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Capital Markets Project

INTERNATIONAL PENSION NEWSLETTER

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Inside:

INTERNATIONAL TRENDS: IT'S TIME TO RAISE THE RETIREMENT AGE

Ageing population is one of the greatest challenges facing retirement systems worldwide. As a result of increased life expectancy combined with a decline in fertility the proportion of the 65 or over age category is growing.

The working – and contributing – population is expected to decline dramatically every year. If no measures are taken to keep older workers in the labor force, this could potentially cause the pension system to collapse.

Today, when results of the global financial crisis have begun to be felt seriously worldwide and that as a result of the deepening recession pension contributions threaten to fall, increasing the retirement age becomes an issue on the pension reform agenda of many countries, including Ukraine.

France: Proposal Allows French to Work Until 70

A new measure allowing the French to work until 70 breathes more flexibility into the existing system. As part of the government's wide-reaching project to overhaul the existing financing of the French social security system, a new measure now allows a person to work until 70 instead of 65. The new law offers the opportunity to continue working for up to ten years beyond the legal retirement age of 60 with full benefits (providing the worker has contributed enough). An employer will not have the right to demand that a worker to retire before age 70 if he does not want to leave.

Switzerland: Flexible Retirement Rejected

The Swiss rejected a motion to introduce a more flexible retirement age, allowing lower income workers to retire early – at 62 instead of 65 – with full benefits. The initiative that was supported by the Swiss socialists and a major trade union confederation was rejected by a clear majority of 59% of voters November 30. It is the seventh time in ten years that an attempt to reform the pension system by popular referendum has failed.

Czech Republic: Retirement Age Increase Approved

New legislation extending workers' employment period to receive pension benefits is gradually being implemented from 2009 through 2030.

International Trends: It's Time to Raise the Retirement Age

The measures – part of a Government social security overhaul initiated last year in response to challenges posed by the country's ageing population – include raising the normal retirement age to 65 for men, childless women, and mothers of one child. This expands previous measures to extend retirement age until 63 by 2016. Mothers with two or more children would still be able to retire 2 to 3 years earlier than the normal retirement age. The reform also extends the minimum working period required to qualify for full benefits from 25 to 35 years.

Cuba Raises Retirement Age by Five Years

On December 28, 2008, Cuban Parliament adopted a new Social Security and Pension reform bill stipulating that the retirement age for women is 60 and 65 for men, instead of 55 and 60 respectively but with increased benefits. The law also increases the minimum number of years required for a full retirement benefit from 25 to 30. Pensioners may go back to work and receive both their pension and the full salary providing they get a job different from the one they used to have before retirement, though they can work in their own professional specialty. The new legislation stipulates that workers who have reached retirement age when the law comes into force may choose when to retire. In Cuba there are 3.1 workers for every pensioner (2007) down from 7.1 in 1970, straining the social security system.

Australia: Retirement Age to Stay at 65 Says Minister

In reaction to an-ongoing debate about putting off retirement until after 65, Minister for Superannuation and Corporate Law responsible for retirement finances Nick Sherry spoke out against working longer. He told ABC television last December that retirement age should stay at 65 in Australia. According to Sherry, Australia's situation differs from that of other countries considering extending retirement age. First, Australia has a means-tested age pension which most other countries don't have. Second, though Australia's population is ageing it is younger than in other Commonwealth countries, preserving it from long-term fiscal pressures suffered by others.

WORLD RECESSION: LOSSES AND POSSIBLE OPPORTUNITIES FOR PENSIONS

Private pension funds have suffered significant losses due to their exposure to financial markets. But a closer look at performances throughout the world reveals a mixed picture.

United States: Workers Hold Fast Despite Falling Asset Values

Value of pension funds fell by much less than the value of equities and few workers in the US abandoned their accumulation accounts. The average account balance fell by 14% in 2008 for US accumulation accounts (401k plans) while the stock market fell by over 30%. Savings rates fell hardly at all (from 8% to 7.8%). Only 4% of workers terminated their participation in their pension plan. Roughly 50% of US workers are covered by a non-state pension scheme and at least half are in schemes with accumulation accounts (the other half still contributing in Defined Benefit schemes but on the decrease).

Thailand: State Pension Fund Sees Opportunity in Depressed Stocks at Home and Abroad

Thailand's largest institutional investor, the Government Pension Fund (GPF) plans to boost its investments in the domestic stock market to profit from bargain stocks. GPF wants to invest about 6 billion baht (172 million $US) this year in big cap stocks, mainly flagship industries, increasing its exposure from 7,5% to 9,5%. Thailand's main exchange, the SETI lost close to 50% of its value in 2008 but GPF representatives believe equities will still outperform bank deposit returns. A long-standing private equity investor, GPF manages about 10 billion $ in civil servant pension assets.

GPF will also be the first Thai pension fund to venture outside of Thailand, entrusting a Switzerland-based private equity firm with 3% of the pension's 330 million $US estimated net asset value to be invested on international markets.

Chile: Funds Say Heavy Losses Do Not Undermine Positive Long-Term Trend

Chile's private pension funds lost 22.5% in 2008, totaling 74.31 billion $US at the end of 2008, 21.56 billion less than in 2007. While all five pension fund categories, which are based on their level of risk and age, posted negative returns, losses in fact varied. While Fund A, a high-risk portfolio with 80% of its assets invested in equities, lost 40% of its value between January and December 2008. Fund C, the most popular portfolio choice, fell 19%. The most conservative option with a fixed-income focus, posted a 0.93% loss. The funds rebounded slightly in December as a result of positive performances by foreign stocks, especially Asian equities, the regulatory agency said. 28.5 % of fund assets are currently invested abroad, mainly in mutual funds. Experts say the pension fund industry is accustomed to ups and downs in the marketplace and should recover from the steep losses as it has from past downturns

World Recession: Losses and Possible Opportunities for Pensions

Turkey: Conservative Investments Help Pension Funds Grow Despite Crisis

Turkish pension funds have suffered less from the financial crisis, because of their conservative investment policy, Turkish newspaper *Hurriyet* reports. With less than 10% of their assets invested in equities, Turkish pension funds' exposure is much lower than in the US (about 60%) or in Chile's high-risk portfolio (80%). Also, nine out of ten funds in Turkey invest only in fixed-yield instruments and government bonds. Only a small number of the Turkish funds – 8% – invest in equity at all. The number of participants in pension funds have also increased reaching 1.75 million while the total value of the funds reached 6.4 billion lira (about 3.88 billion $US), an increase of 32% in 2008.

Central and Eastern Europe: Bad but Not All Bad for Pension Funds

In "Taking a Beating", *Investments & Pensions Europe* 's (IPE) Krystyna Krzyzak takes a hard look at asset management market in Central and Eastern Europe. While most results are bleak from the added effect of the investors' pull out of emerging markets, government and industry try to come up with responses, this specialized magazine and website.

http://www.ipe.com/articles/print.php?id=30325

GOVERNMENT, FUNDS INNOVATE TO STEM EFFECTS OF RECESSION

With markets plunging – down 70% in some Eastern European countries, and funds' assets losing half of their value, Government and industry are trying to come up with new responses to counter the risk of depleted retirement pensions.

Ireland: In Hard Times, Civil Servants Should Also Contribute

Civil servants should start funding their own pensions, the Irish Exporters Association (IEA), an influential lobbying body of private businesses told the Government. It is calling for legislation to reform the existing system. Irish state employees do not contribute to their own pensions, which are funded by the state budget. The government should introduce measures to make civil servants contribute to their own retirement instead of taxing an already strained private sector to cover these expenses, IEA says. Also, an expected 9% fall in exports – twenty times more than state budget projections – is bound to reduce the state's tax revenue in 2009.

Ireland: Pension Assets to Prop up Banks?

The Irish Government is launching a recapitalization program for banks that could be funded by the National Pensions Reserve Fund (NPRF). The Government plans to pump 2 billion euros each into both AIB and Bank of Ireland and another €1.5bn into Anglo Irish Bank. In return, the State will take 75% control of Anglo Irish and a 25% stake in AIB and Bank of Ireland. Finance Minister Brian Lenihan is defending his plan to use money from the National Pension Reserve Fund to recapitalize Ireland's three main banks despite criticism.

Hungary: Too Safe Is Costly for Pension System

Experts from *Investments & Pensions Europe* (IPE) say Hungary's dismal economic state was exacerbated by a social protection policy rendered unaffordable by low rates of return and low competitiveness. Though Hungarian funds have enjoyed relative freedom compared to caps imposed in other Central & Eastern European countries, with the option to invest abroad and in alternative assets like real estate, funds have stayed conservative in their investment choices. Though low risk portfolios may be perceived as positive, sheltering funds from sudden downturns, such conservatism actually generates high costs that may outweigh benefits. The conservative reflex, added to an uncompetitive pensions market has inflated administrative costs. Until now, equity exposure was about 25% on average while funds are slow in implementing a 2008 government policy forcing funds to introduce an array of portfolios offering varying risk-levels with a 40% minimal equity exposure in the more risk-oriented portfolios.

See full IPE analysis about the effect of the crash on the Hungarian private pension sector, "Freefall into the precipice" by Thomas Escritt.

http://www.ipe.com/articles/print.php?id=30322

Italy: Pension Watchdog to Scrutinize Funds

Italy's pension watchdog COVIP is launching a large-scale evaluation of larger complimentary pension schemes (Pillar III) including risk-monitoring, risk-management, investment and cost policies, *Global Pensions* website reports. COVIP wants to evaluate how the crisis is affecting funds' investment choices, as returns declined 8% on average. COVIP also urges pension schemes to communicate to members that they are allowed to delay their exit out of the scheme, even if they have reached retirement age.

FOCUS: PRESIDENT OBAMA'S PROPOSALS TO ENCOURAGE PARTICIPATION IN VOLUNTARY PENSIONS

President Barack Obama has made a number of relatively concrete pension reform proposals. With respect to private pension policy, we identify three major Obama-supported initiatives on the basis of his administration's social security strategy published on the White House website and campaign web sources.

"Automatic workplace pensions" plus "expanded savers' credit"

75 million working Americans – roughly half the workforce – lack employer-based retirement plans. Even when workers are offered the possibility of joining employer-based plans, many do not take up the option because it requires a big personal investment to research and choose the right one. However, "test studies of automatic enrollment retirement plans have found that when employees, including low-income employees who are the least likely to save, are given easy options to save they overwhelmingly choose to do so", as Obama's program points out. Various automatic enrollment tests have resulted in between 75 and 90 percent participation.

Therefore, the new administration proposes an "Obama-Biden retirement security plan" that will automatically enroll workers in a workplace pension plan. Also those employers who do not currently offer a retirement plan to their employees will be required to enroll their employees into a private pension plan (in the US through an Individual Retirement Account (IRA). Though employees retain the right to step out of the program, experts "estimate that this program will increase the savings participation rate for low and middle-income workers from its current 15 percent level to around 80 percent", the program says.

To encourage greater participation, greater personal savings, and to be fair to lower income families the state would match half of the first 1,000 $US that families with less than 75,000 $US/ year will pay into their personal accounts.

Pension investment transparency

Under the proposal, employees would receive detailed annual disclosure about their pension fund's investments. In his program, Barack Obama specifies that such disclosure would include details about which projects have been invested in, their performance, and some information about "probable future investment strategies".

Reform corporate bankruptcy laws to protect workers and retirees

An Obama-reformed bankruptcy code would include:

- "Putting promises to workers higher on the list of debts that companies cannot shed", thereby ensuring that bankruptcy courts do not privilege executives over workers.

- Protecting the jobs and benefits of workers and retirees when corporations file for bankruptcy by making sure that companies do not issue bonuses to executives while at the same time reducing workers' pensions.

- "Increasing the amount of unpaid wages and benefits workers can claim in bankruptcy court against their employer." Limiting the circumstances under which retiree benefits can be reduced.

THIS MONTH'S ANALYSES

OECD/World Bank: "Pensions at a Glance, Asia-Pacific" (January 2009)

According to OECD's press-release, the report concludes that "Asian countries should reform their pension systems in order to deliver sustainable and adequate retirement incomes for today's workers and to prepare for the rapid population ageing forecast over the next two decades." […] The report analyses the retirement income systems of 18 Asian countries. It says that reform is needed because "coverage of formal pension systems is relatively low, pension savings are often withdrawn early or received in an inadequate lump sum […] In OECD countries, an average of 70% of the working-age population are eligible for a pension. However in South Asia, just 7.5% of the working-age population are eligible and in East Asia 18%. Few countries in Asia/Pacific have social pensions to provide safety-net retirement incomes for people who are not members of formal schemes. Only in India are social pensions significant, with around 10 to 15% of older people covered."Read report:

http://www.oecd.org/dataoecd/33/53/41966940.pdf

Reports on Pension Schemes and the Financial Crisis

The effect of the financial crisis on pension assets spurred several reports analyzing long and short term impact. We selected some for you.

OECD: Pension Markets in Focus, Issue#5.

On Private pensions and the 2008 turmoil in financial markets, main private pension trends over 2001-2007.

Read in full:

http://www.oecd.org/dataoecd/42/19/41770561.pdf

World Bank: "The Financial Crisis and Mandatory Pension Systems in Developing Countries".

Potential impacts of the financial crisis on fully funded and pay-as-you-go retirement-income systems in World Bank client countries; identifying key short- and medium-term policy responses. "Read in full on WB website: http://www.worldbank.org/

In full:
International Social Security Association: "Analysis: Social Security in a Time of Financial Crisis", 08.12.2008 http://www.issa.int/aiss/layout/set/print/content/view/full/49088

Analysis: Social Security in a Time of Financial Crisis

ISSA, 08.12.2008

When taking into account the increasing role of fully pre-funded schemes in old-age protection – and the associated requirement to soundly invest these growing funds – the immediate negative impact of the current global financial crisis on social security is obvious: according to the OECD, developed country stock markets have lost 43 per cent of their value in a year.

In the United States alone, assets in retirement plans dropped in value by about USD 4 trillion, half of which were in defined benefit plans. The knock-on effect of the financial crisis is now translating into economic recession, which will affect social security programmes more generally, not least through reduced earnings (thus lower income from contributions and also from tax revenues) and higher levels of unemployment (thus higher expenditure for unemployment benefits).

Unsurprisingly, questions are being asked. What will be the wider ramifications for social security provision? Should pension funds continue to rely so heavily on financial markets? What are the longer-term implications for the financial sustainability of social security programmes?

There is a common concern that social security programmes will be affected negatively by the global financial crisis. Among a small sample of national social security bodies that rely on reserve funds to help finance pay-as-you-go pension schemes (Figure 1), the majority experienced some loss in returns in 2008, ranging from 7.7 to 17.3 per cent.

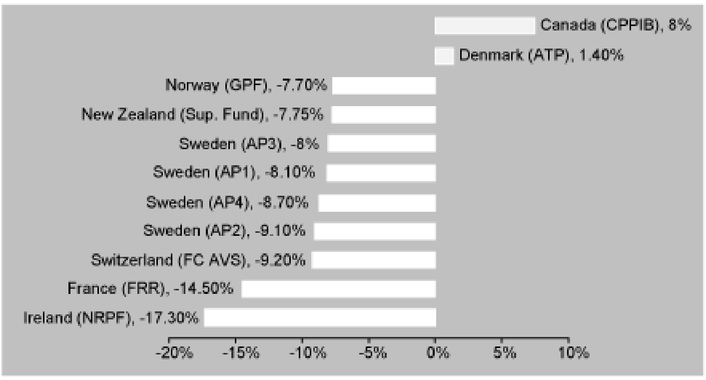

Figure 1: Year-to-date nominal returns in selected reserve funds

These figures are largely consistent with OECD data for pension funds in industrialized countries, showing a real rate of return of between minus 2.5 to 33.4 per cent. (Figure 2).

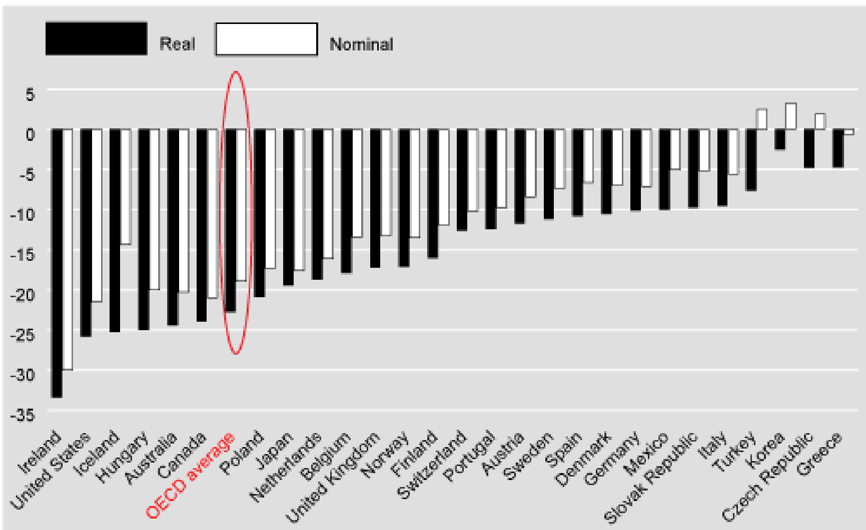

Figure 2: Year-to-date nominal returns in selected OECD pension funds
Source: OECD global pension statistics (January – October 2008).

Losses in the value of funds held by defined contribution pension schemes will have a direct impact on pension benefits, especially so for individuals close to retirement. The scale of the impact will also depend on the nature of the pension income that individuals expect to receive: whether the major source of income comes from (often private) pension funds or a public social security old-age pension. In the former case, questions may be asked about the wisdom of making old-age protection mainly dependent on financial market performance.

For the majority of countries globally that rely on public defined benefit pension schemes (Figure 3), the impact of the crisis will be different. In contrast to countries with defined contribution plans, the effects on defined benefit pension schemes will be indirect. Nonetheless, this will require a new assessment of the financial sustainability of these schemes. In the short term, other social security programmes will have to meet the immediate challenges of, and face the growing social needs created by, the economic downturn. Unemployment benefit programmes will be in the front line: according to a preliminary estimate from the International Labour Office (ILO), global unemployment could increase by 20 million by late 2009. Health care and family benefits programmes will also have to take measures to help mitigate the negative effects of the crisis.

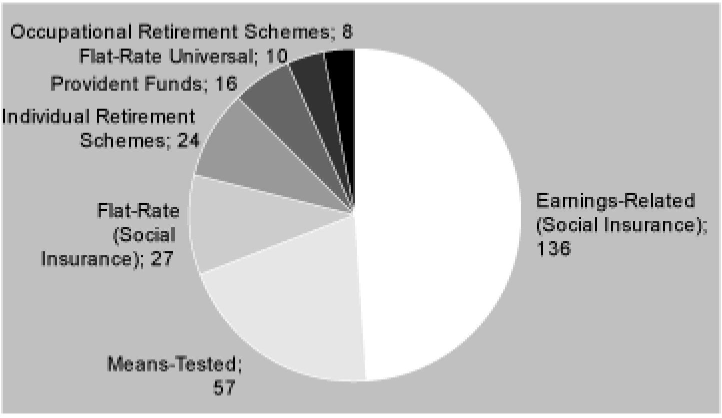

Figure 3: Types of mandatory systems for retirement income in 172 countries

In view of these considerations, the International Social Security Association (ISSA) plans to organize a joint meeting with the ILO in 2009 in order to assess the likely impacts of the financial crisis on social security programmes and especially on ISSA member organizations. To this end, a worldwide survey has already been launched.

While we wait for the findings of this survey, and despite a pressing need for further study and analysis of the effects of the financial crisis on social security provision, a few issues are already clear. In countries that rely mainly on pension funds, the financial crisis will have a direct negative impact for many individuals close to retirement. However, for a majority of countries, there is no reason to panic, especially in cases where funds have been duly managed following "prudent person" rules as outlined in the ISSA *Guidelines for the investment of social security funds (http://www.issa.int/aiss/layout/set/print).* The financial crisis is now spilling over into the real economy, and this will impact negatively on employment levels. As such, additional efforts to protect unemployed people and promote employment will be required. In many countries, support has already been granted to the financial sector. In coordination with this, what is now required is for appropriate support to be similarly provided to the social sector.

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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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