Pensions, Benefits and Social Security
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Pensions, Benefits and Social Security from a Supranational Perspective

Financial Crisis and the future of risk management

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SECTION SUR LES PENSIONS, AVANTAGES SOCIAUX ET SÉCURITÉ SOCIALE DE L'AAI
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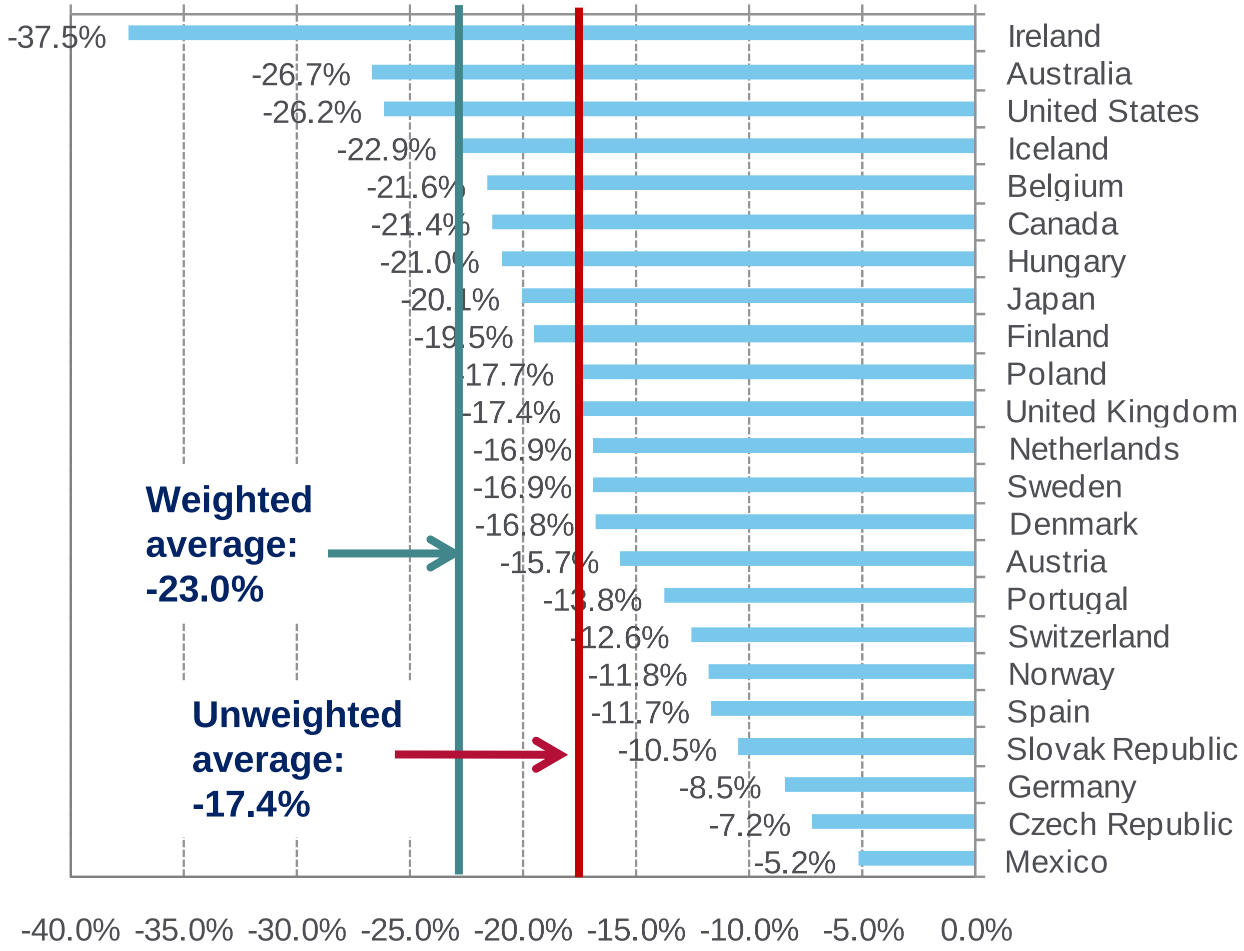
Topics

- Effect of financial crisis on pension funds
- Policy actions from public and private schemes
- Lessons learned and future challenges

Effect of financial crisis on pension funds

Private pension funds had a dreadful year in 2008



Note: Returns are in real terms
Source: OECD Pensions at a Glance 2009, Figure 1.3

Public reserve funds also suffered from the crisis

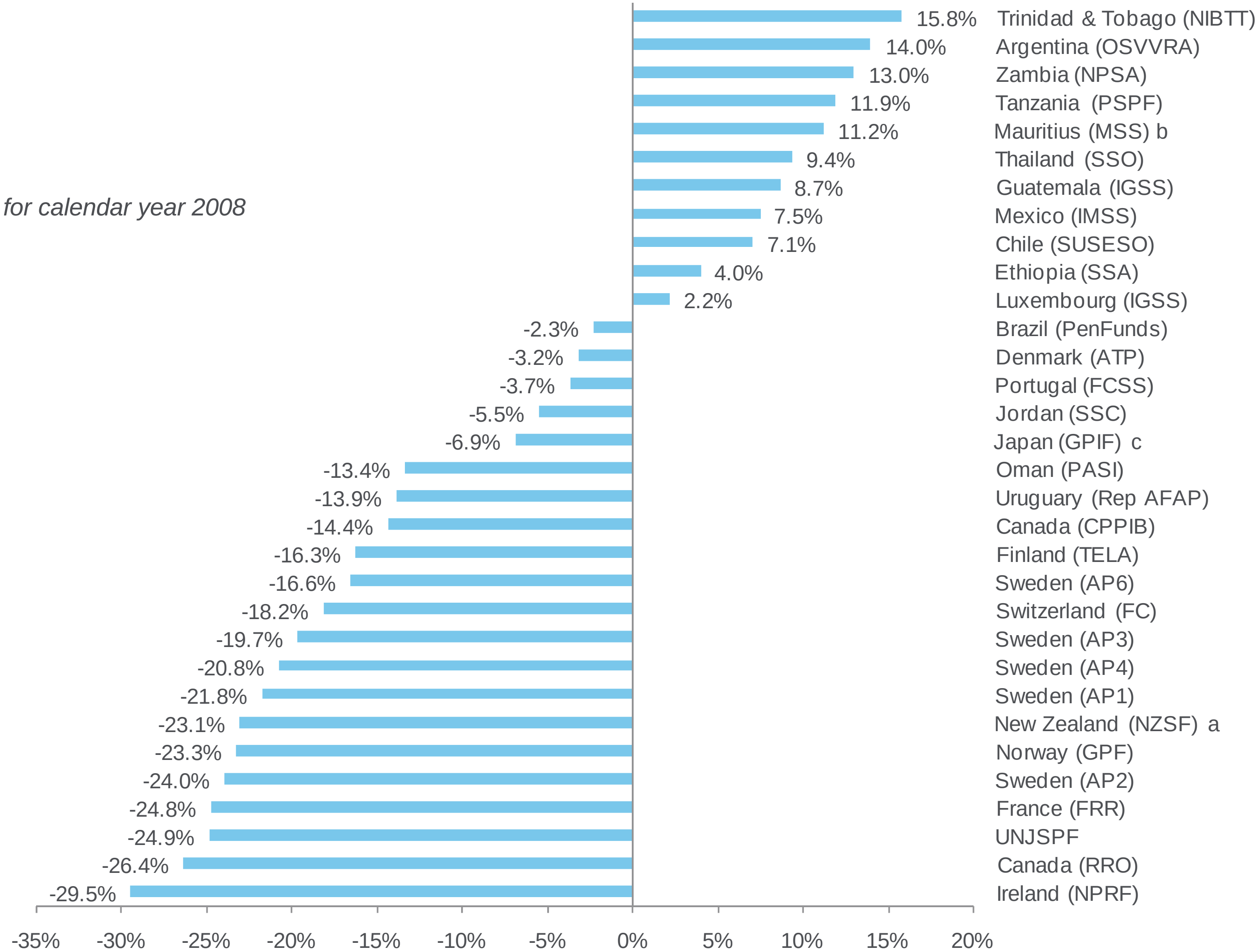
Notes:

a)June-Dec 08;

b)b) Year ended 30.06.09;

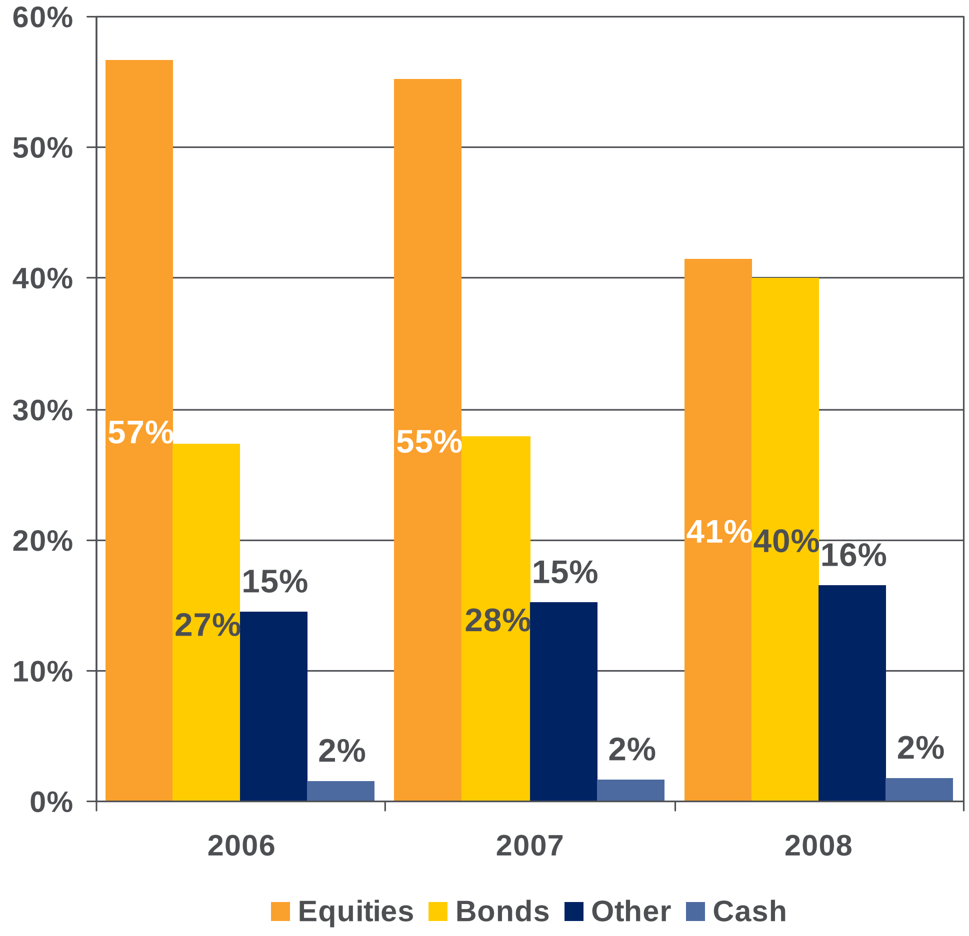
c)c) Apr-Dec 08

Source: ISSA fund reports for calendar year 2008



Aggregate asset allocation
2006 – 2008

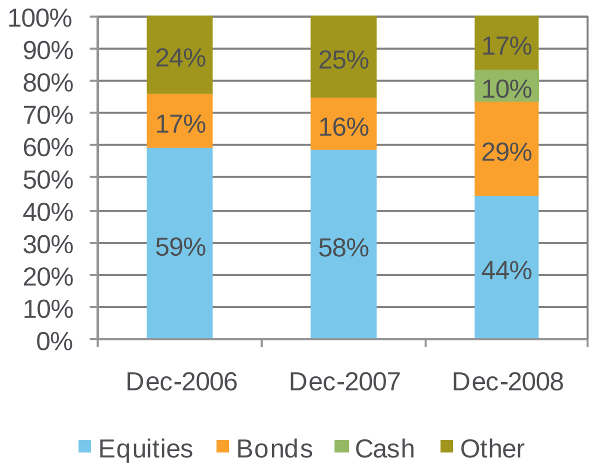
- The effects of the financial crisis on asset allocation have been striking. Asset allocation remained almost static between 2006 and 2007 but changed profoundly in 2008
- Compared to 2006 year-end, allocation to equities at the end of 2008 fell 16% while allocation to bonds increased by 13%
- The allocation to cash remained unchanged, while allocation to alternative assets increased slightly.



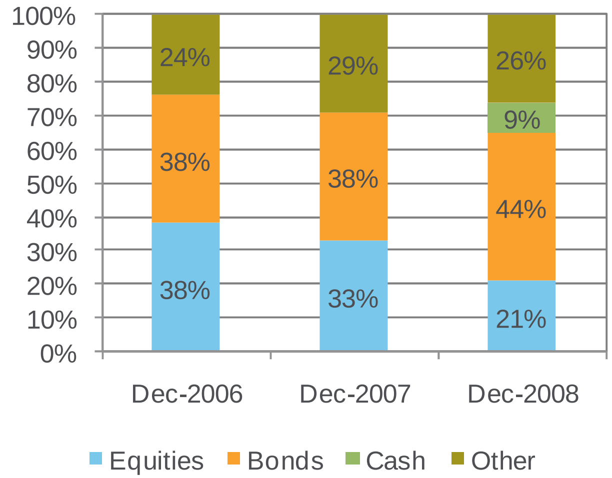
Sources: Watson Wyatt Worldwide and various secondary sources

Allocation of pension assets
2006 - 2008

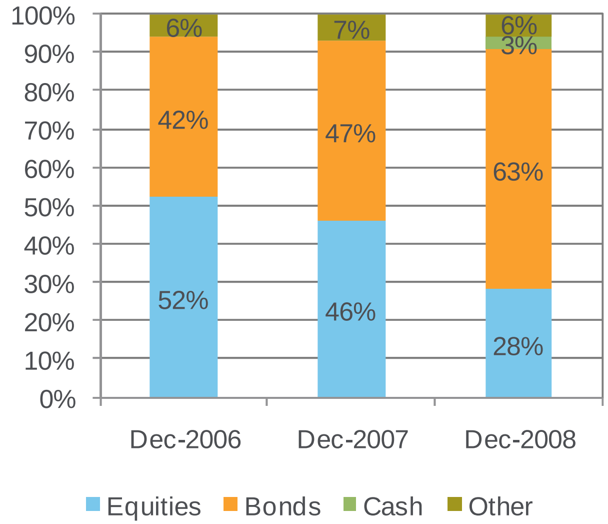
Australia



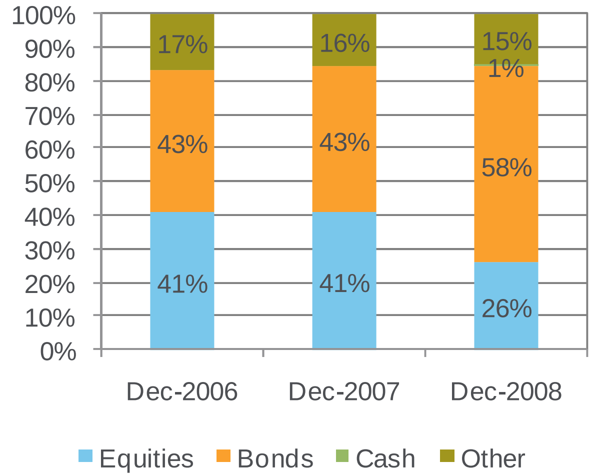
Switzerland



Japan



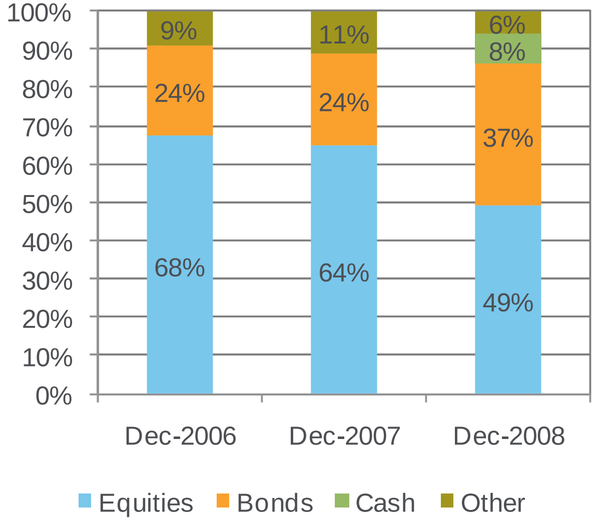
Netherlands



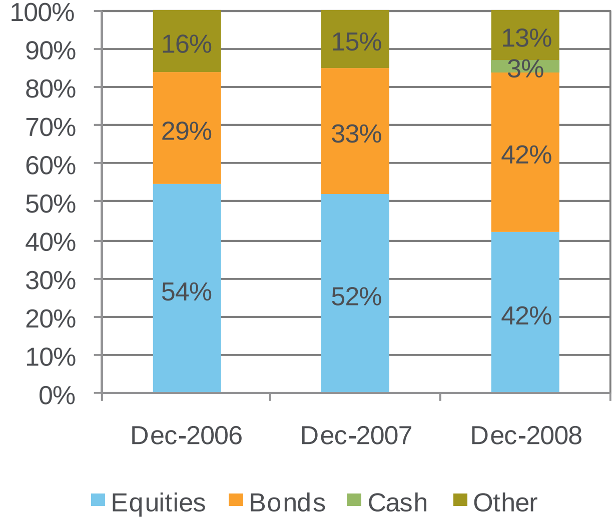
Sources: Watson Wyatt Worldwide and various secondary sources

Allocation of pension assets
2006 - 2008

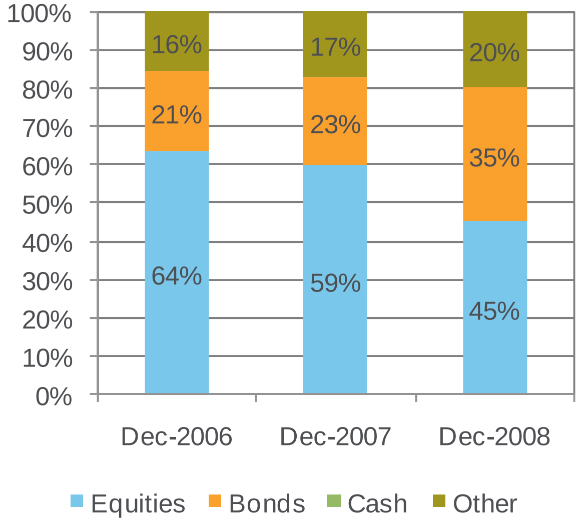
UK



Canada



US



Sources: Watson Wyatt Worldwide and various secondary sources

US DC assets include IRAs

Policy actions:
public and private schemes

Reaction from public schemes

- Increase overall contribution rate
- Switch back to PAYG system
- Make second pillar voluntary for new entrants
- Alter indexation rules/levels
- Increase retirement age
- Use reserve as economic stimulus or recapitalize bankrupt industry
- Review strategic allocation, rebalance, monitor managers (hire or fire), investigate new asset classes – those with reserves

Reaction from private DB schemes

- Respond to pressures from drops in funding levels by raising contributions
- Relax solvency rules and/or valuation methods
- Raise contribution rates
- Establish insolvency/guarantee funds
- Allow longer amortization period for recovery
- Review strategic allocation, rebalance, monitor managers (hire or fire), investigate new asset classes and focus on risk management

Reaction from DC schemes

- Concede that not much can be done *ex-poste*
- Recognize that older workers are most affected (less time and ability to recover losses)
- Raise concerns about providing minimum guarantees (either as minimum ROI or minimum pension)
- Engage in more debates on adopting a target date (age-dependent) fund to manage the risk profile of different cohorts
- Acknowledge the importance of having a sensible default option

Lessons learned and future challenges

What did we learn?

- There is no country or pension scheme that can claim immunity from the effects of the crisis
- Even plans with supposedly best practice status ended up bowing to political pressures and economic realities
- Risk cannot be eliminated – it can only be managed through diversity, by diversifying provision and asset allocation

How should we move forward?

- Manage risk at all stages – before, at and after retirement
- Pay more attention to governance, accountability and transparency requirements
- Increase diversification – explore options such as multi-pillar retirement income provision and Liability Driven Investments (LDI) for DB
- Improve the ability to determine and measure Value-at-Risk (VaR) under different types of extreme scenarios

Questions?

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