



Will he ever have a pension?

By Jill Kerby

The pensions industry may be a global one today, but not everyone may be aware that the problems in the industry – of lower birth rates, longer life-spans, improving medical treatments and faltering investment strategies, are universal, and not exclusive to western, developed countries.

Recently, much of Paris, other large French cities and the major airports came to a standstill for 24 hours when protesting civil service workers took to the streets to protest about reforms to the state pension system which would require them to work the same number of years as private sector workers to qualify for a full state pension.

Eastern Europeans, South Americans, Asians and Africans are all facing the same challenges as the French and most other developed European and western countries: how to provide their citizens with a retirement income without bankrupting national exchequers, crippling employers, or leaving the individual to cope alone.

At the World Pension Conference, which was held in Dublin last April for the first time a multi-national viewpoint was adopted by the speakers, who aimed to put the seemingly intractable problems of ageing

populations and uncertain funding and investment performances into perspective. In effect, they suggested that the more we accept that it is a shared problem, the greater the chance that there will be a shared solution.

The Minister for Social and Family Affairs Mary Coughlan TD adopted a positive tone in her speech to the assembled audience at the Shelbourne when she pointed out that the current difficulties being experienced in the pensions community was also an opportunity for everyone to reassess the definition of working life and retirement.

“The combined effect of large numbers reaching retirement age and rising life expectancy will be a doubling of the old age dependency ratio,” said Ms Coughlan. “In 2000 the over 65s were equivalent to about one quarter of the working age population in the EU; by 2050 it is projected to be nearly 50%. Ireland stands out from other EU countries in that just over 11% of our population are over age 65.

“This does not mean that we are exempt from the difficulties faced by other countries. Ireland faces the same so called challenges; the only difference is that these appear later.

“I think, in this context, it is important to state clearly that the increasing numbers of older people in our society should be celebrated - sometimes it is referred to as “a burden” and this is not appropriate. Conventional approaches and indeed wisdom need to be challenged, and new models, especially in relation to labour market participation need to be developed. I would like to think that the changing role of older people in our society is firmly on our agenda in this country.”

Richard Hinz of the World Bank, takes a regular birds-eye view of the global pensions situation – as he flies around the world gathering research and passing on recommendations to the world’s pension community.

According to Mr Hinz, not only is pension provision more widespread in developing countries than we may have presumed, but the people of Eastern Europe, South America, Asia and parts of Africa are trying to come to grips with the pressure that is being inflicted on their Pay As You Go state pension schemes, which are the most common retirement vehicles in these countries.



MARY COUGHLAN T.D., MINISTER FOR SOCIAL & FAMILY AFFAIRS

"Most countries in the developed world face the same challenges going forward; how to provide pensions that are both adequate and sustainable in a context where our populations are ageing fast. In 2000 the over 65s were equivalent to about one quarter of the working age population in the EU; by 2050 it is projected to be nearly 50%.

"Ireland stands out from other EU countries in that just over 11% of our population are over age 65. This does not mean that we are exempt from the difficulties faced by other countries... the only difference is that these appear later."

Already in Europe and other developed economies, such systems are experiencing serious systems failures, and according to Mr Hinz, governments face some tough choices if they want to maintain benefits at current levels going into the future: to double contribution rates from 15%-30% to 30%-60%, (which is clearly impossible); to reduce income benefits by half or extend the working period by as much as 10 years.

But it isn't just in France, Germany or Italy that these tough choices need to be made, however. Countries in Eastern Europe and South America, for example, which only provide state benefits, however modest, are discovering that a sizeable part of the annual deficits are now due to the cost of pension provision.

There has been "uneven progress in the reform of pension systems around the world," Mr Hinz told the conference, with "most of it happening in places like Latin American and Central and Eastern Europe. Progress has been slower in the OECD while the process is just beginning "in other

places like the Middle East, Asia and Africa."

Reform is happening in many different ways. Some countries are moving from defined benefit systems to defined contribution ones without transforming the entire system. Others are privatising pensions altogether; some are pre-funding a portion of the liability; others are diversifying from solely a state funded Pay As You Go system to one of multiple pillars.

As one method is adopted or is seen to be working – such as pre-funding, additional pillars, the transfer of risk from employer to employee, even longer working years and lower benefits – they are adopted by others, he says.

Countries everywhere are experiencing the same difficulties and are asking the same questions: what is the most efficient pay-out systems? How can you devise an annuity system that will work fairly? How do you reach lower and middle income groups to convince them to participate more in the

pension system? How do you educate large groups of people about investment risk, and responsibility? How do you encourage political reform, or create a flexible enough pension system that doesn't automatically exclude 65 year olds who can still make an important contribution to the economy and society?

Other speakers at the conference also concentrated on the issues of risk and reward, on the technical juggling act that has become modern fund management, and on the increasingly important issues of fund governance.

Three speakers – Divyesh Hindocha of Mercer Investment Consulting, Stefan Duchateau of KBC and John Caslin of Eagle Star – all posed the same question from different perspectives: how can trustees and fund managers learn from the mistakes of the boom and bust markets of the past decade to once again produce steady, risk-acceptable returns?



PIIA-NOORA KAUPPI, FINNISH MEP

"Pensions in Europe will have to be reduced in the future or more of our GDP will have to be spent providing pensions.

"On average only 25% of people in Europe are covered by supplementary occupational and personal pension schemes. This underlines the need to develop Pan European Pension Funds. This development of Pan European Pensions has now been facilitated by the passing of the EU Directive on Institutions for Occupational Retirement Provision by the European Parliament."



RICHARD HINZ, WORLD BANK

"Our current systems of pension provision are unsustainable. Demographic changes will mean that in some countries pensions could have to be reduced by half or retirement age increased by up to 10 years to make the current systems financially viable in the long run.

"This means that around the world pension systems are being reformed. Life expectancy is longer everywhere; birth rates are lower everywhere and converging to replacement levels only."

It isn't an easy task, especially since it means setting aside long held conventions about equities and requires some serious 'thinking outside the box'. The conference certainly came away with the message that demographics, uncertain market performance and a striking loss of confidence in equity funds by pension fund holders and trustees means that finding a new way – one that includes more diversity of investment assets – is an urgent priority.

Finally, the conference also heard about Ireland's pension developments, with up-to-date reports on the Pension (Amendment) Act, which introduced PRSAs, from the Chief Executive of the Pensions Board Anne Maher and about the progress of the National Pensions Reserve Fund, by its Chairman, Donal Geaney.

Equity investment in the NPRF is currently well below the fund's long-term benchmark, which targets 40 per cent investment in euro-zone equities, 40 per cent in non-eurozone equities and 20 per cent in bonds. Although the €8.2 billion fund has lost approximately €760 million over the past two years, the Commissioners will only be modifying, not abandoning their strategy of keeping to relatively heavily weighted equities.



George Lee, RTE Economics Editor; John Feely, IAPF; Mary Coughlan TD, Minister for Social and Family Affairs and Anne Maher, Chief Executive of the Pensions Board at the World Pensions Conference, April 28, 2003.

It has been decided to also diversify the portfolio in the future "in principle... to invest in corporate bonds, small-cap equities, public-private partnerships and property." The Commissioners are working on an "appropriate entry strategy" and absolute return models. "We will be looking at how the fund might access these."

In keeping with all the other speakers, Mr Geaney gave equities a vote of confidence, albeit a guarded one:

"For equities to under-perform bonds on a 30 year view, it would be necessary to hypothesise a scenario where, over that time period, the return on invested equity capital did not exceed its cost.

"Should that scenario come to pass it is highly likely that the fundamentals of capitalism would have failed. Though this may be remotely possible, the Commissioners did not feel it would be sensible to plan for it."

He hoped future generations would not judge them too harshly for their failure to forecast the end of the capitalist system.

Later, a Conference delegate was overheard to say, "Donal Geaney may have said what every speaker at this Conference was afraid to say: that none of us can be complacent. We have to come up with solutions. We have to plan for success in this industry, not failure."

STEPHAN DUCHATEAU, KBC ASSET MANAGEMENT

"The fundamental rule of fund management is, Rule Number 1: 'Don't lose money' and Rule Number 2 "Don't Forget Rule Number 1' The pension investor only wants to know 'when do I get my money back', he is not interested in your investment strategy or the reasons for a failing market..

"It is an absolute fallacy, from a statistical point of view that risk reduces over time. It is what everyone says, but in fact risk increases over time. It can take up to 120 years before equities will outperform risk free assets by a certainty ratio of 95 per cent."