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Capital Markets Project

INTERNATIONAL PENSION NEWSLETTER

Responding To Financial Turmoil

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This month's newsletter puts special emphasis on how markets, governments, and households are reacting to economic recession and what responses are being worked out to stem negative consequences for retirement savings.

Inside:

INTERNATIONAL TRENDS: MARKETS SHOW THAT DIVERSIFICATION IS SAFER CHOICE

International: Global Pension Asset Losses at 19%

Global institutional pension fund assets (excluding Pillar I) shrank by around 19% during 2008 from US$25 trillion to US$20 trillion according to a study of global pension assets by Watson Wyatt consulting firm. The contraction is all the more striking compared to an average growth rate over five years (until 12/2007) of +12%. All countries saw negative growth in pension assets, except Germany which was helped by its high allocation to bonds. Roger Urwin, global head of investment content at Watson Wyatt calls the results "a wake-up call for governments worldwide to engineer bigger allocations to pension savings." Urwin says that pension systems are being tested at every level. Among the worrisome factors that need to be addressed are demographics, as well as liquidity and risk management issues concerning pension assets.

Worldwide Pension Markets: Top Three Remain the Same

According to the same report, despite losing market shares last year, the U.S. Japan, and the UK remained the largest pension markets in the world accounting for 61%, 13%, and 9% respectively of total pension global fund assets. Australia is the fastest growing market, now ranking fifth. The eleven largest pension markets in the world are: Australia, Canada, France, Germany, Hong Kong, Ireland, Japan, Netherlands, Switzerland, the UK, and the US. The P11 accounts for more than 85% of global pension assets.

Switzerland: Pension Funds Lose but Less than Average

Swiss pension funds report an average loss of 13.25%. According to Credit Suisse, publisher of the quarterly Pension Fund Index, pension funds managed to over-compensate potential effect of volatility by "shifting weight between asset classes, reducing volatility. The analysis of asset allocation diversification shows that Swiss and foreign equity fell by 2% while bonds increased 2%, Swiss franc exposure rose (to the detriment of the dollar and Euro), real estate and deposits also increased."

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Finland: Funds' Exposure to International Markets Limits Losses

Finnish funds fell an average of 14%, IPE.com reports. This is less than the average 19% (see Watson Wyatt report above). According to USAID Capital Market Pension expert Gary Hendricks, these results may be due to the large international diversification of Finnish pension assets. In Finland, domestic investments make up 36% of the total pension asset portfolio, while other European investments account for 32% of holdings, and the rest of the world about 32% in 2008. According to Finnish pension fund alliance TELA, an increase in domestic investments may have contributed to pension funds' losses. Finnish pension funds may reduce their equity exposure, IPE.com reports, but TELA funds do not foresee "drastic changes".

France: Losses Attributed to High Exposure to Equity

The French "Fonds de Réserve pour les Retraites" reports a loss of 24.8% and attributes the contraction to high asset exposure to equities in 2003-2006, "Global Pension" website reports. During this period equity represented over 60% of the portfolio, which was brought down to 49% following new guidelines in October 2008 that also increase holdings of government debt securities.

Sweden: Major Fund Plans Change in Investment Portfolio to Reduce Exposure

According to news reports, all of the first four Swedish pension "buffer funds (AP-1 through AP-4 which act as buffers through their role to counterbalance the high disbursements caused by baby boomers massively retiring) have now reported losses of between 20-24% as the global economic crisis significantly impacted investments, particularly in Swedish equities, the Wall Street Journal reported last month. State pension fund AP Fonden 1 announced that it will change its investment style after the value of its assets fell by almost 50 Billion Swedish kronor, or US$6 billion last year. According to the paper, AP1 will lay off most of its staff that was involved in investment decisions and will restructure its investment management branch. It announced reallocation plans, most likely reviewing its current philosophy of allocating 50-60% of portfolios to long-only listed equities in light of the two market crashes in the last eight years. Publicly traded equity will be reduced from about 60% in favor of private equity which will increase to 5% (from 1%), and real estate may increase to 8%, the Pensions & Investment news website (pionline.com) reports quoting AP1 managing director Johan Magnusson.

Central and Eastern Europe: Downturn May Boost Interest in International Assets

With a drop in assets of 38.1% in Central Europe's strongest market Poland and of 80% in Russia, the shock is driving investors to reflect and to learn, remarks an article in the Financial Times. According to the newspaper, many investors in Eastern Europe underestimated the volatility of market placements treating them instead "as saving accounts with better performances." While the fall was made even harder by the fact that most of the equity was invested in local equity, some experts interviewed by the paper are counting on a learning process that will include better diversified assets to spread risks. The near future will probably show an interest in the safer conservative and more transparent products. Also, there is the possibility of more interest in international assets which were not deemed attractive until now due to their lower rate of returns compared to Eastern markets.

Russia: Official Statistics Give Motley Picture of Pension Fund Results

Average losses in pension assets amount to 25,5% with extremes ranging from -52% for some asset management companies (Troika Dialog, Metlinvestrust) and 2,2% ("Vika") and a slight loss of under 2% for state-controlled Vneshekonom Bank (VEB) that is managing 90% of pension assets. VEB declared a loss of 1.16 billion rubles in 2008, Russian business daily Vedomosti reported last month. The VEB manages about 352 billion rubles in funds (9.7 billion dollars) - the assets of the large majority of Russian workers that chose not to transfer their pension accumulation accounts to the Non-State Pension Fund or to asset management companies. The NPF manages 39 billion rubles in pension assets, and private asset managers 12 billion. According to the Russian Pension Fund which oversees the VEB's activity, these results "hardly represent a loss" considering the market, the paper reports. However, some experts remark that VEB may have not reassessed the market value of the inflation-hit government bonds.

WORLD RECESSION: GOVERNMENTS RESPOND WITH NEW MEASURES

If the global financial crisis taught the pension industry one lesson it is to welcome and push for flexibility and adaptability. Governments throughout the world are reconsidering regulations, limitations and conditions in order to allow pension funds to optimize investment strategies.

Ireland: Civil Servants To Contribute More

The Irish government introduced a new contribution rate for civil servant pension schemes. The new contribution will be deducted at the source from civil servants' pay and will be graduated to the income levels. Civil servants will be contributing 7.5% on average, with rates varying between 3% for those earning 15 000 euros or less/year (US$ 19000), and 9.6% for top salaries. The new contribution would bring in 1.4 billion euros. According to the Government the new scheme is meant to iron out discrepancies: until now, Irish civil servants did not contribute while benefiting from pensions that are more favorable than pensions in the private sector. However, trade unions representing public sector workers call the measure unfair because it impacts low incomes more than high incomes. (Global pensions.com)

Iceland: New Law To Allow Emergency Access to Private Pensions Savings

The new center-left Prime Minister Johanna Sigurdardottir's program to combat the economic crisis includes relaxing pensions fund asset rules for workers. She says new laws will allow contributors a temporary authorization to withdraw some of their private pension savings "to meet pressing financial needs". These individual accumulation accounts hold contributions paid in by both workers and their employers. Until now, account holders had to wait until they turned 60 to access their accounts. The PM estimated about 80 bn to 90 bn Icelandic crowns (US$703-790 million) could be released this way. (Reuters, IPE.com)

Romania: Pension Funds Allowed More Investment Freedom

Romanian pension funds are now allowed to invest in private equity and commodities, and also abroad. Up to 2% of Pillar II pension assets can be invested in equity in Romania, and internationally, and up to 3% in commodities and derivatives. For Pillar III pensions, the cap is set at 5% for private equity and commodities. These measures are meant to help fund managers protect portfolios against currency and interest rate risks through broader diversification, the national regulator told IPE.com. There is an increase of inflow expected through the gradual increase in contributions from 2% in 2008 when pillar II was launched to 6% in 2016.

Switzerland: New Law to Lower Conversion Rate Spurs Opposition

The Swiss Social Democratic party will support a referendum against a plan to lower the conversion rate for pillar II pensions. The conversion rate, which measures the amount of the annuity compared to the pension assets (the higher the conversion rate, the higher the future pension), will go down from over 7% now until 6.4% in 2015, according to a new law adopted by Parliament. As a consequence, a capital of 100000 Swiss francs will render a retirement pension of 6400 Swiss francs instead of 7000 today. However, this measure can be overturned by a popular referendum in line with Swiss traditions of direct democracy. For the referendum to take place its supporters will have to collect 50000 signatures by April 16.

FOCUS: HOW HOUSEHOLDS RESPOND TO CRISIS

U.S.: Consumers Spend Less, Save More

The deepening mortgage-led recession has seen households saving more money than previously data collected by the US Commerce Department show. Despite a 0.24% decline in their incomes between November and December, personal savings increased to 3.6% of disposable income from 2.8% during the same period according to The Christian Science Monitor newpaper. It is the highest rate since May 2008. If this rate is maintained, it would be the highest savings rate since 1998. Savings were at their lowest in 2005 at 0.4% and at their highest in the 1990s when savings rates reached 8 to 10 % of disposable income. Consumer spending fell in December for a record sixth straight month, and the savings rate rose. As Americans held onto more of their income, consumer spending fell 3.5%, accounting for much of a 3.8% annualized dive in gross domestic product (GDP).

United Kingdom: One in Three Britons Does Not Have Any Savings

A recent survey on wealth and assets conducted by the Office for National Statistics, the United Kingdom's official statistics bureau, shows a third of the U.K's adult population has no savings at all to meet harder times or prepare for retirement. 60% of people believe that the best way to save for retirement is to invest in property while 49% believe pension investments offer the best option for retirement savings. More than two-thirds of Britons either already own their home or hold a mortgage.

Germany: Crisis Hasn't Affected Savings-Oriented Households

In Germany where households show a solid savings tradition, and where the effect of the economic recession may be delayed until 2010, consumption appears to be holding steady… for now. According to a study conducted by GfK (Gesellschaft für Konsumforschung), an institution studying consumer behavior, German consumer spending may even rise in 2009 by 0.5%. About half of all households are considered "crisis resistant" with reliable salaries or pensions. Such households have not changed their habits significantly so far. This relative confidence is due to low inflation figures, plummeting energy prices, stable salaries, as well as a savings backbone for a large part of the population. But unemployment is expected to increase at the end of 2009, compromising this positive trend. About 1/3 of the population already feels vulnerable, and are "spending smart". Consumption in electrical appliances, clothing and eating out, are expected to go down while discounters are expected to win from the crisis. About one fifth of the population – those reliant on unemployment subsidies or who feel their jobs are insecure - is categorized as very vulnerable and will have to significantly cut spending, the German press reports. The bottom line is that Germany is going into the recession economically much stronger than other countries, but the country is still likely to suffer near the end of 2010.

France: Households Start Saving on Food, Energy

Household consumption grew 0.9% in 2008, despite people spending less for food and energy. Services and manufactured products sales increased slightly. Some experts expect a real contraction in consumer spending for 2009 which, if it happens, would be for the first time since 1993 (at -0.3%). Overall consumption accounts for 57% pf GDP.

Household Savings Rate by Country:

This table of Household Savings rate from 1991 until 2008 throughout the OECD zone shows important differences from country to country, reflecting specific domestic factors but also socio-economic traditions. In Germany and Switzerland it is traditionally high (over 10%), while in the United States and the United Kingdom it is below 2%. In nearly all countries the rate of saving has been falling since 2000.

HOUSEHOLD SAVINGS RATES
(Per cent of disposable household income, based on OECD data)

	1991	1995	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Savings (Net)													
Australia	5.1	6.4	1.8	1.9	1.8	2.0	-2.3	-3.1	-2.6	-0.8	0.2	0.9	1.4
Austria	13.3	12.1	8.7	9.9	9.3	8.1	8.1	9.2	9.4	9.8	10.8	11.7	11.8
Belgium	12.7	16.0	12.4	12.7	10.9	11.9	11.2	9.6	8.1	7.5	8.0	8.6	7.9
Canada	13.3	9.2	4.9	4.0	4.7	5.2	3.5	2.6	3.2	2.0	3.1	2.7	2.8
Czech Republic	..	10.0	4.1	3.4	3.3	2.2	3.0	2.4	0.5	3.2	4.5	4.3	3.3
Denmark	1.8	1.3	0.0	-3.3	-1.9	3.7	4.1	4.1	0.7	-4.0	-3.1	-2.8	-1.9
Finland	7.3	4.1	0.4	1.7	-1.7	-0.7	0.2	1.2	2.3	0.3	-2.4	-2.8	-2.7
France	10.4	12.8	12.4	12.1	12.0	12.7	13.8	12.7	12.6	11.7	11.7	12.4	12.7
Germany	12.9	11.0	10.1	9.5	9.2	9.4	9.9	10.3	10.4	10.6	10.5	10.8	11.6
Hungary	..	..	..	..	8.9	8.7	6.6	4.4	7.0	6.9	7.3	7.6	7.1
Ireland	..	..	..	..	..	..	5.4	5.4	8.3	5.6	3.8	5.3	10.6
Italy	21.4	17.0	11.4	10.2	8.4	10.5	11.3	10.3	10.2	9.9	9.0	7.9	9.2
Japan	15.0	11.9	11.3	10.0	8.6	5.0	4.9	3.9	3.5	3.9	3.3	3.1	3.3
Korea	24.6	17.5	24.9	17.5	10.7	6.4	2.2	3.9	6.3	4.7	3.4	2.5	3.7
Netherlands	14.5	14.3	12.2	9.0	6.9	9.7	8.7	7.6	7.4	6.4	5.3	7.3	5.8
Norway	3.4	4.8	5.7	4.7	4.3	3.1	8.2	8.9	7.2	10.1	0.1	-0.3	2.0
Poland	..	14.6	12.1	10.6	8.4	9.9	6.0	5.2	4.7	4.7	4.0	6.0	8.1
Sweden	7.1	9.5	4.0	3.6	4.8	9.3	9.1	9.0	7.7	6.8	7.1	8.3	9.2
Switzerland	13.1	12.7	10.7	10.8	11.7	11.9	10.7	9.4	9.0	9.9	12.0	13.0	12.6
United States	7.3	4.6	4.3	2.4	2.3	1.8	2.4	2.1	2.1	0.4	0.7	0.6	1.6
Savings (gross)													
Portugal	..	13.1	10.5	9.8	10.2	10.9	10.6	10.5	9.7	9.2	8.1	6.6	6.9
Spain	14.6	17.5	14.4	12.7	11.1	11.1	11.4	12.0	11.3	11.3	11.2	10.2	11.2
United Kingdom	10.3	10.3	7.4	5.2	4.7	6.0	4.8	5.1	4.0	5.1	4.2	2.5	-0.2

THIS MONTH'S ANALYSIS: RETIREMENT AGE GROWING, WOMEN CATCHING UP

In addition to the general trend of increasing retirement age, more and more governments are considering equalizing the retirement age of men and women. The table on the next page provides pension age statistics as of today for both categories – men and women – in different countries. No one has a lower retirement age for men or for women than Ukraine. The normal retirement age for both men and women is around 62 in Eastern Europe. In higher income OECD countries the age is almost always 65 or older.

United States: Older Workers Feel Crisis

As the economy worsens, more and more retirement age workers lose their jobs. Last month the national jobless rate for those 65 or older hit 5.7%. That's still below the overall U.S. unemployment rate but the highest level for that age group since 1977. In January there were 373,000 people 65 or older who were unemployed in the U.S. Not only can the loss of a job hurt an older person's ability to pay today's bills and plan for tomorrow's retirement, but it can also take away private health insurance. Last year, people 65 or older accounted for 4.1% of all workers, many in the hard-hit retail sector, up from 2.8 % a decade earlier. The reasons for the shift include economic necessity, but also longer average life spans, changing societal views and a greater appreciation for "mature" workers' loyalty and experience. (Baltimore Sun)

Italy: Plans to Raise Retirement Age

The Italian government will push pension reforms further by having women retire later. According to the International Monetary Fund, increase in retirement age, especially for women, would reduce Italy's comparatively high level of pensions spending. It addition, such a strategy would allow Italy to reduce debt faster and free resources to strengthen Italy's weak social safety net. The European Court of Justice urged Italy to adjust the coefficients used for the calculations of retirement age. The adjustment will take place starting from January 2010. (Globalpensions.com)

Russia: Considering Raising Retirement Age

The Russian Ministry of Finance proposes to start increasing retirement age beginning 2015, though it would still distinguish between men (62.5 years) and women (60 years). For now, even after officially reaching retirement, Russians continue working. The rate of working pensioners in Russia is high: 35% vs. 10-15% in Europe. (Prime-Tass)

Bahrain: Shelves Law Allowing Extra Early Retirement for Women

Bahrain's Upper House of Parliament, the Shura Council, blocked a lower house motion to allow female civil servants to take early retirement at the age of 50, the Gulf daily News reported. Councilors described the government-drafted bill on this issue as being "unconstitutional, discriminatory and dangerous". Under the law, female civil servants would be given five 'virtual years' at 50 to ensure they get the same benefits when they retire at 55. The chairman of the Council's woman and child committee called the law "discriminatory" as it differentiates between male and female civil servants. The only Gulf Cooperation Council (GCC) country with such a "differentiated scheme is Kuwait, but women need to contribute more to the fund to benefit from the lower retirement age.

PENSION AGE BY COUNTRIES
(Sources : OECD, World Bank, national statitistics)

	Retirement Age	
Countries	**Men**	**Women**
Bulgaria	63	60
Croatia	65	60
Czech Republic	63	59-63
Estonia	63	63
Hungary	62	62
Latvia	62	62
Lithuania	62.5	60
Poland	65	60
Russia	60	55
Slovak Republic	62	62
Slovenia	63	61
Ukraine	60	55
High-Income OECD Countries	**Men**	**Women**
France	60	60
Austria	65	60
Switzerland	65	64
Netherlands	65	65
Norway	67	67
Italy	65	65
Ireland	65	65
Iceland	67	67
Greece	65	65
Germany	65	65
Korea	60	60
Finland	65	65
Denmark	65	65
Canada	65	65
Belgium	65	65
Australia	65	65
Japan	65	65
Luxembourg	65	65
New Zealand	65	65
United States	67	67
United Kingdom	65	65
Sweden	65	65
Spain	65	65
Portugal	65	65

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The USAID Capital Markets Project (CMP) was launched in October 2005, and is a five-year program designed to assist the country in developing a vibrant and effective financial sector. This effort will promote sustained economic growth and reduce the costs and risks to a sound pension system. You can find out more on the CMP website www.capitalmarkets.kiev.ua or on the website about pension reform in Ukraine: www.pension.kiev.ua

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