ISSN 1995-2864
Financial Market Trends
© OECD 2009
Pre-publication version for Vol. 2009/1

Private Pensions and Policy Responses to the Financial and Economic Crisis[1]

Pablo Antolin and Fiona Stewart[*]

This article discusses responses to current financial and economic crisis by regulators, supervisors and policy makers in the area of private pensions. These responses are examined in the light of international guidelines, best practices and recommendations to improve the design of private pensions. Policy makers are reminded that private pensions continue to play an important role in a balanced pension system, with security coming from diversity of provision.

* Pablo Antolin and Fiona Stewart are, respectively, principal economist and administrator in the Financial Affairs Division of the OECD's Directorate for Financial and Enterprise Affairs. The authors would like to thank André Laboul, Juan Yermo and delegates to the OECD Working Party on Private Pensions and to the IOPS for helpful comments. The paper is issued under the responsibility of the OECD Secretary General. The authors are solely responsible for any errors. This article is based on Working Paper 36 of the Working Paper Series on Insurance and Private Pensions, a full version of which is available at http://www.oecd.org/dataoecd/37/54/42601323.pdf.

The impact of the financial and economic crisis

Global pension assets declined by 20-25% in 2008

The financial turmoil and the ensuing economic crisis have had a major impact on private pension assets. The current economic and financial crisis has reduced the value of assets accumulated to finance retirement by around 20-25% on average, according to the latest OECD figures. However, there is large variability across countries, varying from positive but small returns in some countries to falls of over 30% in Ireland and the United States. This variability is explained in part by differences in portfolio compositions, as well as the regulatory environment (OECD Private Pension Outlook, 2008). Additionally, the increase in unemployment stemming from current economic conditions will reduce the amount of pensions' savings, which will negatively affect future retirement incomes.

Assets were allocated towards more conservative investments

The crisis is also causing a shift in asset allocation patterns, with investors moving into more conservative investments – a trend which has been noted by pension regulators in OECD countries such as Norway, Slovakia, Spain and Turkey and in other areas (*e.g.* Kenya, Bulgaria, and Costa Rica – where domestic investments have increased). Such moves risk locking in portfolio losses and could also reduce the potential of funds to generate retirement incomes in future. For the longer term, regulators expect conservative investment strategies to set in as "bad outcomes", such as the one experienced in 2008, will have more weight in long-term strategies than in the recent past.

The fall in the value of assets accumulated for retirement affects on one hand the solvency of pension plan sponsors and the funding levels of plans providing defined benefit (DB) pensions. On the other hand, it reduces the amount of money that individuals have accumulated in defined contribution (DC) pension plans to finance their retirement.

Funding levels of many DB pensions have declined to below 90%

The funding levels of pension funds providing DB pensions have fallen well below 90% in most OECD countries. As a result, the value of their assets fails to cover their pension liabilities. For example, many US companies had funding levels in 2007 that were close to 100% following the requirement of the Pension Protection Act to bring the funding of their pension plans to at least 92% by 2008. However, as a result of the crisis, companies have fallen behind this target. The Dutch regulator (DNB) and the Dutch Association of Industry-Wide Pension Funds (VB) report that the coverage ratio in most pensions funds in the Netherlands has dropped below 95%, while their minimum requirement is of 105%. Funding levels in the United Kingdom have dropped from around 94% at the end of March 2007 to 85% at the end of March 2008. Whilst funding in countries such as Belgium and Finland remains in positive territory, levels have also declined over the last year (to around 115% from 130%). For the longer term, there is an expectation that the crisis will accelerate the trend for plan sponsors to close their DB arrangements, and there is a risk that individuals in countries where benefit guarantee schemes do not operate, could lose their retirement income should their employer become bankrupt.

Members of DC plans close to retirement have

The loss of value of assets accumulated in DC pension plans materialises once people sell. The main concern is with older workers who will have to retire soon, and retirees that are currently financing their retirement using their

been adversely affected

accumulated balances. These groups may have to take part of their losses, finding themselves with much lower incomes in retirement compared with just a few months ago.[2] Their situation is compounded if their exposure to equity is relatively high. In this regard, the crisis has severely dented the confidence of investors in many countries in DC systems, with some countries suggesting a decline in contributions to voluntary schemes.

Policy responses to the crisis

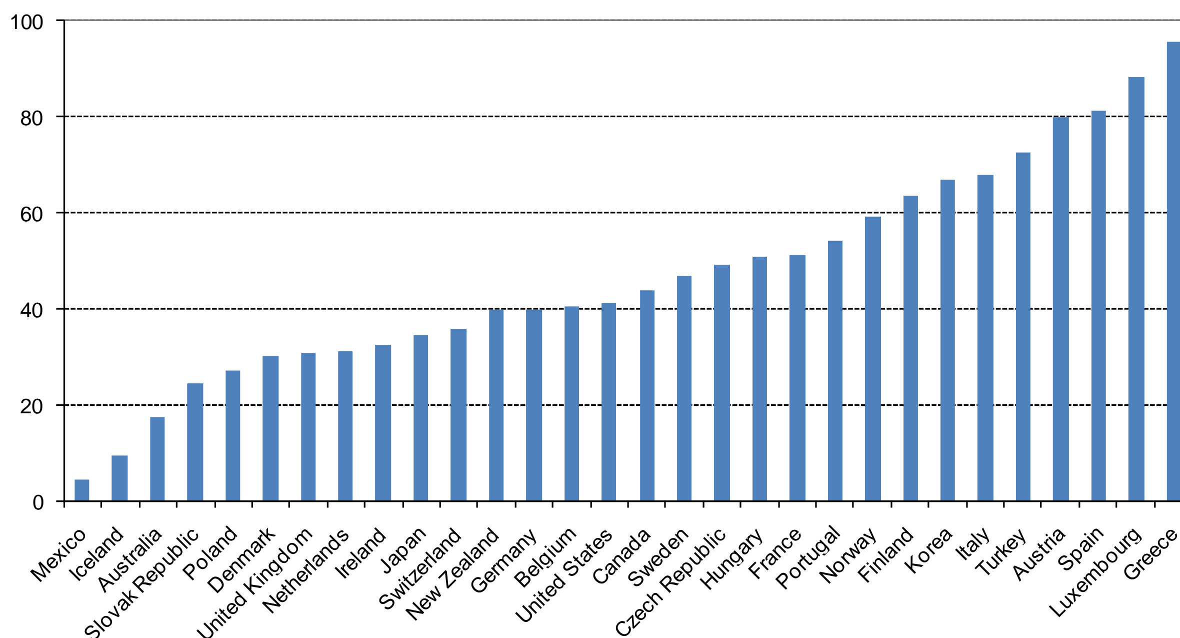
The policy responses to the crisis have been quite diverse across OECD and non-OECD countries. These responses are examined in the light of international guidelines, best practices and recommendations to improve the design of private pensions.

- **Stay the course: complementary private provision for retirement remains a necessity.**

Private pensions remain an important part of a balanced pension system

The crisis has not diminished the importance of private pension provision in a well balanced pension system. Private pensions are necessary to diversify the sources of income at retirement and, as such, they complement public pensions. Moreover, the sustainability problems facing public pensions in some countries remain challenging. As a result of the large projected increases in public pension expenditures in the near future,[3] retirement income from public sources is expected to continue to decline, and therefore private pensions need to be expanded further to bolster income replacement rates in retirement (Figure 1).

Figure 1. Gross replacement rates in public pension plans



Note: Gross replacement rate for an individual entering the system in each country at age 20 with average worker earnings.

Source: OECD (2007), *Pensions at a Glance*.

Reverting to PAYG systems compounds sustainability problems

Some governments are, or are being pressured, to retreat from private pension provisions. For example, Argentina has *de facto* nationalised private pensions, and there are policy discussions about reverting back towards PAYG public pensions in some Central and Eastern European countries (allowing individuals to reverse their previously decision to opt out of the public system and join the new, individual account arrangements). However, the sustainability problems of public pensions will be compounded were these systems to take on more promises.

- **Saving for retirement is for the long-term.**

The OECD classification and glossary of private pensions[4] states that "a pension (or retirement income) plans (arrangement or scheme) is a legally binding contract having an explicit retirement objective (or – in order to satisfy tax-related conditions or contract provisions – the benefits cannot be paid at all or without a significant penalty unless the beneficiary is older than a legally defined retirement age)."

Access to pension savings…

In the context of the current crisis, the call for some flexibility and access to pension assets in the face of severe economic difficulties is understandable. However, policies allowing temporary or early access to private pension savings (as have been introduced, for example, in Australia, Iceland, Spain and are being considered in Turkey, or have been marginally extended, as in Australia) for those in dire financial difficulties (*e.g.* the unemployed) could endanger the future adequacy of retirement income.

… and lower contributions risks future adequacy of retirement income

Additionally, policy measures decreasing contributions to personal accounts also risk permanently reducing future retirement income. Assets accumulated in DC pension plans risk falling short of financing an adequate level of retirement where countries allow employers to stop making matching contributions to personal occupational account (such as in the United States), revoke approved increases in contribution levels (as has been the case in Romania) or decide to reduce overall contribution levels (which has been decided in Lithuania).

Good governance suggests public pension reserve funds should be ring-fenced

Finally, regarding the governance and investment of public pension reserve funds, the OECD recommends that these funds should have a specific investment goal, which is usually defined as a rate of return objective (and associated risk) over a certain time horizon.[5] The objective of public pension reserve funds is to meet, as far as possible, the future pension costs to national budgets that will result due to the ageing of populations.Therefore, the use of these accumulated funds for other purposes - even those driven by the current financial crisis, (*e.g.* the use of the Irish National Pension Reserve Fund to recapitalise banks) - does not meet the specified aims of these funds and risks undermining the sustainability of pension promises in future.

- **Supervisory oversight should be proportionate, flexible and risk-based**

Supervisory oversight…

As an immediate response to the crisis, pension regulatory and supervisory authorities have increased the monitoring and supervisory activities of pension funds around the world. For example, the German federal financial supervisory

authority, BaFin, has stepped up its stress testing with a sample of the largest German insurers and pension funds, reporting their liquidity, (group-) solvency margin, the assets covering technical provisions and any other key risks on a weekly basis. The authorities in Portugal and Slovakia have also introduced stricter scenario testing. Monitoring of exotic assets, offshore investment and counterparty risk have been highlighted by the supervisory authority in Thailand and Spain, stepping up both "on-site" and "off-site" inspections; the Swedish financial authority has increased the frequency of analysis of solvency, whilst the authority in Lithuania installed a new IT system at the start of 2009 to aid information gathering. Meanwhile, a risk-based approach to supervision has been introduce in Costa Rica and in Albania and is being extended in Poland and Kenya. Finally, in several countries regulators and supervisors have held special meetings with selected pension funds (*e.g.* Canada, Italy, Thailand) in order to assess the impact of the crisis.

…and co-ordination have been increased…

Coordination between supervisory authorities and dialogue with the pension industry has also increased in some jurisdictions. For example, communication between supervisors and pension funds has increased in some Canadian provinces (such as Alberta) and between the Swedish Financial Supervisory Authority, industry and with policy makers. In Spain, meetings between supervisors and industry participants (*e.g.* INVERCO, the Spanish Association of Investment and Pension Funds) have been held to discuss problems faced, including asset valuation and liquidity problems whilst the FSA in Norway see close dialogue with supervised entities and the trade organisations as crucial to a successful supervisory handling of the crisis. In Poland cooperation has intensified between the pension supervisor and other financial sector authorities, whilst the pension supervisor in Romania note that they are signatories to an EU MoU on cross–border financial stability. The FSC in Bulgaria holds communication and exchange of information with the relevant expert groups within the Ministry of Finance and the Bulgarian National Bank, and the Pensions Regulator in the United Kingdom is also working closely and in tandem with officials and members of all the major government ministries and other regulators. CONSAR in Mexico have been in contact with legislators in order to explain that the main concerns raised by politicians are of a transitory nature and that it may not be advisable to overact with stiff policy measures. The issue of uniting financial regulatory authorities has been raised in Lithuania, and the formation of a national regulator has been raised in Canada.

…but should remain proportionate

As the pension supervisory authorities around the world have shown, oversight during a time of financial instability needs to be stepped up and to focus on the main risks facing pension fund beneficiaries and the pension system as a whole. Supervisory authorities also need to ensure that their response is proportionate, not placing too high burden on supervised entities, or on plan sponsors, which could risks adverse effects (such as forcing the closure of funds).

The IOPS Principles of Private Pension Supervision recommend that pension supervision should be risk-based.[6] The Principles also state that pension supervisory authorities should have sufficient resources and powers to fulfill their objectives, and that they should act in transparently, coordinating with industry and other authorities.

- **Funding and solvency rules for DB plans should be counter-cyclical.**

The OECD Guidelines on Funding and Benefit Security state that "The legal provisions should not prevent funding methods that seek to dampen the short term volatility in firms' funding contributions.", and allow for temporary reprieves to be granted by regulatory authorities (3.5). Moreover, (3.6) states that "Funding rules should aim to be countercyclical, providing incentives to build reserves against market downturns." The Guidelines also allow the position of the plan sponsor to be taken into funding considerations (3.1).

Funding regulation should be flexible but robust…

Pension regulatory and supervisory bodies, in permitting pension funds flexibility in meeting funding requirements and other regulation, avoid 'pro-cyclical policies' and allow pension assets to act as long-term investors, and potential stabilising forces within the global financial system. However, in allowing for this flexibility in meeting funding requirements it is important to distinguish between temporary impacts of the economic cycle on sponsor cash flows and long-term structural changes to strengthen the scheme sponsor. In ensuring long term funding levels a number of different measures may be appropriate. This could include solvency rules that aim at increasing funding levels in good times to have higher coverage rates of future pension liabilities well above a hundred percent. These funding levels will act as a buffer in bad times when they could be allowed to temporally fall below a hundred percent.[7] It may also include a range of other security mechanisms designed to protect scheme assets and members, such as employer covenant and guarantee schemes. Such diverse policies and flexibilities aim to avoid placing intense pressure on plans sponsors facing difficult financial conditions, which could lead to the closure of pension plans, or, in the face of extreme calls for pension contributions,[8] could even force the sponsor into bankruptcy.[9]

…and counter-cyclical

Making funding and solvency rules counter-cyclical may present consistency problems as they depend on stakeholder consensus. Namely, flexibility in funding during difficult market conditions must be matched by a consensus to increase contributions during better economic times, which may be perceived later on as a drag on economy recovery or as depressing wage improvements. Unless funding and solvency increases occur as market conditions improve, DB plans will remain endemically underfunded.

The IOPS Principles also recommend that supervisory authorities act proportionately, in a risk-based manner and encourage a flexible response. [10] As Principle 5.1 states: "*Pension supervisory authorities should be proactive, seeking to avoid significant problems before they occur and intervening, in a proportionate way, at as early a stage as possible and searching for those supervisory instruments which had most value to the desired supervisory result"*, whilst 6.3 advises that: *"In fulfilling its supervisory powers, the pension supervisory authority should give pension funds and plans flexibility, where appropriate, in the way they achieve compliance with regulatory requirements."*

For example, time to submit recovery plans and recovery

In this context, recent policy responses introducing such needed flexibility include the extension of the time required to submit recovery plans and the lengthening of recovery period for pensions funds from three to five years

periods have been extended

allowed by the Dutch government, the new US legislation easing temporarily the funding requirements for employer-sponsored pension plans included in the 2004 Pension Protection Act; the Canadian authorities considering increasing solvency funding periods from 5 to 10 years. The Irish Pension Board is taking numerous measures including temporarily granting additional time for the preparation of funding proposals, dealing as flexibly as possible with applications for approval of funding plans, and is allowing longer periods for recovery plans (*i.e.*, greater than ten years), in appropriate circumstances and taking into account voluntary employer guarantees in approving recovery plans. Pension funds in Norway had 3 years to increase their premium reserves as a result of new mortality statistics, but in light of the current crisis this period has been extend to 5 years. In Finland a new bill (passed in December 2008) aims at securing the solvency requirements of pension funds without leading to forced sales of equities in a disadvantageous market position, with these legal provisions remaining in place until the end of 2010.

The Pension Protection Fund in the United Kingdom has also been debating allowing deferrals of levy payments. Though such flexibility may be warranted, OECD analysis of guarantee schemes stresses the need to ensure that levies are properly risk-based in order for these funds to operate effectively.[11] In Jamaica, amendments to legislation propose that private pension plans be given preferred creditor status upon the winding-up of companies.[12]

Accounting rules are being reexamined in light of the crisis

Additionally, in the context of funding and solvency the debate over accounting rules has been reopened by the crisis. For example, the Czech authority notes that the adoption of full mark-to-market valuations has been postponed due to the extreme volatility currently being experienced. Meanwhile, the Spanish Ministry of Finance has undertaken studies on using held-to-maturity valuations, using expiry dates instead of mark-to-market prices. Furthermore, the discussion about appropriate discount rates has also been heightened by the crisis (in particular in countries such as the Netherlands, Sweden and the United Kingdom). Liabilities in DB pension funds have experienced much volatility as a result of falls in corporate triple-A bonds, government bonds or the swap curve. Conversely, future market increases in interest rates have the potential to diminish pension liabilities and related annuity costs.

The OECD Guidelines on Pension Fund Asset Management[13] state that pension fund assets should be valued on a proper, transparent and disclosed basis. The guidelines also recommend that if the smoothing of asset prices is used, regulators and supervisors should make sure that they understand the potential impact of such techniques. In terms of discount factors, the OECD Guidelines on Funding and Benefit Security state that these should be prudently chosen taking into account the plan liabilities' risk and maturity structure.

- **Use the safety net to address issues of insufficient income at retirement.**

Adequate public safety nets are required to protect

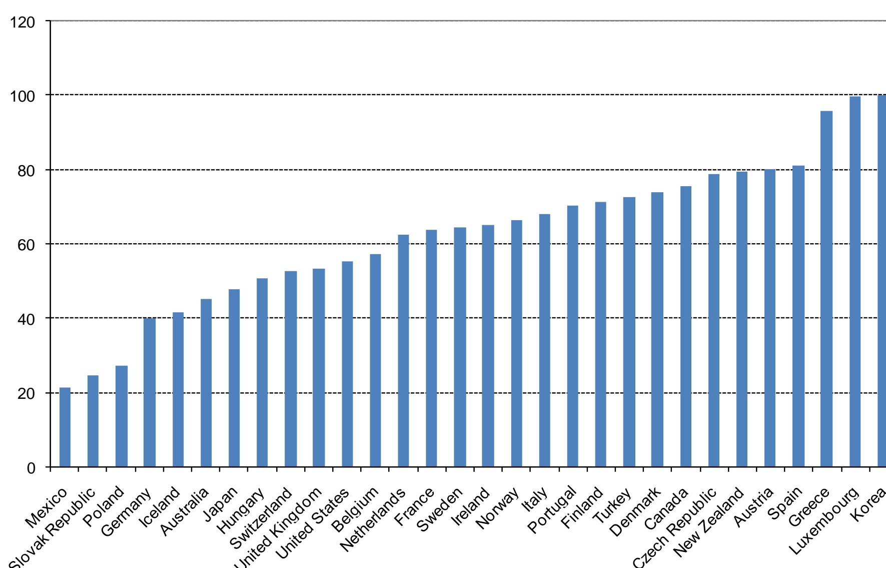
Countries should address issues related to unemployment and poverty which arise from the current financial crisis primarily via their publicly funded safety nets (*e.g.* unemployment insurance, minimum income provisions). The

against elderly poverty

OECD's Pensions at a Glance[14] modeling work warns that there is a risk of elderly poverty in some countries (Figure 2). Some countries' authorities have consequently been revising their social safety nets. For example, the Finnish government has announced a guaranteed minimum pension will be introduced from 2011, whilst the Mexican government is considering reforms to redistribute government contributions to lower income workers' accounts. Chile approved a comprehensive reform before the crisis introducing a solidarity or basic pillar that provides protection to lower income groups, including those receiving low pensions.

Figure 2. Gross replacement rates in public pension plans – low income

Low income individuals: half average worker earnings



Note: Gross replacement rate for an individual entering the system in each country at age 20 and earning half average worker earnings.

Source: OECD (2007), *Pensions at a Glance.*

Bailing out pension funds could be costly and problematic

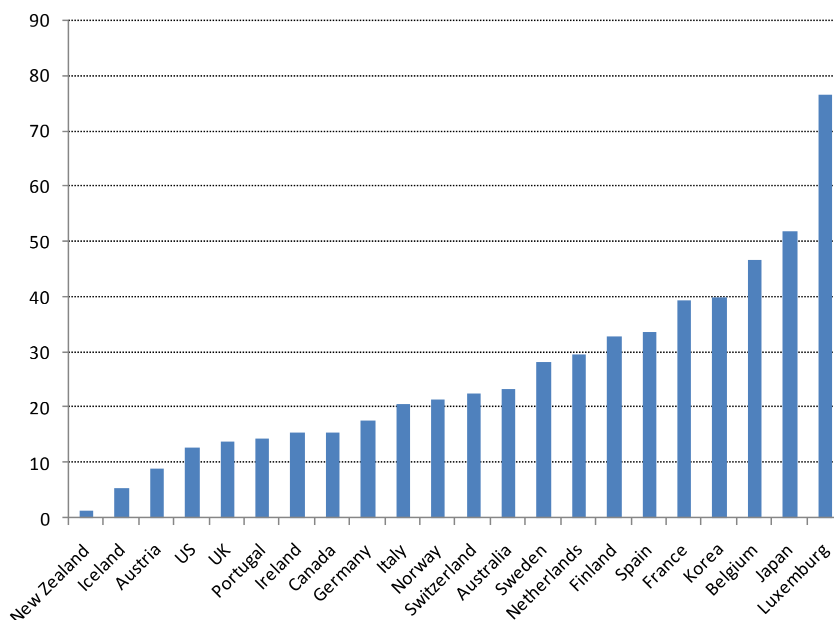
Given the recent declines in DC accounts, there have been increasing calls on governments (*e.g.* in Israel) to provide some type of "bail out" or top up for pensions, as have been seen in other financial sectors. These calls focus in particular on people with pensions from DC plans near retirement or in retirement and in countries that lack formal safety nets (*e.g.* developing countries). However, such top ups could be costly, difficult to implement fairly (should everyone get a top up or only those near or in retirement?), and risk introducing misalignments into the system (*e.g.* by encouraging overly risky investment in the future). If such policies are utilised, they should be carefully designed and it should be made very clear that they are a one-off, temporary measure.

Incentives to work longer should be encouraged

Individuals who have seen the value of their accumulated assets eroded as a result of the equity market falls may need to postpone their retirement and continue contributing to their pension funds in order to rebuild enough assets to finance an adequate retirement income.[15] Governments may wish to allow

increased levels of tax incentives (as is being considered in Turkey) or contributions levels (as is being considered for DC schemes in Japan), and should examine their labour policies carefully to make sure that incentives for early retirement, and disincentives for later retirement, are not build into the system.

Figure 3. Incentives to retire: implicit tax of working an extra 5 year.



Note: Average implicit tax rates on continued work over the next five years in old-age pension systems from age 61 to 65, for a single worker with average production worker earnings as a percentage of annual earnings. These figures are under revision by the OECD as some countries may have recently passed reforms reducing incentives to retire.

Source: OECD *Economic Studies* No. 37 (2004), Chapter 1.

- **Improve the design of DC plans, including default investment strategies.**

Life-cycles funds can help protect members of DC plans close to retirement

One way of improving protection in DC schemes is through the careful design of default investments and payout options. These could include the use of 'life cycle' funds (*i.e.* shifting to more conservative assets as retirement approaches) as well as investment policies to prevent people close to or in retirement having large equities exposures. Moreover, the current crisis has also highlighted the importance of communicating these default strategies and the risks involved. One example of such policy was seen when the previous Israeli government gave regulators six months to mandate a more conservative system for investing older workers' pension savings. Additionally, several countries seem supportive of introducing or encouraging life-cycle funds (*e.g.* United States).[16] However, it should be noted that life-cycle investing needs to be implemented carefully as such strategies do still involve timing risk (*i.e.* when moving from one asset allocation stage to the next). Some flexibility in when portfolio shifts occur may be included, and the suggestion current being

considered in Chile to allow individuals to choose more or less 'aggressive' life cycle paths is also an interesting proposal.

Flexibility of regulation depends on the pension system as a whole

Regulation relating to voluntary pensions needs to be considered in light of the pension system as a whole. For example, when public pensions already provide protection from longevity risk and a minimum adequate level of retirement income, regulators may allow individuals more flexibility in their choice of investments than when assets accumulated in DC plans are the main source of retirement income, in which case the protection offered by life-cycle funds coupled with default options that focus on reducing the risk of "worst case" scenarios, may be required.

Guaranteeing DC plans could be expensive

Another debate opened by the crisis is whether guarantees should be introduced in DC accounts – as already operate in some countries. However, questions on who provides such guarantees, how much they cost and whether they may encourage conservative investment (and herding) need to be addressed. Moreover, guarantees will not eliminate market fluctuations in replacement rates, unless limits are quite high (well above the riskless rate of return). Unfortunately, only insurers that are willing to bear more risk than the average market's aversion to risk (*i.e.* more than other investors) could guarantee such high guarantee returns, which raises the issue of counterparty risk.[17]

Other mechanisms for sharing risks within DC systems should be explored

Mechanisms for increasing risk-sharing within DC systems also need to be explored further. For example 'collective DC plans' and other hybrid designs drawing on both DB and DC mechanisms.[18]

- **Allow for more flexibility in the payout phase and avoid materializing losses by selling at the bottom of the market**

Flexibility could alleviate some of the timing risk relating to annuities

Recent OECD reports recommend flexibility in the design of the payout phase of DC pension plans when protection from longevity risks is already provided by public and DB plans.[19]

In this context, measures that increase flexibility in the timing of buying an annuity, in particular in countries where annuitisation is mandatory (such us the recent two year extension in Ireland or the flexibility in mandatory annuitisation announced by the United Kingdom, where already for most people annuities do not have to be taken until age 75) permit people near retirement to avoid locking in losses (liquidating their assets when markets are down) and buying an annuity when interest rates are low (*i.e.* their accumulated assets will buy an annuity that will pay lower monthly payments). A more flexible system for purchasing annuities has also being introduce in the Netherlands, allowing one-half of accumulated capital to be used to purchase an immediate 5-year annuity, deferring the rest of the purchase after this date.

- **Improve the governance and risk management of pension funds**

The crisis has

Some of the decline in assets recently experienced by pension funds around

shown that the governance and risk management of pension plans needs to be strengthened

the world may well have been avoided through better pension fund governance and stronger risk-management systems. Some funds seem to have been exposed to instruments whose risk profiles they did not fully understand. The current financial turmoil has therefore highlighted the importance of proper risk systems, controlling investments and other risks, which shows that sound risk architecture of pension funds is essential for their prudent operation and the stability of the financial system as a whole. The OECD Guidelines on Pension Fund Governance[20] state that: "*The governing body should collectively have the necessary skills and knowledge to oversee all the functions performed by a pension fund, and to monitor those delegates and advisors to who such functions have been delegated. It should also seek to enhance its knowledge, where relevant, via appropriate training.*"

Pension supervisory authorities are increasingly focusing on these issues

Pension supervisory authorities have an important role to play in this respect. Pension fund governance and risk-management can be improved via increased oversight by supervisory authorities, and through their providing guidance on good practices to pension funds. The IOPS Guidelines for the Supervisory Assessment of Pension Funds[21] note checking a pension fund's risk management systems as a key supervisory objective and an important part of an in-depth analysis. In Spain, for example, the Ministry of Finance has strengthened the monitoring of pension entities' internal control mechanisms, codes of behaviour and risk management systems, whilst the Portuguese authorities note that the regulation on risk management and internal controls for pension funds (including issues relating to outsourcing) will be reinforced. The supervisory authority in Australia expects to intensify its ongoing focus on risk management and governance by the trustees of superannuation funds. The authorities in Canada and Poland also expect to place greater emphasis on risk management and governance in the future, whilst the United Kingdom is specifically reviewing the governance of investment decisions by pension funds through the Investment Governance Group, set up as a result of a review of the Myners Principles for Institutional Investment Decision Making. The Italian supervisory authority (COVIP) asked pension funds to check and take appropriate measures as regard their compliance with the principle of diversification of investments.

Increased pension fund activisms may also help financial stability

Pension funds and other institutional investors may make a greater contribution to the stability of the financial system in future through greater shareholder activism.[22]

- **Step up disclosure and communication**

Disclosure and communication are needed to rebuild confidence in pension systems

The recent crisis and the related scandals may have severely tested the confidence in financial institutions in general. While pension funds are neither the source of nor a mechanism propagating the crisis, they are unlikely to escape the general decline in confidence in financial services. There is moreover some evidence of a decline in contributions to voluntary schemes. This highlights the importance of rebuilding confidence in pension systems – particularly when arrangements are voluntary – and the need to reduce and better communicate the risks and the exposure to "worst case" scenarios for those individuals financing retirement mainly through assets accumulated in DC pension plans.

Campaigns to stress the long-term nature of pension investments may be helpful

In this context, many countries (*e.g.* Costa Rica, Kenya, Lithuania, Mexico, the United Kingdom, Turkey) have reported a step up in their communication strategies. For example, Turkish pension funds have been running a joint information campaign on TV, with the support of the regulator, to reemphasise the long-term benefits of pension savings. In Mexico, the pension supervisory authority, CONSAR, has led an intensive media campaign explaining the differences between a permanent loss and a mark-to-market drop. CONSAR have also been in contact with legislators in order to explain that the main concerns raised by politicians are of a transitory nature and that it may not be advisable to overact with stiff policy measures. The IOPS Principles highlight the need for supervisory authorities to act in a transparent manner. They state that the pension supervisory authorities should: *"provide and publish clear and accurate information for the pension industry and the general public on a regular basis – such as the financial situation of the pension fund industry and observations on major developments in the pension sector."*

Disclosure should help individuals make efficient choices

Disclosure requirements, to help individuals make efficient choices, have also been strengthened in some countries. For example, in Turkey and in Slovakia where new legislation requires Pension Fund Management Companies to provide more detailed information about participants rights, fund management and results. In Hungary the HFSA has introduced a new communication strategy, emphasising the importance of the disclosure of 10 year performance records, including an explanation of weak returns. The United Kingdom has significantly increased communications activity via a series of public statements to employers and trustees setting out their general position in relation to current market conditions. The IOPS Working Paper No.5 outlines international experience regarding providing information to members' of DC pension plans.[23] Communication with pension funds, trustees, sponsors and particularly with pension fund members will be helpful in reducing uncertainty and maintaining members' commitments and engagements with private saving for retirement.

- **Improve financial education**

The OECD Good Practices on Financial Education relating to Pensions highlight the role various stakeholders (including governments, plan sponsors, social partners, providers etc.) can play in achieving this goal. [24]For example, governments may institute national awareness campaigns to ensure that populations understand the nature of pension systems and the impact of potential reforms[25].

Financial education can help explain that pensions are long-term investments

Improving financial education may help in promoting income security at retirement. Adequate financial knowledge and awareness would permit people to recognise the long-term nature of saving for retirement, and the importance of keeping up contributions to pension plans to guarantee an adequate level of retirement income. Moreover, better understanding of the long-term nature of pensions may avoid materialising losses by selling in the downturn, and may increase the support for the stabilising function of pension funds' investment strategies. However these measures and the information provided need to be carefully crafted to avoid overly negative reactions in difficult financial times.

- **Don't over regulate**

'Knee-jerk' policy reactions can be counterproductive

Finally, governments and pension regulatory authorities should be encouraged not to over regulate in response to the current crisis. Financial sector regulation has a history of showing that short-term policy responses do not always strike the right balance between stability and growth, and can have unintended consequences over the long term.

The first OECD core principle of occupational pension regulations, "conditions for effective regulation and supervision" states that "*An adequate regulatory framework for private pensions should be enforced in a comprehensive, dynamic and flexible way (taking into account the complexity of the schemes) in order to ensure the protection of pensions plan members and beneficiaries, the soundness of pensions plans and funds and the stability of the economy as a whole. This framework should however not provide excessive burden on pensions markets, institutions, or employers*"[26]

Therefore, the regulatory framework should be robust and flexible. Robust in the sense that it addresses the main concerns of members, in particular the protection of their benefits. However, it should be flexible in addressing funding problems as well as having flexible rules about the payout phase and around when to purchase an annuity. Governments should therefore resist introducing too many regulations in face of the crisis that may jeopardise flexibility. Finally, industry associations may also be able to play a role via responsible self-regulation.

NOTES

[1] This paper has been prepared in the context the '*OECD strategic response to the financial and economic crisis.*' It builds on responses to an OECD/IOPS questionnaire provided by pension regulatory and supervisory authorities in the following economies: Albania, Austria, Australia, Belgium, Bulgaria, Canada (provincial level), Chile, Czech Republic, Columbia, Costa Rica, Egypt, Finland, Germany, Greece, Hong Kong – China, Hungary, Ireland, Jamaica, Japan, Kenya, Korea, Lithuania, FYR Macedonia, Mexico, the Netherlands, Norway, Poland, Portugal, Romania, Slovak Republic, Spain, Sweden, Swaziland, Switzerland, Thailand, Turkey and the United Kingdom.

[2] Preliminary results on the impact of the timing of retirement on DC pensions show that replacement rates from DC plans can be quite volatile. Moreover, those retiring at the end of 2008 would have a much lower replacement rate than those retiring a year before even though they have the same labour histories.

[3] Most countries project important increases in public pension expenditure for the next 40 to 50 years as a result of ageing populations (*e.g.* European Commissions Working Group on Ageing).

[4] http://www.oecd.org/dataoecd/5/4/2496718.pdf

[5] Yermo, J. (2008), "Governance and Investment of Public Pension Reserve Funds in Selected OECD Countries", O*ECD Working Papers on Insurance and Private Pensions*, 15. http://www.oecd.org/dataoecd/26/53/40194872.pdf

[6] http://www.iopsweb.org/dataoecd/59/7/40329249.pdf

[7] Nevertheless, in the case of cross-border activity within the European Union, according to the IORP Directive, a pension fund has to be fully funded at all times.

[8] For example, a provincial regulator reports that many firms in Canada with actuarial valuations due in 2009 are faced with increased contributions of 100% to 150%.

[9] While it is important to understand what it is reasonable for the sponsor, all unsecured creditors must be treated equitably and the pension scheme should not be put in disadvantaged, for example in order to allow sponsors to continue paying dividends to shareholders. In the United Kingdom, for example this important balance has been identified through a high profile statement to employers sponsoring DB pension schemes in February 2009.

[10] http://www.iopsweb.org/dataoecd/59/7/40329249.pdf

[11] See OECD Working Paper No.5, '*Benefit Security: Pension Fund Guarantee Schemes'* http://www.oecd.org/dataoecd/38/63/37977335.pdf

[12] For a discussion of the status of pension creditors in bankruptcy, see OECD Working Paper No.6, '*Benefit Protection: Priority Creditor Rights for Pension Funds'* http://www.oecd.org/dataoecd/39/0/37977393.pdf

[13] http://www.oecd.org/dataoecd/59/53/36316399.pdf

[14] OECD (2007), *Pensions at a Glance*.

[15] Removing barriers to extended work will allow people more time for additional contributions and for recouping losses. Removal of these barriers (*e.g.* age discrimination and labour stratification), as well as policies to retrain workers, present broad labour market challenges that go beyond pension design.

[16] However, some countries (*e.g.* Hungary) note that the current market context requires to postpone the introduction of life-cycle funds as such arrangements would increase equity weightings – due to the minimum equity allocations required in these funds.

[17] Center for Retirement Research (2009): "What does it cost to guarantee returns?" No. 9-4

[18] Forthcoming OECD papers on '*Evaluating the Design of Private Pension Schemes'* and '*Investment Regulations and Retirement Income from DC Pension Plans'* will address these issues.

[19] *OECD Working Papers on Insurance and Private Pensions* No. 25, 2008: "Policy Options for the Payout Phase" http://www.oecd.org/dataoecd/39/2/41407986.pdf

[20] http://www.oecd.org/dataoecd/18/52/34799965.pdf Annotation to Guideline 8: *The governing body should regularly review its collective skill set and consider whether it is adequate. Where relevant, it should seek to enhance its collective knowledge of pension fund matters via appropriate training, paid for by the pension entity. In general, training is recommended both initially on appointment and on an on-going basis (at least every two years). Such training could be supported by pension fund regulatory or supervisory bodies (for example via free on-line courses, other material or approval of other education providers). Alternatively, the supervisory authorities may identify or approve suitable courses. More advanced training may be needed to ensure that the governing body fully understands investment in complex financial instruments.*

[21] http://www.iopsweb.org/dataoecd/38/47/41042660.pdf

[22] See OECD *Principles of Corporate Governance* http://www.oecd.org/document/49/0,3343,en_2649_34813_31530865_1_1_1_1,00.html

[23] http://www.iopsweb.org/dataoecd/7/16/41269701.pdf

[24] http://www.oecd.org/dataoecd/4/21/40537843.pdf

[25] See paper on "Private Pensions and Government Information Campaigns: Lessons from OECD countries" in http://www.iopsweb.org/dataoecd/53/16/42349127.pdf

[26] OECD (2004): *Recommendation on Core Principles of Occupational Pension Regulation*, 2004