EXECUTIVE SUMMARY

PRIVATE PENSIONS OUTLOOK 2008

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In 1998, the OECD published *Maintaining Prosperity in an Ageing Society* in which it warned governments that "the main demographic changes start to come about in 10 to 15 years' time. This gives our societies a limited window of opportunity in which to introduce reforms in areas such as pensions and other social programmes." (p. 18).

The last ten years have been a period of rapid expansion in private pension systems. Governments have reformed public pension systems in order to make them financially sustainable and hence more secure, and have promoted private pensions to offset future declines in retirement income from public pensions. In half of the OECD countries, private pensions are now mandatory or cover the vast majority of the workforce.

Unfortunately, the last ten years have also been a period of turbulence in financial markets and the world economy. The "perfect storm" that pension funds suffered at the beginning of the millennium has been widely surpassed by the current crisis. With asset values dropping by 20% on average in the OECD countries between January and October 2008, the ongoing crisis is affecting the retirement savings of millions of individuals around the world (Figure S.2). Even if long-term investment performance figures are still relatively healthy (Figure S.3), workers are rightly worried about the security of their pensions and there is growing pressure on governments to act.

In this context, there is a critical need for comparable information on the evolution and performance of private pension systems. Such information can help pension authorities design better policies and allows employers and pension professionals to better understand what features of private pension systems work best in different contexts. The general public also needs to be better informed on the virtues and challenges of their pension system, become more conscious of the risks they face, and act accordingly.

The OECD Private Pensions Outlook is a new OECD publication that guides readers through the changing landscape of retirement income provision, distilling the complexity of private pension systems in a way that is accessible to both the professional and the lay reader. This edition starts with a special feature on the implications of the financial crisis for private pensions, followed by a series of chapters including in-depth, international analyses of private pension arrangements. Data draw primarily from the OECD Global Pension Statistics' project. This project, initiated in 2002, has become a leading reference point for comparable indicators and statistics on funded pension systems from an international perspective, including also selected non-OECD countries. The Outlook consists of five main chapters.

Chapter 1 describes the major expansion of funding and private pensions but raises concerns over their growth in some countries.

- The average growth rate of OECD private pension assets between 2001 and 2007 was 9.4%. In December 2007, nearly USD 28 trillion in assets (111% of GDP on average) were accumulated in pension funds (64% of the total), retirement savings accounts managed by banks or investment companies (18% of the total), pension insurance contracts (16% of the total), and other private pension arrangements in the OECD area. More than 60% of the total OECD private pension assets were held by the US system (USD 17 trillion). By October 2008, total OECD private pension assets were down to about US 23 trillion, or about 90% of the OECD's GDP.

- Prior to the onset to the crisis, some countries were already failing to accumulate a sufficiently large asset pool to cover the retirement savings "gap" caused by falling public pension benefits. The combination of low public pensions and sluggish private pension markets could potentially lead to insufficient retirement income for a large portion of the population in these countries (Figures 1.3 and 1.4). Such concerns have grown further during the current crisis.

- Greater efforts are also needed in most OECD countries to buffer public pension systems with large enough reserve to withstand the impact of population ageing on the finances of these pay-as-you-go systems. Only countries like Ireland, Japan, Mexico and Sweden have accumulated reserves sufficient to cover more than twice the annual expenditure on public pensions.

- Although all the main types of institutional investors contribute to the financing of retirement benefits, pension funds are losing some importance among the "traditional" classes of institutional investors. Largely thanks to the growth of defined contribution systems, insurance companies and mutual funds are capturing a growing share of the global pensions market. By December 2007, pension funds represented less than two thirds of the total assets in private pension arrangements.

- The shift towards defined contribution, though clear in terms of coverage of plans and members, has not yet affected the distribution of assets in countries like Canada, Finland, France, or Korea. In all of these countries, assets in defined benefit plans have actually grown faster than those in defined contribution plans over the past five years.

As shown in Chapter 2, there are concerns over the small size of individual pension funds in many OECD countries and the suitability of different investment strategies. Pension fund investments had become increasingly aggressive before the crisis in some countries, while in others they remained excessively conservative, with little equity and foreign investment. The crisis is also expected to wipe out the net positive income flows of the last few years.

- With a few exceptions, including Poland, Finland, and the Netherlands, the average pension fund in the OECD has less than USD 1 billion in assets under management, which can be considered to be a minimum threshold to achieve economies of scale in governance and investment. In countries like Belgium, Mexico, Spain and Turkey, the average pension fund has less than USD 100 million in assets. (Figure 2.10)

- In some countries, for example Ireland and the United States, pension funds raised their equity allocations substantially between 2001 and 2007, to over 60% of total assets, exposing them to large losses in 2008. On the other hand, pension funds in countries such as Denmark, the Netherlands and Switzerland engaged in a substantial shift in their portfolio from equities

to bonds between 2001 and 2007 (Figures 2.13 and 2.14). In the case of Denmark and the Netherlands this portfolio reallocation appears to be partly driven by the introduction of stricter, risk-based funding requirements. The most conservative portfolios are found in countries such as Mexico, Poland and Turkey, with little equity and foreign investment. Major declines in equity allocations and increases in bonds and cash took place in 2008 across the OECD as equities crashed while government bonds yielded strong, positive returns.

- Pension funds have also increased their diversification in foreign markets in recent years. Over 2001-2007, pension funds based in the euro area benefited from the elimination of currency risks, leading to greater international diversification in pension fund portfolios. Of the OECD sample surveyed, the Netherlands has the most internationally diversified pension fund portfolio, with 82% of total assets issued by entities located overseas and nearly 40% in currencies other than the euro. On the other hand, pension funds in Korea, Mexico, Poland, and Turkey invest on average less than 5% of their assets overseas.

- Pension fund net income flows already turned negative in Belgium and Denmark in 2007. As equity markets crashed in 2008, many more countries are expected to have negative pension fund net income flows. The expected losses in 2008 will easily exceed the net income gains of the previous two years. Contributions are likely to increase rapidly in relation to GDP, intensifying a trend triggered by the "perfect storm" of the start of the millennium.

- Pension fund markets in non-OECD countries, although small in comparison to the OECD average, have grown rapidly in recent years. The Chilean pension fund industry, for example, grew from USD 55.6 billion in 2004 to USD 105.6 billion in 2007 (64% of GDP). Only a few non-OECD countries such as Chile, Israel, Liechtenstein and Singapore have mature pension fund markets (assets to GDP ratios greater than 20%). Pension fund assets in the BRIC countries were all relatively low in relation to GDP (17% in Brazil, 2% in the Russian Federation, 5% in India, and 1% in China).

As shown in Chapter 3, assets accumulated in Public Pension Reserve Funds, the funds set up to support pay-as-you-go public pension systems, had grown rapidly before the onset of the crisis and portfolios had become increasingly exposed to equity markets.

- During 2001-2007, public pension reserve funds (PPRFs) continued their steady growth. By the end of 2007 the total amount of PPRF assets within the countries covered in this publication was equivalent to USD 4.3 trillion, compared to USD 2.6 trillion in 2001. In relation to the size of the economy, the largest PPRFs were the Swedish AP Funds (32% of GDP), Japan's Government Pension Investment Fund (26% of GDP) and Korea's National Pension Fund (24% of GDP). PPRFs are expected to play a major role in the future financing of public pension systems, alleviating the impact of population ageing on the public purse. (Table 3.1)

- Even more than pension funds, PPRFs embarked on a major reallocation towards riskier assets between 2001 and 2007, albeit from a situation of relatively conservative portfolios. The highest equity allocation, and hence the worst performer in 2008, was the Irish National Pension Reserve Fund. This experience mirrors that of private pension funds, as Irish pension funds on average had the highest equity allocation in the OECD area in 2007 and experienced the worst investment performance in 2008. (Table 3.3)

Chapter 4 provides an evaluation of the performance of private pension systems according to key policy criteria such as the extent of coverage of private pension systems, the adequacy and security of benefits provided, DB pension fund solvency, investment performance and administrative efficiency.

- The analysis on coverage focuses on countries with relatively low average public pension benefits and voluntary private pensions. Although well above half of the employed population in the eight OECD countries surveyed have private pensions, coverage is unevenly distributed. Younger workers and people with low incomes are much less likely to be members of a voluntary private pension plan. As a result, barring countries where lower income individuals benefit from relatively high public pensions, OECD governments should focus their policy efforts to expand coverage among middle income workers and low earners. (Figures 4.1 and 4.2)

- The analysis of benefit adequacy and security indicates that individuals in many OECD countries may run the risk of not having enough income in retirement to maintain the same standard of living as they enjoyed while in active employment. In some countries like Australia, Canada, France, Germany, Japan and Mexico, even workers with a full contribution record of 40 years or more in both the public and private pension system, and earning average wages will be unlikely to reach a replacement rate greater than 60%. (Figure 4.3)

- The cross-country analysis of investment performance makes some initial observations regarding the data that would be needed to undertake an in-depth analysis of the risk-adjusted performance of pension funds. For countries where good quality data is available, the evaluation of pension fund investment performance against market benchmarks is generally positive, at least after taking regulatory constraints into account. (Table 4.4)

- Using a large, international sample of publicly quoted companies, the analysis of defined benefit plans indicates that the companies with the largest liabilities relative to their market capitalisation are those domiciled in the United Kingdom, followed by a large margin by other countries like the Netherlands, Ireland, Switzerland and the United States. Despite the move towards defined contribution that has been made by many companies, legacy defined benefit plans and their obligations often remain on company balance sheets and continue to have a major financial impact. This is especially the case where these plans are underfunded which was the case in nearly all the countries surveyed. (Figure 4.11 and 4.12)

- Countries with defined contribution systems (e.g. Australia, the Czech Republic, and Mexico) and those with large numbers of small funds (e.g. Canada, the United Kingdom) have higher operating costs as a percentage of assets managed than countries with only a few funds offering collective pension arrangements (e.g. Denmark, Finland, Germany, and Iceland). Fees paid by plan members in mandatory defined contribution systems are highest in Hungary (nearly 2% of assets under management) and lowest in Sweden (less than 0.5% of assets). Outside the OECD the highest fees are observed in Costa Rica (2%) and the lowest in Bolivia (0.5%). Such wide differences in fees can result in benefit gaps as large as 30% between low and high fee countries. (Figure 4.13 and 4.15)

The last part of the publication contains a set of country profiles which describe in a concise manner the design of private pension systems in OECD countries.

EXECUTIVE SUMMARY: SELECTED FIGURES AND TABLES

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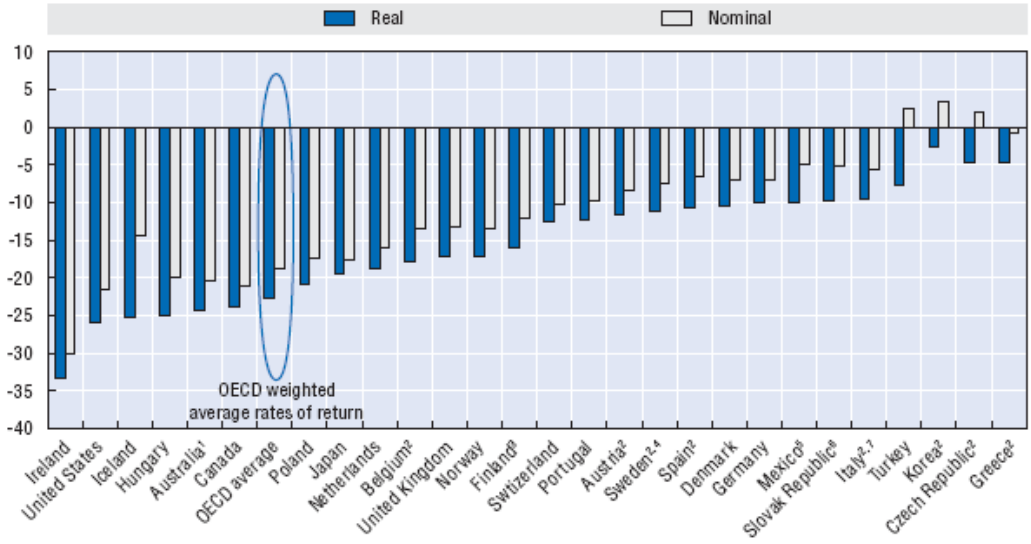
Figure S.2. Nominal and real pension fund returns in selected OECD countries, January-October 2008
In percent



Note: OECD average is an asset-weighted average.

Some data draw on official data received from Delegates to the OECD Working Party on Private Pensions Delegates (Australia, Austria, Belgium, Czech Republic, Denmark, Finland, Greece, Hungary, Ireland, Italy, Korea, Mexico, Poland, Portugal, Slovak Republic, Spain, Switzerland, and Turkey).

1. Official data up to June 2008 then complemented by OECD estimate up to October.
2. 2008 data refer to 30 September 2008.
3. Data refer to statutory earnings-related pension plans.
4. Data refer to occupational pension plans only.
5. Data refer to the mandatory and voluntary pension systems.
6. Data refer to balance funds.
7. Data refer to new pension funds (contractual and open) instituted after 1993 legislation.

Source: Various sources and OECD estimates.

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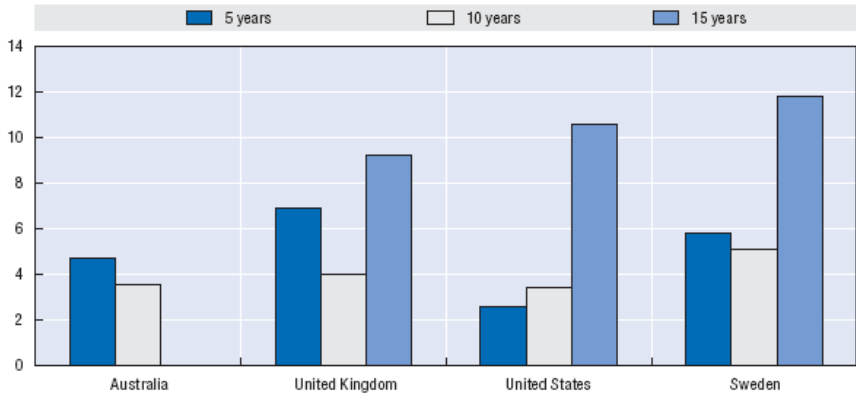
Figure S.3. Nominal average annual pension fund return in selected OECD countries over the last 5, 10 and 15 years



Source: Various sources and OECD estimates.

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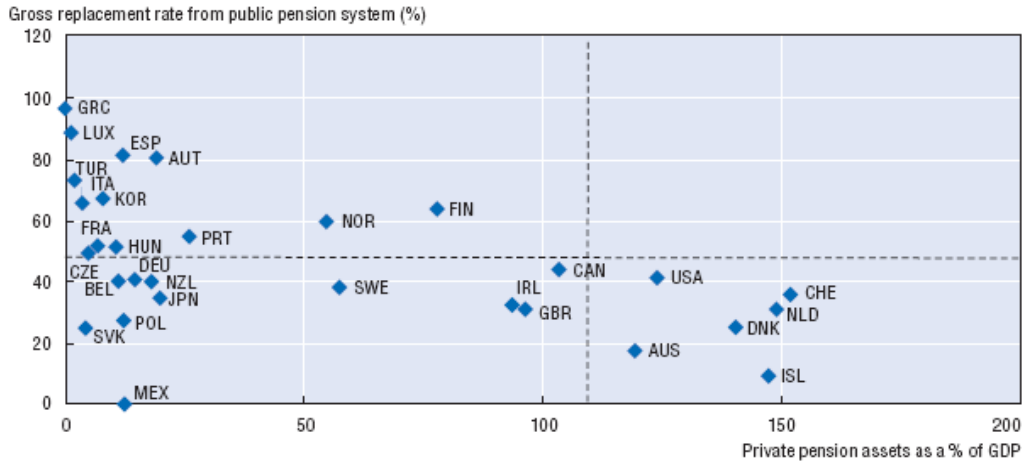
Figure 1.3. Private pension assets compared with the public pension system's gross replacement rate, 2007



Note: Public pension system refers to pay-as-you-go financed (PAYG) pension plans.
Pay-as-you-go pension plan replacement rates refer to the year 2004 and are defined as the ratio of an individual's - or a given population's - (average) pension to his or her average income over a given period, in this case, the final salary before retirement.
Data for Luxembourg refer to the year 2006.
The vertical line gives the OECD-weighted average of assets as a percentage of GDP, while the horizontal line gives the OECD simple average of public gross replacement rates.

Source: OECD Global Pension Statistics and OECD estimates.

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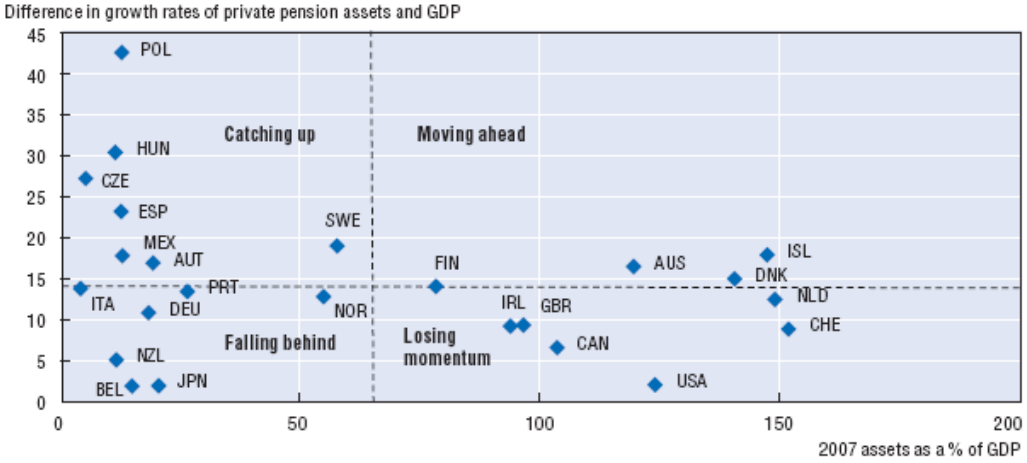
Figure 1.4. Private pension assets in 2007 compared to the difference in average growth rates of private pension assets and GDP over the period 2001-07 in selected OECD countries



Note: The vertical line gives the OECD simple average assets as a percentage of GDP, while the horizontal line shows the OECD simple average of the difference in growth rates of private pension assets and GDP. Countries in the upper right quadrant are moving ahead because both their assets and the rate at which they are growing are above the OECD average. Countries in the bottom left quadrant are "falling behind" because they are below the OECD average on both counts.

Source: OECD Global Pension Statistics and OECD estimates.

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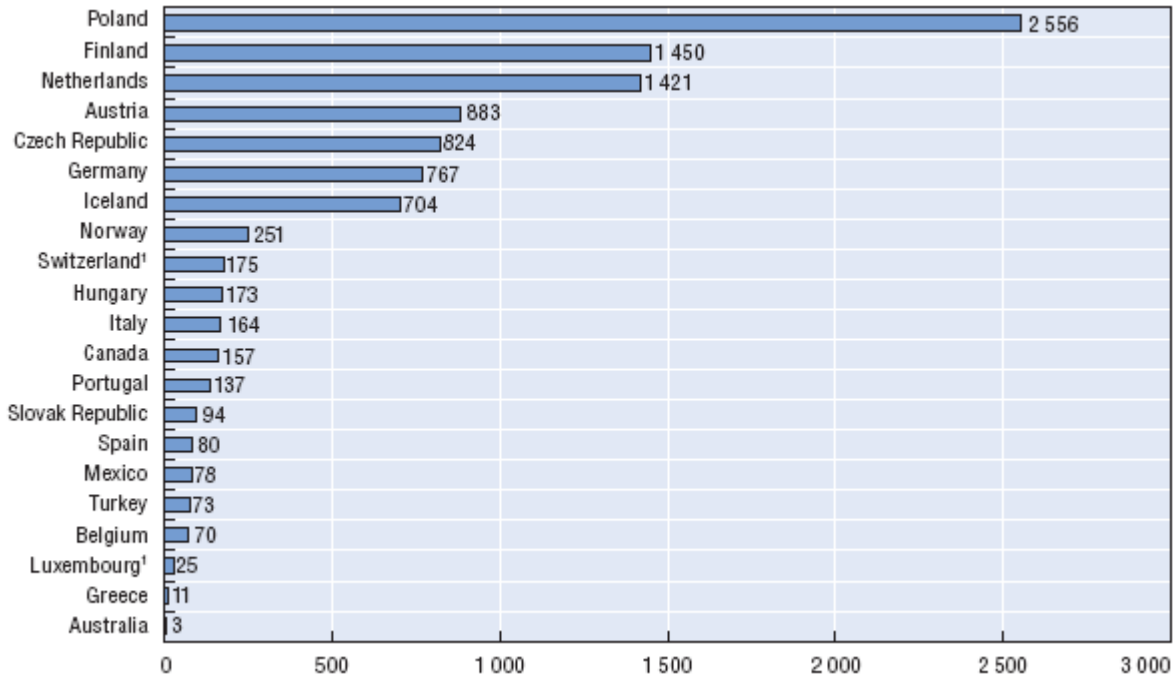
Figure 2.10. Average size of pension fund (ratio of pension funds' total assets to the number of funds) in selected OECD countries, 2007

In millions of USD



1. Data refer to the year 2006.

Source: OECD Global Pension Statistics.

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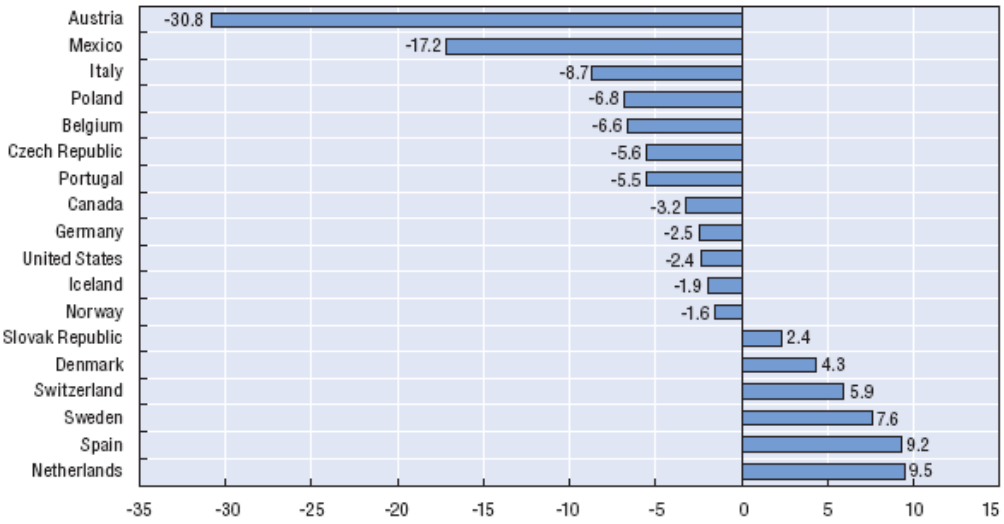
Figure 2.13. Variations in bills and bonds allocations between 2001 and 2007 in selected OECD countries

In percentage points



Source: OECD Global Pension Statistics.

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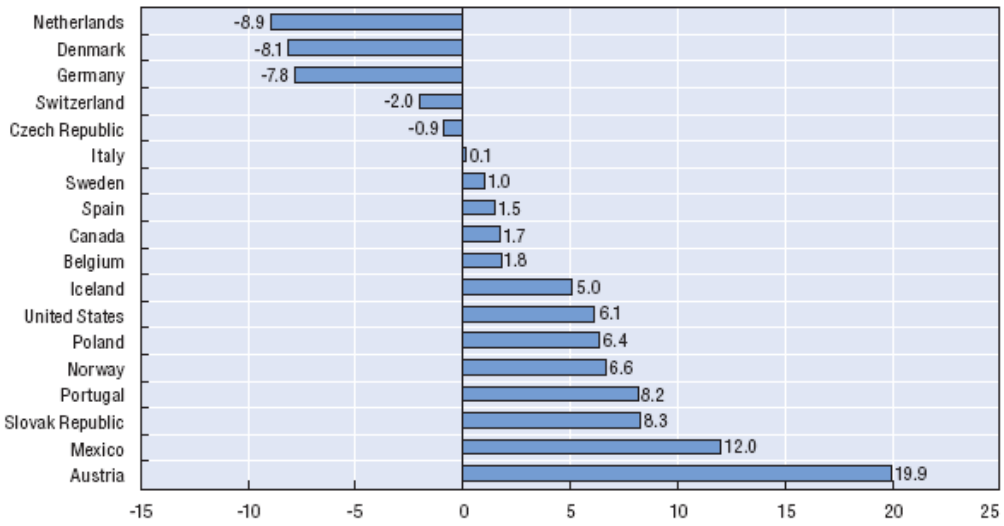
Figure 2.14. Variations in equities allocations between 2001 and 2007 in selected OECD countries

In percentage points



Source: OECD Global Pension Statistics.

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Table 3.1. Size of public pension reserve fund markets in selected OECD and non-OECD countries, 2007

Type of fund		Name of the fund or institution	Founded in	Assets	
				USD billions	As a % of GDP
Selected OECD countries					
Social security reserve funds	Canada	Canadian Pension Plan	1997	108.7	7.9
	Denmark	Social Security Fund	1964	0.8	0.3
	Japan	Government Pension Investment Fund	2006	1 149.2	26.2
	Korea	National Pension Fund	1988	228.7	23.9
	Mexico[1]	IMSS Reserve	n.d.	7.4	0.9
	Spain	*Fondo de Reserva de la Seguridad Social*	1997	62.1	4.5
	United States	Social Security Trust Fund	1940	2 238.5	16.6
Sovereign pension reserve funds	Australia	Future Fund	2006	43.7	4.9
	France	*Fond de Réserve des Retraites*	1999	47.4	1.9
	Ireland	National Pensions Reserve Fund	2000	29.0	11.5
	New Zealand[2]	New-Zealand Superannuation Fund	2001	9.5	7.8
	Norway	Government Pension Fund – Norway	n.d.	20.1	5.2
	Poland	Demographic Reserve Fund	2002	1.2	0.3
	Portugal[1]	Social Security Financial Stabilisation Fund	1989	8.3	4.3
	Sweden	National Pension Funds (AP1-AP4 and AP6)	2000	137.0	31.7
Total selected OECD				4 091.8	14.5
Selected non-OECD countries					
Social security reserve funds	China	National Reserve Funds	1951	94.6	3.1
	Jordan[1]	Social Security Corporation	1980	5.3	36.7
	Pakistan	Employees' Old-Age Benefits	1976	2.4	1.8
	Saudi Arabia[1]	General Organisation for Social Insurance	1973	8.6	2.4
	Thailand[1]	Social Security Office	1990	11.6	5.6
Sovereign pension reserve funds	China	National Social Security Fund	2001	57.8	1.9
	Russian Federation	National Wealth Fund	2007	32.4	3.3
Total selected non-OECD				212.7	4.5

1. Data refer to the year 2006.
2. The fund was not established until 2003.
Source: OECD and various national sources.

StatLink http://dx.doi.org/10.1787/516120477572

Table 3.3. Changes in public pension reserve fund allocations to equities and bonds in selected OECD and non-OECD countries, 2001 vs. 2007

As a percentage of total investment

	Equities		Bonds	
	2001	2007	2001	2007
		Selected OECD countries		
Australia	..	25.6	..	0.0
Canada	15.6	57.9	64.6	28.3
Denmark[1]	50.9	0.7	43.8	26.4
France	..	64.5	..	33.5
Ireland	..	72.1	..	16.9
Japan[1]	39.9	37.3	58.9	62.7
Korea[2]	5.2	13.7	50.8	83.2
New Zealand[3]	..	59.9	..	17.3
Poland	..	22.7	..	66.8
Norway	14.7	59.6	19.3	35.5
Portugal[1]	10.5	20.8	51.5	70.1
Spain	0.0	0.0	100.0	100.0
Sweden	56.0	52.9	37.2	38.5
United States	0.0	0.0	100.0	100.0
		Selected non-OECD countries		
China[1, 4]	1.3	24.2	46.8	53.7
Jordan[1]	..	63.5	..	17.0
Pakistan[2]	..	17.7	..	76.9
Russian Federation	..	0.0	..	100.0

1. 2007 data refer to the year 2006.

2. Data refer to investment assets.

3. "Bonds" include both bonds and cash.

4. Data refer to the National Social Security Fund only.

Source: OECD and various national sources.

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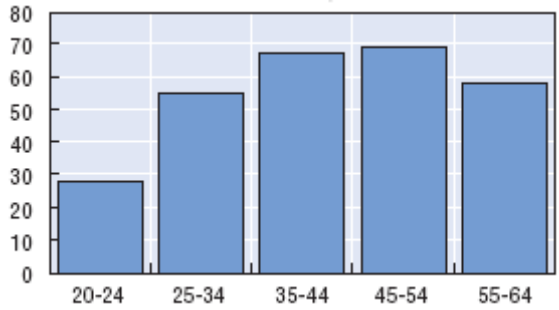
Figure 4.1. Coverage of voluntary private pension plans by age, United Kingdom

As a percentage of total employment

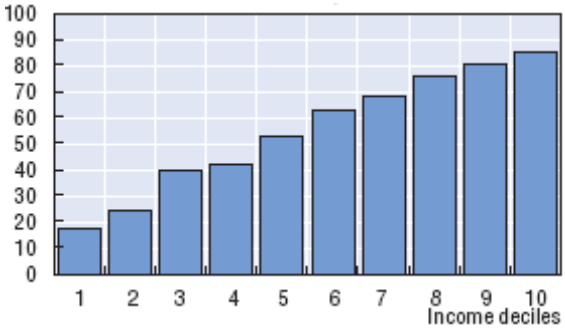


Source: Antolin, P. (2008), "Coverage of funded pension plans", Working Paper on Insurance and Private Pensions No. 19, OECD, Paris.

StatLink http://dx.doi.org/10.1787/516367716648

Figure 4.2. Coverage of voluntary private pension plans by income, United Kingdom

As a percentage of total employment



Source: Antolin, P. (2008), "Coverage of funded pension plans", Working Paper on Insurance and Private Pensions No. 19, OECD, Paris.

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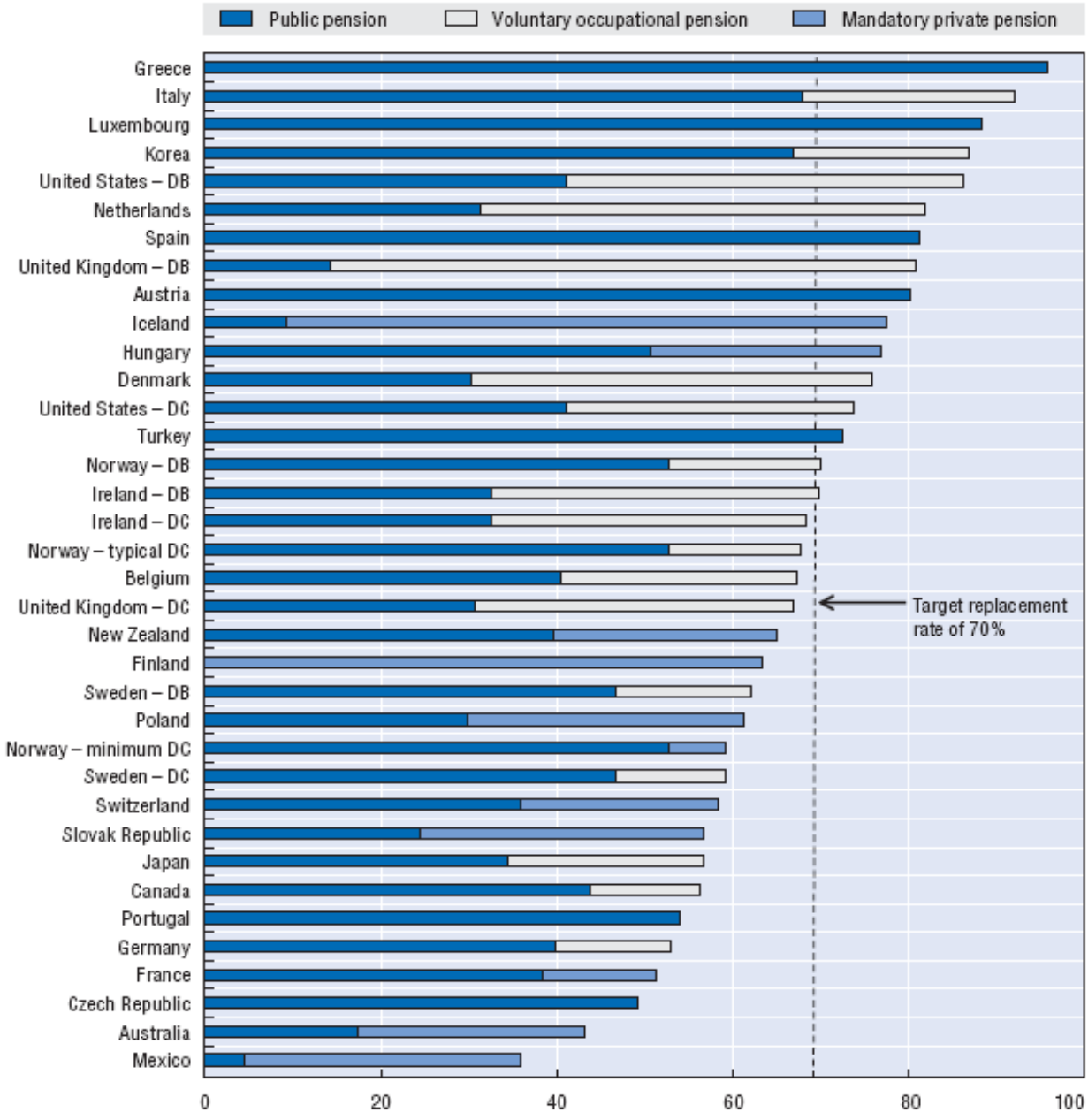
Figure 4.3. Potential replacement ratio at normal retirement age: public pension, mandatory private pensions and typical occupational plans

As a percentage of final earnings



Source: OECD estimates.

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Table 4.4. Countries pension funds' returns net of benchmark returns (extract)

	Gross nominal investment return[1]	Standard deviation	Returns net of benchmark returns	
			Un-restricted benchmark portfolio	Benchmark portfolio with the highest overall return subject to investment constraints
(1)	(3)	(4)	(9) = (3) – (5)	(10) = (3) – (7)
Argentina	11.6	0.216	–2.8	–1.9
Australia	12.0	0.059	2.0	*
Canada	8.7	0.027	2.2	2.0
Chile	23.0	0.168	–0.1	4.2
Czech Republic	6.7	0.020	0.3	0.4
Hungary	10.0	0.056	–1.3	–1.3
Japan	2.8	0.076	–3.0	*
Mexico	16.1	0.075	–0.1	1.6
Netherlands	8.6	0.078	–0.6	*
Poland	13.9	0.070	1.9	1.9
Sweden	8.3	0.091	–0.5	
United Kingdom	10.1	0.135	–1.8	*
United States	10.3	0.097	–1.1	*

1. Returns in column (3) do not necessarily coincide with those in table 4.3. The periods considered can be different due to data constraints resulting from the different asset classes used to construct the hypothetical benchmark portfolio.

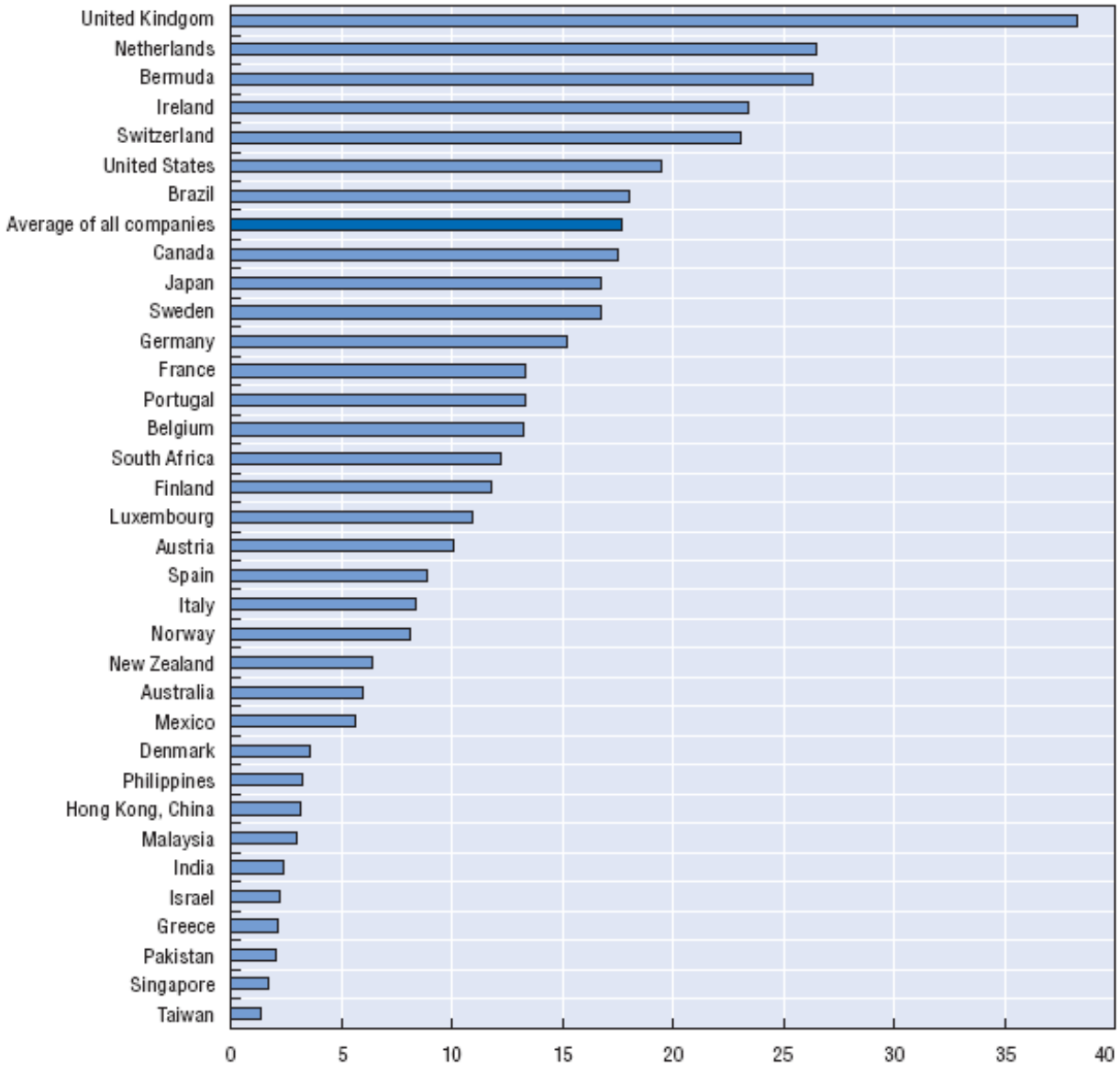
Note: * means countries with a "prudent man" framework, i.e. there are not strict investment restrictions. The six asset classes used to construct the hypothetical portfolio are: equities (national and overseas); government bonds (national and overseas); money market securities (with overnight and 3 month maturities) and corporate bonds.

Source: OECD calculations.

StatLink http://dx.doi.org/10.1787/516686086805

Figure 4.11. Weight of pension obligation (DBO) compared with market capitalisation in selected OECD and non-OECD countries, 2007

As a percentage of market capitalisation



Note: Average for companies reporting a DBO grouped by country of domicile.

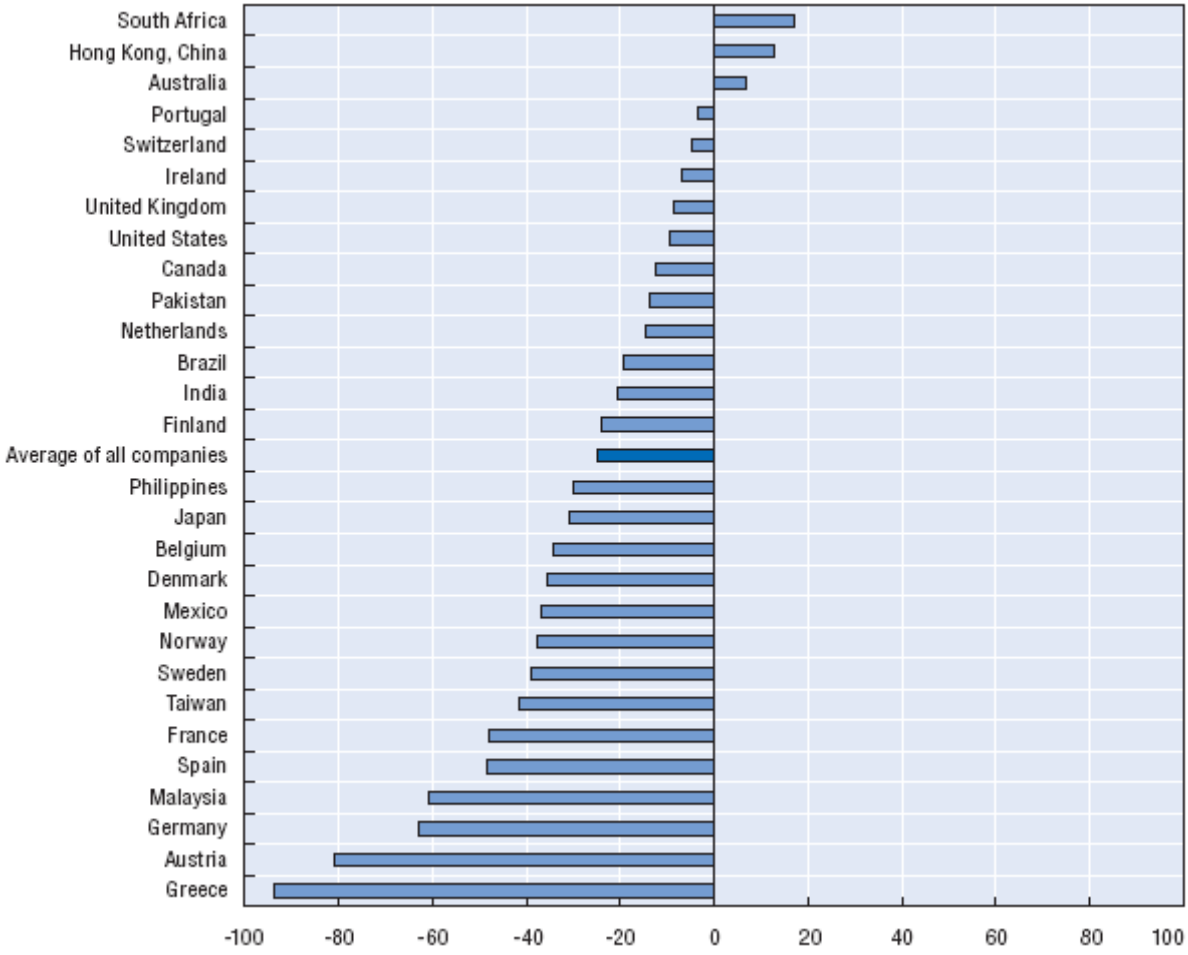
Countries with 10 or more companies reported only.

Source: Thomson Financial Datastream and OECD calculations.

StatLink http://dx.doi.org/10.1787/516865008800

Figure 4.12. Average percentage over/(under) funding of sampled companies in selected OECD and non-OECD countries, 2007

In percent



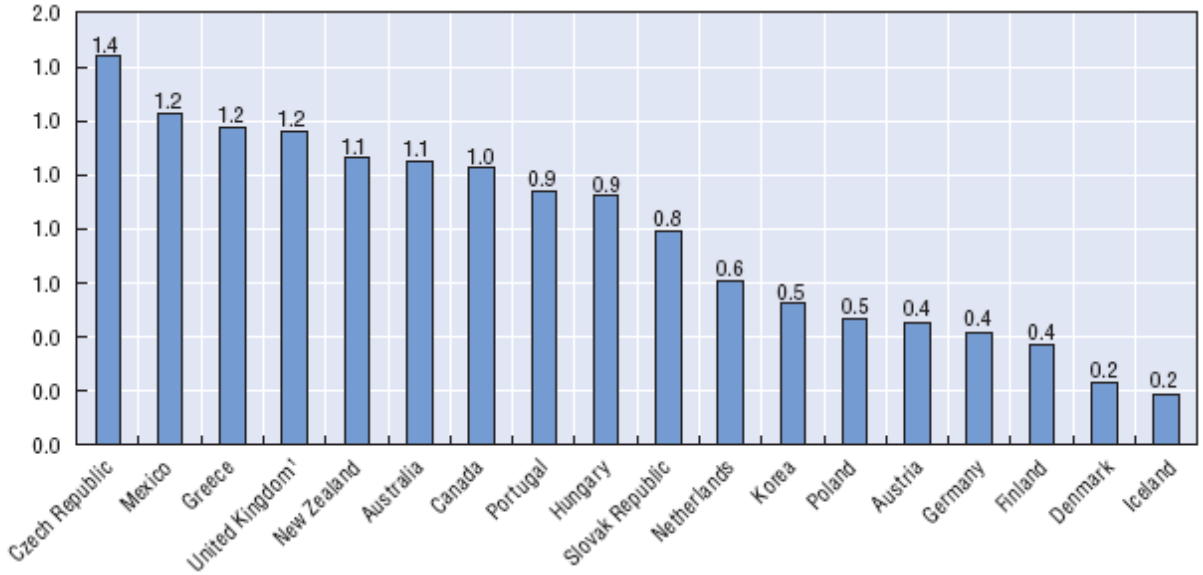
Note: Per cent over/(under) funded = (Plan assets – DBO)/DBO. Only companies from our index that reported a 2007 DBO were included. Only countries with 10 or more companies reporting a DBO are included.

Source: Thomson Financial Datastream and OECD calculations.

StatLink http://dx.doi.org/10.1787/516882051311

Figure 4.13. Total operating costs of pension funds, 2007

As a percentage of total assets

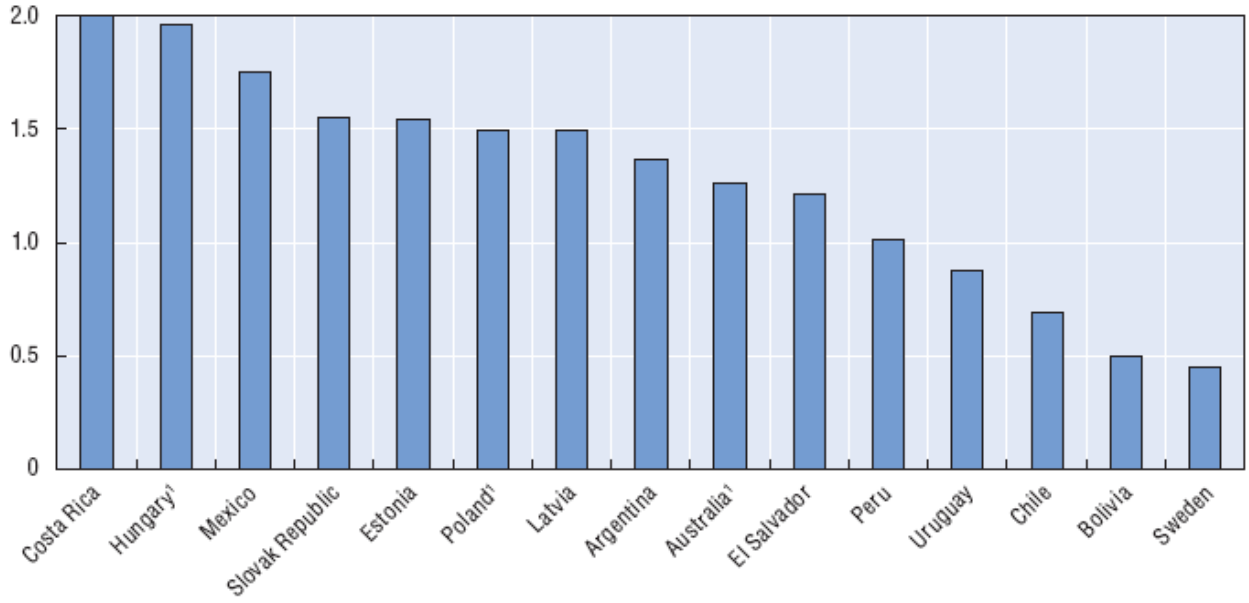


1. Data refer to the year 2006.
Source: OECD Global Pension Statistics.

StatLink http://dx.doi.org/10.1787/516888750186

Figure 4.15. Administrative charges in selected OECD and non-OECD countries, 2007

As a percentage of total assets



1. Data refers to the year 2006
Source: Tapia and Yermo (2008).

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