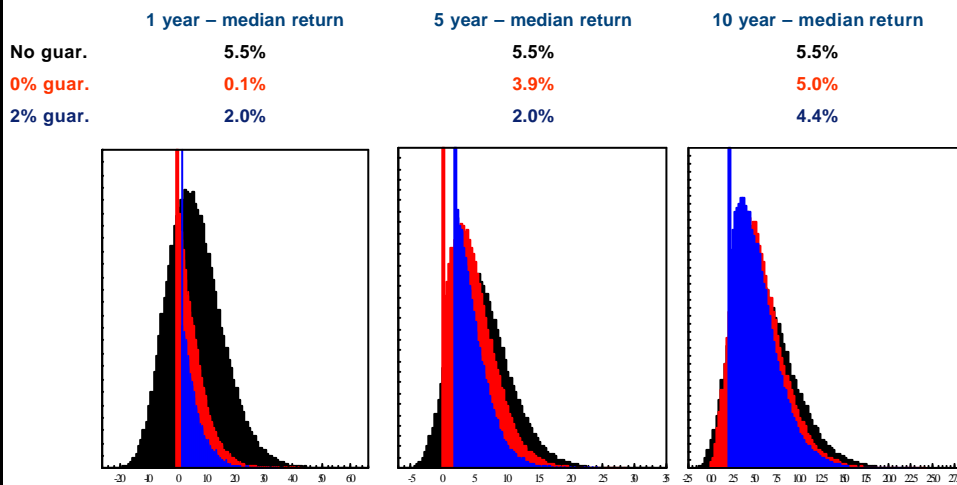
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## Equity risk declines with investment horizon



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## 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

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## 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

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## 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

*Keith Ambachtsheer (2005) 13*

## 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

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## 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 <sup>15</sup>

## Key messages



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- There is an important role for funded pensions organised through the workplace
  
- Pension systems is about the long term and need stability

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