

15th Regional Social Security, Pension and Provident Funds Conference

“Pensions in Crisis”

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**Keynote speech of
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**President of the
International Social Security Association**

Mr. (Ms.) Chairperson,
Colleagues,
Ladies and Gentlemen,

I am most pleased to attend this Conference held under the auspices of His Excellency the President of the Republic of Cyprus, Mr. Demetris Christofias and to speak with you today. As President of the International Social Security Association (ISSA), my intention this morning (afternoon) is to present you with the ISSA's views on the **challenges that social security is facing in the current financial crisis.**

I would like to start with a strong statement: despite the unquestionable impact of the current crisis, both financial and economic, social security is stronger than what is implied, in

particular by the media. Social security today shows robustness in a context of unfavourable circumstances. The ISSA message is that social security is dependable, and is in a position – like it did in many difficult economic circumstances these last fifty years – to continue to respond to the expectations of the population and moreover can be a core element of public policies aimed at supporting economic recovery and employment by adopting a proactive approach with the ultimate objective of reducing the social impact of the crisis.

Several national social security administrations have reaffirmed these days that, despite some substantial losses in funds, this does not threaten their long term sustainability.

Ladies and Gentlemen,

It is essential to underline the positive role that social security institutions are able to endorse in this time of financial and economic turmoil because they encourage entrepreneurship, generate employment and reduce poverty through their investment activities. In some countries, their net assets amount to 65 per cent of the gross domestic product. It can also be noted that social security is an investment in, or support for, people. Indeed, people who enjoy a minimum material security can afford to take entrepreneurial risks. They can invest rather than holding low-interest and unproductive savings.

Moreover, social security is an investment in social cohesion and political stability, which, in turn, is a prerequisite for successful economic activities. In its 2005 *World Development Report*, the World Bank explicitly recognizes that poverty and inequality can trigger crime, and a high level of crime and physical insecurity of

persons and assets is a major infringement on the investment climate in a country.

With globalization, population ageing and the extent of the current turmoil, social security becomes more necessary than ever.

The current financial crisis will affect social security in at least two ways: it will not only deplete funds, challenging the financial viability of all schemes that rely on some level of funding, but the economic slowdown, as a result of the financial crisis, will bring about falling levels of contributions and increased demands for benefits, affecting the financial soundness of all social security programmes. It is essential to take these two aspects into account.

Ladies and Gentlemen,

What are the real effects of the current financial crisis on pensions? Is it as catastrophic as the media suggest when forecasting the depletion of funds?

We know that the crisis has dealt a heavy blow to pension schemes: falling stock markets around the world have hit both private pension fund plans and occupational pension schemes. The overall impact for the retiree-to-be will depend on the nature of the pension income that one expects to receive: whether from pension funds or a public old-age insurance pension. In the case of pension funds, one may wonder about the decision to make old-age protection mainly dependent on financial market performance. This point was made in a recent issue of the *Economist*.

According to the OECD¹, by October 2008 it is estimated that the total assets of private pension plans in OECD countries had declined by about 5 trillion US dollars, or nearly 20 per cent of their value compared to December 2007 when their assets stood at 28 trillion US dollars.

We also observe that pension funds, which account for most private pension assets, have been hit hardest in OECD countries where equities make up over a third of total assets invested. In this way, Irish pension funds experienced the worst investment performance, losing just over 30 per cent of their value in nominal terms last year.

At this stage, it is important to emphasize that both defined benefit and defined contribution schemes are being weakened by the crisis. In Switzerland and the United States, for example, the funding position of defined benefit plans has deteriorated by more than 10 per cent, with high bond yields partly offsetting the decline in asset values. As companies have difficulties compensating for these losses due to the economic recession, benefits may have to be reduced or solvency requirements made more flexible.

In practice, the impact of the crisis will be felt most by workers who are nearing retirement age and those whose pensions fall under unprotected defined contribution schemes (that is, no guarantee for the final pension level, which is entirely dependent on the pension fund financial performance and the contributions made). Beneficiaries who receive annuities will also be affected, as annuities are frequently indexed to financial performance.

¹ OECD, Pension fund losses highlight need for private pension reform, www.oecd.org.

It should be mentioned that the impact of the crisis on pension funds is unequal. This is linked to the implementation of adequate investment and risk management strategies, as evidenced by a recent ISSA study². Among a sample of eight national social security bodies³ relying on reserve funds to help finance pay-as-you-go pension schemes, the majority experienced some loss in returns in 2008, ranging from around 7 to 17 per cent. However, the ATP fund in Denmark experienced a positive investment return of 1.4 per cent. This shows that not all social security programmes are affected in the same way by the crisis, and outcomes can depend on specific choices or practices followed in the investment of social security funds.

It is useful to mention that the ISSA technical commissions have adopted guidelines for social security institutions for the investment of funds. In general, there are two primary objectives for the investment of social security funds: security and profitability. In this manner, investments should at the same time assist the social security scheme to meet its commitments in a cost-effective way and achieve optimal returns, subject to acceptable risk.

My intention here is not to list all the recommendations developed by our experts. If you are interested in reading more, I encourage you to download our *Guidelines for the investment of social security funds* available on the ISSA's Website (www.issa.int). However, I would like to point out that the ISSA has been a long-time advocate of achieving a reasonable balance between these twin objectives, developing the guidelines well before the onset of the current financial crisis.

² See *Social Security Observer*, Nr. 3, available on www.issa.int.

Ladies and Gentlemen,

I have discussed the impact of the current financial crisis on pension funds and occupational pension schemes. However, the unfolding global recession will also stress public pension schemes financed on a pay-as-you-go basis: higher unemployment levels and a commensurate fall in contributions may lead to financial troubles.

According to the ILO, global unemployment in 2009 could increase over 2007 by range of 18 million to 30 million workers, and more than 50 million if the situation continues to deteriorate. This could raise the world's jobless total to 198 million, or 230 million people in the worst case scenario. The crisis could also push another 200 million workers into extreme poverty as they seek work in informal, underpaid and unstable employment.

Indeed, the crisis will hit hardest those groups who were already struggling to find and keep a job, such as older workers, the disabled and youth. The low-skilled, and in particular low-skilled immigrant workers, are among the first to be laid off because they are highly concentrated in vulnerable sectors, such as construction and tourism, and often are only temporarily employed.

The social impact of the crisis will be even more dramatic in many low- and middle-income countries. Often, these countries have weak social safety nets, which provide insufficient protection in the case of unemployment, and cover only a small fraction of the labour force, while a large proportion of workers are employed in the informal sector.

³ Canada (CPPIB), Denmark (ATP), France (FRR), Ireland (NRPF), New Zealand (Sup. Fund),

Under these circumstances, the ISSA calls for coordinated policy measures in the financial, economic and social sectors, so that social security can play – as mentioned at the beginning of my speech – a key role as a social and economic buffer and as an income booster in these times of crisis. The State should also play a role as regards the sustainability of schemes and the level of benefits, as was done for the banking sector in securing their toxic assets.

In order to meet this target, it is paramount that social security institutions practice good governance, involve all social partners, provide adequate benefits, extend coverage and – as already underlined – implement specific, prudential rules for the investment of funds and impose investment limits on some asset classes.

These recommendations are embedded in a wider strategy. The concept of “Dynamic Social Security” provides the framework for ISSA’s vision of social security geared to better ensure accessible and sustainable social protection systems. These systems should not only provide protection, but also adopt preventive approaches, support rehabilitation and reintegration and contribute to socially-inclusive and economically-productive societies.

The following list⁴ presents some - but not all - of the possible outcomes which the proposed dynamic social security framework should help achieve, taking into consideration the need to develop new and/or complementary programmes:

Norway (GPF), Sweden (AP1, AP2, AP3, AP4), Switzerland (FC AVS).

⁴ Roddy McKinnon, Dynamic social security: A framework for directing change and extending coverage, *International Social Security Review*, Vol. 60, 2-3/2007.

- advance, at the very least, a basic level of income security and access to healthcare for all and in particular for older people;
- better adapt social security programmes to evolving life-cycle and labour market risks by, for instance, providing training, retraining and job search arrangements, by focussing on preventative measures to secure workers health as well as by facilitating the integration of migrants ;
- better tailor social security policy to changing demographic realities, family structures and gender roles, thereby creating more inclusive societies ;
- better contribute to maintain social peace and global security that are necessary to restore economic growth.

Ladies and Gentlemen,

Let me conclude by underlying the importance of the previous point. Dynamic Social Security can provide social security institutions with effective strategies for adopting social policy measures that can restore confidence in public social security programmes, contribute to better guarantee social cohesion by providing an adequate protection to the most vulnerable, those most affected by the economic crisis. Moreover, with a careful and efficient management practices, social security programmes will play an important role in absorbing social and economic shocks, in particular by sustaining consumption.

The ISSA provides a unique forum to carry out these objectives. Here, social security institutions and policy makers can discuss and

improve upon the roles they have in mitigating the negative social and economic effects of the crisis. The ISSA can also strengthen the representation and voice of its member organizations at the international level by taking a leading role in the development of a global social security partnership.

The ISSA is ready to face the challenges brought on by the international financial and economic crisis and to play a key role, relying on the capacity of its members to alleviate the current turmoil. True to its past, social security will adapt. Likewise, the ISSA will adapt too. This is the only way forward. And it is my firm belief that looking forward, and doing so constructively with the aim of promoting social security for all, can only lead to a more optimistic future.

Let me finally inform you that next month, on 24 and 25 April in Geneva, the ISSA will organize a technical seminar in cooperation with the Social Security Department of the ILO, entitled "Social Security in Times of Crisis: Impact, Challenges and Responses". This will be a unique opportunity to strongly reaffirm the crucial role of social security - and of the institutions that deliver social benefits - in times of economic crisis. It will also allow for a debate on how social security could be a core element of public policies aimed at supporting economic recovery and employment by adopting a proactive approach with the ultimate objective of reducing the social impact of the crisis and preserving the wellbeing of all people.

Thank you for your attention.