



Pension Crisis and the EU: Present effects and policy responses - likely implications for the future

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Contents

- **Extent & Character of Funded Pensions in EU MS**
- **Impact of financial crisis**
- **First responses from supervisors and regulators**
- **First reactions from pension funds**
- **Longer term implications for investments and scheme design**
- **Conceivable national and EU policy responses**



Extent & Character of Funded Pensions in EU MS - Currently



Funded Pensions In EU retirement systems		Coverage (% of the workforce)			
		Low (<10%)	Medium (between 10% and 50%)	High (between 50% and 90%)	Very high (> 90%)
Average share in income of retired people	Low or negligible (<10%)	EL FR IT	CZ ES LV LT LU AT SK	BE EE HU PL SI	
	Medium (between 10% and 25%)	FI PT		DE IE	SE
	High (> 25%)			UK	DK NL
	Very high (More or around 50%)				



Table 3. Reformed pension systems in EU25 according to main features

	PAYG Flat-rate Public 1st pillar	PAYG Earningsrelated, Public Single or 1st pillar			Pre-funded “Mandatory” or “Major” 2nd pillar
	<i>“Beveridge” DB</i>	<i>“Bismarck” DB</i>	<i>“NDC”</i>		<i>DC</i>
Austria					
Belgium					
Denmark					
Finland					
France					
Germany					
Greece					
Ireland					
Italy					
Luxembourg					
Netherlands					
Portugal					
Spain					
Sweden					
UK					
Cyprus					
Czech Republic					
Estonia					
Hungary					
Latvia					
Lithuania					
Malta					
Poland					
Slovakia					
Slovenia					

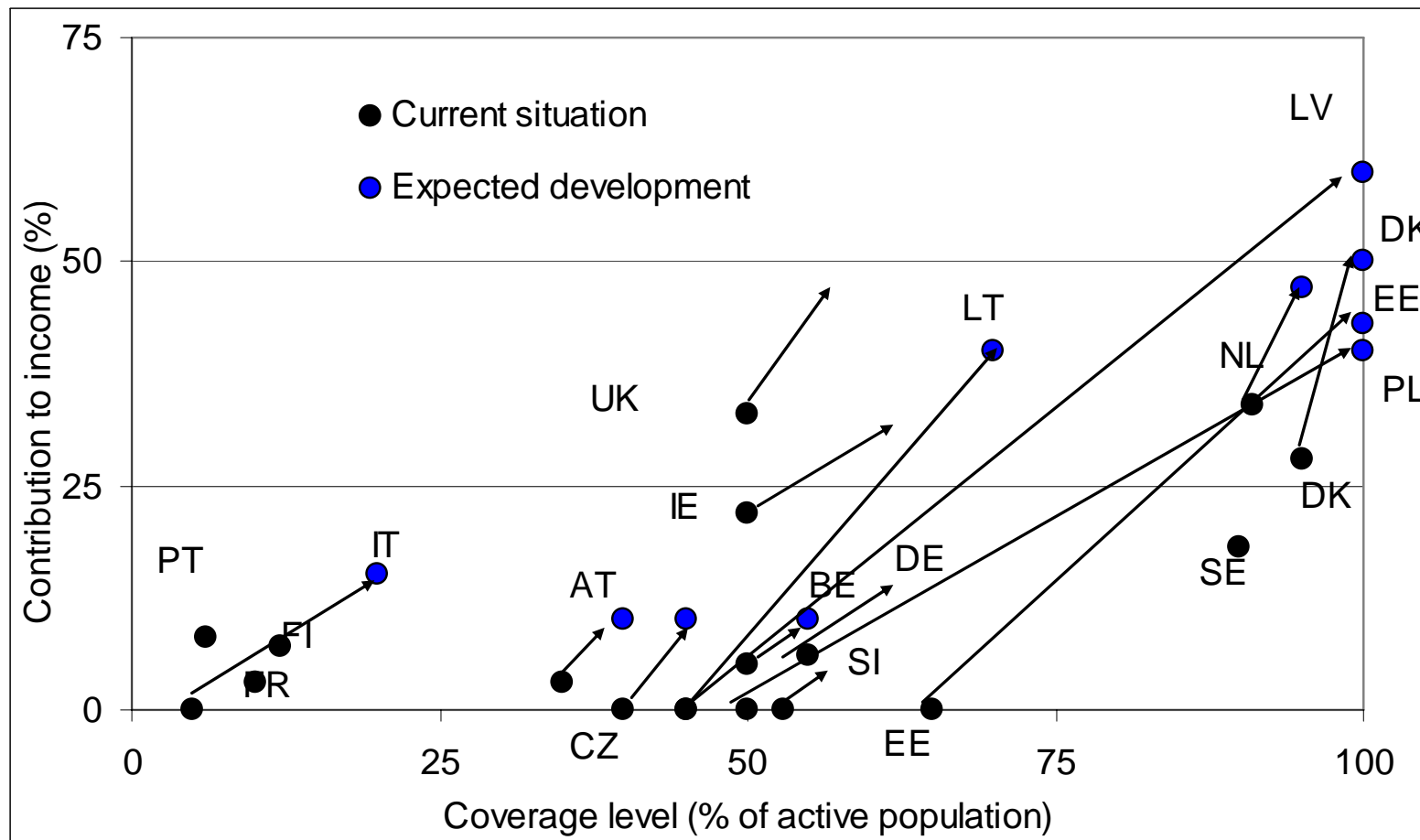


Funded Pensions in Member States in Central & Eastern Europe



Country	% Wage to Funded Scheme	Proportion of total Contribution to Funded Scheme	Year Funded Scheme Started	Participation in Funded Scheme	Year Funded Participants Retire
Bulgaria	5%	21.7%	2002	Mandatory <42	Full cohorts in 2023
Estonia	6%	20.0%	2002	Voluntary	Partial cohorts by 2012
Hungary	8%	23.9%	1998	Mandatory new entrants; voluntary for all others	Partial cohorts by 2008 ; full cohorts by 2035
Latvia	8%	24.0%	2001	Mandatory <30, Voluntary 30-50	Partial cohorts by 2013 ; full cohorts by 2033
Lithuania	5.5%	22.0%	2004	Voluntary	Partial cohorts by 2014
Poland	7.3%	26.1%	1999	Mandatory <30; Voluntary 30-50	Partial cohorts of women by 2009 and of men by 2014 ; full cohorts of women by 2029 and of men by 2034
Romania	2%, increasing to 6%	6.7%	2008	Mandatory <35; voluntary 36-45	Partial cohorts of women by 2023 and of men by 2028 ; full cohorts of women by 2033 and of men by 2038
Slovak Republic	9%	31.3%	2005	Voluntary for all	Partial cohorts by 2015

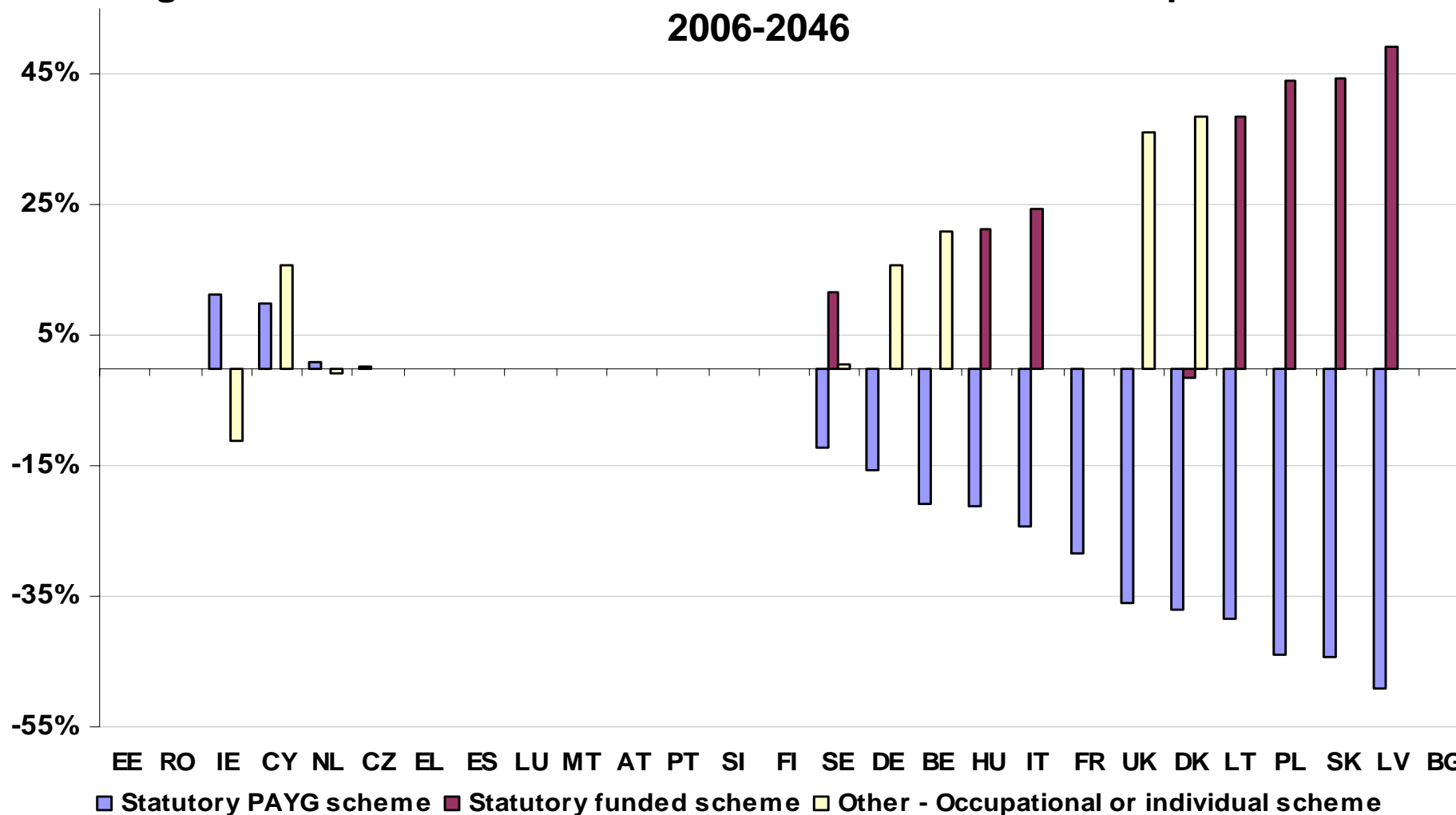
Funded Pensions: Current situation and expected evolution



Shift from Statutory PAYG to FUNDED (privately managed) pensions



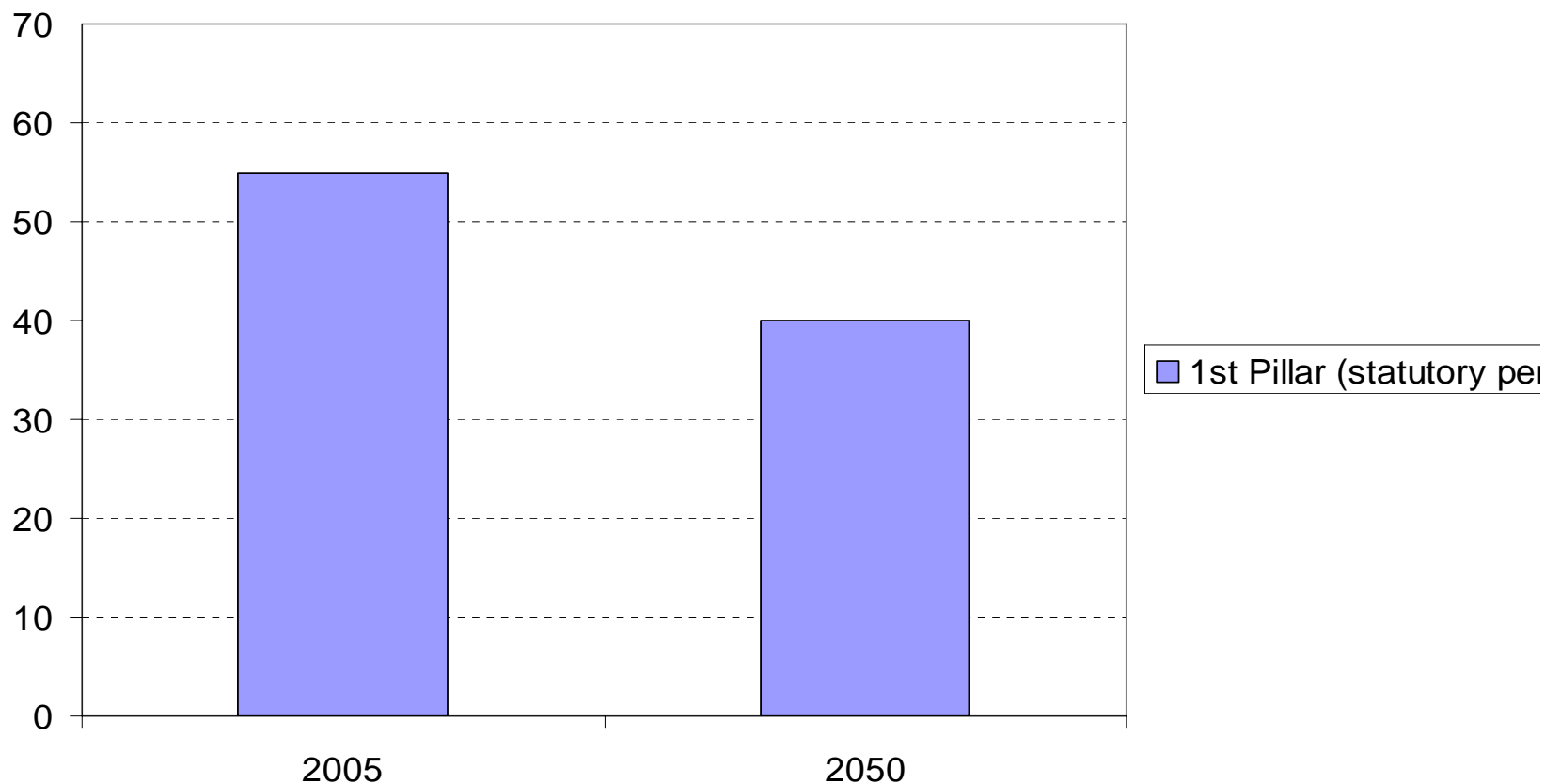
**Change in contributions of various schemes to theoretical replacement rates
2006-2046**



Source: Source: Indicator Subgroup (ISG) of the European Commission's Social Protection Committee



A trend toward a decline in most statutory schemes



Source : Stylised illustration from ISG results on gross replacement rates



- Mandatory funded DC pension schemes
- Funded elements in NDC schemes
- New Voluntary schemes promoted
- Reserve funds in PAYG
- Promotion of occupational scheme coverage





- Contribution of funded schemes to retirement income set for radical increase
- But public PAYG schemes will remain principal source of pensioner income in all but a few Member States





Coordination with Member States:

- Stability of Public Finances – (EPC); impact of ageing – Maastricht criteria
- OMC on Social Protection (SPC)

EU legislation:

- IORP directive
- Solvency directive





- **Equity in access**
- **Coverage and contribution levels**
- **Ensuring security in provision**
- **Issues in design**
 - Transition costs and impacts from p-a-y-g to funded
 - Administrative cost
 - 'Lifestyling' of investments
 - De-cumulation phase of funded pensions
 - Information requirements
 - Transparency





- Increasing requirements about:
 - **Information** (Unbiased advice on choice, Pension package portals etc.)
 - **Transparency** (prices, costs, performance)
 - **Security**
 - **Accountability**
- The larger the role for private funded the more public regulation and supervision

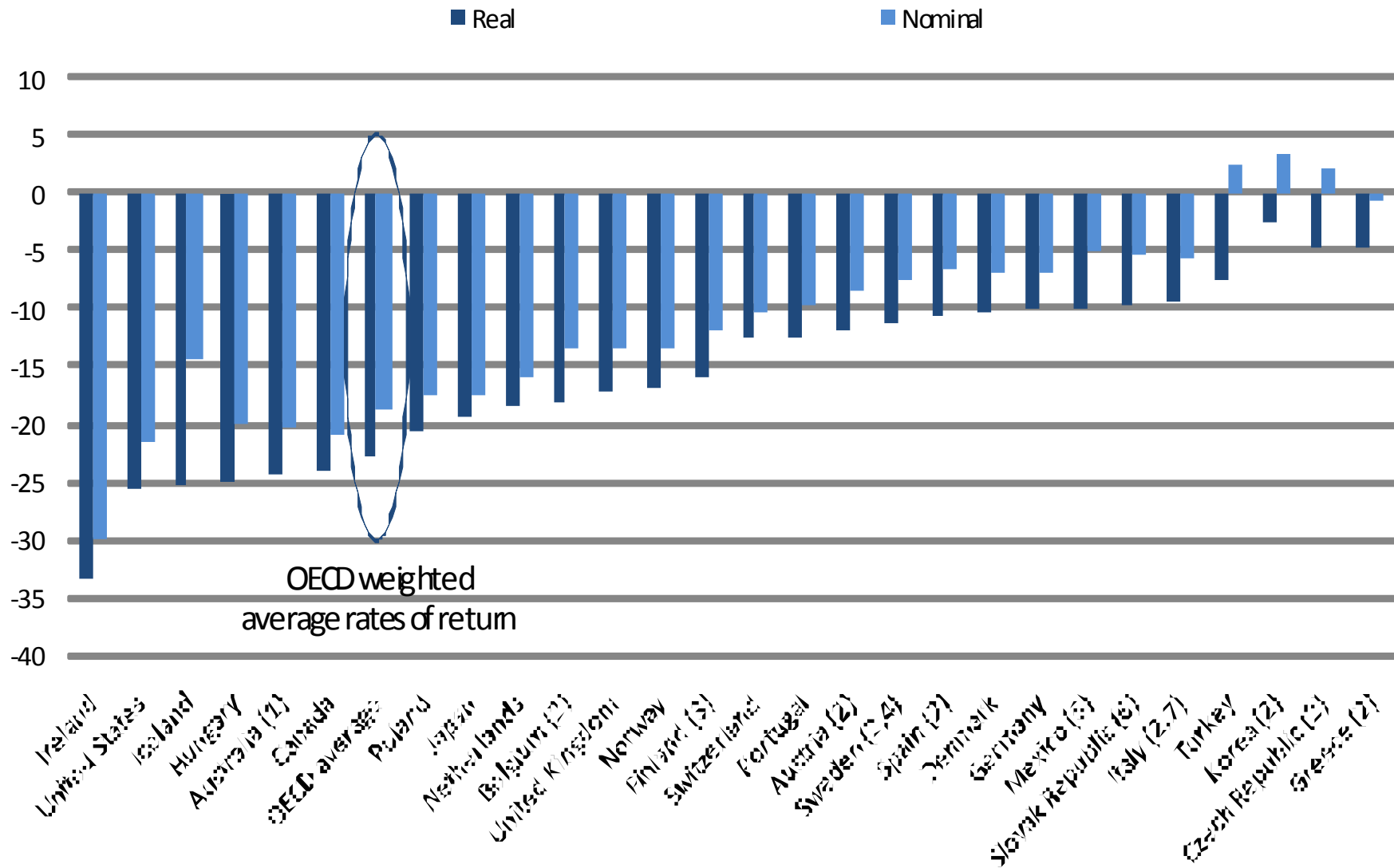




- Radical book value reductions of assets backing pension liabilities
- Financial market tumble only first effect
- Real economy contractions will cause secondary reduction of book values
- No sign of market recovery in sight – by measure of earlier crises market depressions could last for years



Nominal & real pension fund returns January-October 2008 (OECD)





- Ireland:
 - 35% loss; 90% of DB in deficit (€30 billion?), (context: PF=54% of present pensioner income (PPI); DB; low funding requirements; no co-insurance or employer liability) [e.g. Waterford/Wedgewood]
- UK:
 - 35-30% loss; 90% DB in deficit (£191=20% of liabilities) (context: PF= 30% of PPI;DB; medium funding requirements; employer liability & co-insurance)
- Netherlands:
 - Funding levels reduced 130->98; large funds at 90 (context: PF=60% of PPI; DB; high funding requirements; good regulation, protections, adjustment mechanisms)
- Denmark:
 - Losses 20-25% (context: PF=25% of PPI; DC/DB; good regulation; protections; adjustment mechanisms)





- So far supervisors have taken very measured actions – biding their time.
- Used possibilities to relax time-frame for funds to establish realistic plans for returning to required funding levels.
- Avoiding that funds & pension savers be forced to lock in book value losses
- Averting further market deteriorations caused by institutional investor offloading assets on massscale





- Ireland:
 - timeframe extended; regulations relaxed; public reserve fund used for bank bail out
- UK:
 - timeframe extended,
- Netherlands:
 - change in discount rate refused; timeframe reluctantly extended; retirement age increase floated
- Denmark:
 - timeframe relaxed; temporary relaxation of valuation & discount standards (to avoid pension savers locking in losses and implosion of mortgage bond market)
- Sweden:
 - timeframe relaxed





Schemes have sought to:

- get a more stable view of valuations and extend recovery periods to smooth impacts
- raise cost to individuals of leaving schemes to stem stampede to escape share in losses
- increase contributions from employers and members
- reduce indexation of pensions in payment





Funded pension schemes have sought to:

- Ireland:
 - raise contributions
- UK:
 - raise employer contribution (collective negotiation)
- Netherlands:
 - raise employer & employee contributions; drop/reduce indexation of pensions in payment (plead for extension of recovery periods & change in discount rate)
- Denmark:
 - negotiate relaxed timeframe, change in valuation and discount standards and solvency monitoring (success)





- Trust in funded pensions eroded
- In New Member States the very legitimacy of reforms to funded pension have suffered
- Requests for stronger control likely to dominate regulatory mood for many years
- Funding sceptics likely to use relative virtues of public payg in crisis to brake funding shift





Rules & Mechanisms allowing for shock absorption as well as protection of pension accruals must be in place

DB pensions

- Co-insurance style insolvency protection necessary
- More employer/employee risk sharing necessary to retain DB schemes.
- Adjustment mechanisms such as reduced indexation should be allowed to fully operate

DC pensions

- Crucial to ensure individuals have a realistic understanding of the rates of return and the inherent risks of DC provision both in general and to avoid the risk of hasty actions locking in losses during downturns.
- Payout phase needs to be properly worked out from the outset, both so leakage of pension savings for other purposes (eg bequests) is minimised but also to avoid the potential to lock in investment losses by having too narrow a timeframe for the payout phase to begin.
- 'Lifestyling' approach to investment risk must be obligatory

PAYG pensions

- Reserve funds designed to cope with demographic pressures need to be ring-fenced and supported by public sentiment as well as rules. Drawing on pension reserve funds in difficult times for other purposes undermine their credibility.





- Investment freedoms more circumscribed - both for members & schemes - lifestyling
- Co-insurance obligatory
- Better risk sharing
- Shock absorption / adjustment mechanisms
- Stricter information, disclosure and accountability requirements
- Better designs (accrual, annuitisation & pay-out phases)





- Protect members as savers & pensioners
- Speed recovery of pension industry
- Correct weaknesses and excesses – improve functioning and resilience
- Stabilise schemes in long-term – prepare better for next recession
- Re-establish confidence in multi-pillar systems and funding





- Still too early to tell effects & outcomes
- Backlash against funding
- More controls & regulations, less freedoms
- Conceivably safer investment vehicles at EU-level: Eurobonds
- Better security for members in accrual & pay-out phase
- More clarity & stability for industry





All information about the European Union:

<http://europa.eu.int>

Social Protection Committee

Pension Studies & Reports & Joint SP-SI Reports

http://europa.eu.int/comm/employment_social/soc-prot/pensions/index_en.htm

Economic Policy Committee

Reports on budgetary implications of ageing:

http://europa.eu.int/comm/economy_finance/epc/epc_ageing_en.htm

