Pension Fund Protection Schemes

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OECD work on private pensions

OECD is a unique forum to discuss issues relating to private pension systems through the Working Party on Private Pensions (WPPP)
30 member governments + observers + international organisations

Main Focus of Work:

- International comparative information
  Taxonomy/ Global Pension Statistics Project / Regulation database with ISSA
- Development of regulatory principles and guidelines
  - International standard-setter on private pension regulation – 6 Core Principles for the regulation of occupational pension systems approved by the OECD Council in 2004
  - In addition, three guidelines have been approved:
    1. “Guidelines for Pension Fund Governance”,
    2. “Guidelines for the Protection of Rights of the Rights of Members and Beneficiaries in Occupational Pension Plans”
- Policy analysis
  Focus shifting from DB to DC related issues
- Cooperation with non-OECD countries
  Involved pension reform in Chile, China, India, S. Africa
After the ‘Golden Age’ of 1990’s, ‘Perfect Pension Storm’ since the Millennium saw thousands of pensioners in OECD countries loose all or part of their promised benefits.

Calls for governments to strengthen pension protection

Ultimate risk faced by beneficiaries in DB schemes is the loss of their retirement income when the plan sponsor become bankrupt whilst the pension plans is underfunded

Pension benefit protection schemes one way to protect against such a situation

This policy adopted in the UK - also considered elsewhere (e.g. Korea, Ireland) + debate over extending schemes in Canada + Japan / reforms in USA and Germany

Other OECD countries taken different approach (e.g. Netherlands risk-based funding rules)
Pension Protection Schemes

Arguments For

Market Failure: workers don’t understand wage / pension trade off + asymmetry of information

Diversification: current and future income from 1 source/ particularly with book reserves

Arguments Against

Moral Hazard: plan sponsors act irresponsibly if know insurance will cover pension promises

Adverse Selection: if premiums not priced properly, good firms subsidize weak and may pull out of system

Practical Issues

Systemic Risk: bankruptcies / underfunding correlated

Political Involvement: economic / social goals ahead of efficient insurance
OECD Policy Conclusions

- OECD recommend these schemes for book reserve systems
- For funded pensions, should combine with other mechanisms (including adequate funding rules) and ensure that premiums are properly risk-adjusted

- PBGC in the USA well known. Schemes also exist in UK, Ontario (Canada), Germany, Sweden, Switzerland, and Japan

- OECD survey of these schemes shows that they can be effective if implemented correctly

Lessons learnt include the need to:
- *Limit benefit coverage*
- *Risk-based premium setting*
- *Accurate and consistent funding rules*
- *Prudent Asset Liability management*
- *Adequate powers*
## Country Case Studies

<table>
<thead>
<tr>
<th>Country</th>
<th>Assets (€m)</th>
<th>Asset Allocation (% Fixed Income / Equities)</th>
<th>No. Members Covered (million)</th>
<th>Maximum Pension (€)</th>
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</thead>
<tbody>
<tr>
<td>Canada</td>
<td>154 (2005)</td>
<td>100/0</td>
<td>1</td>
<td>8300</td>
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<tr>
<td>Germany</td>
<td>963 (2005)</td>
<td>84/16</td>
<td>9</td>
<td>7245</td>
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<tr>
<td>Japan</td>
<td>183 (2007)</td>
<td></td>
<td>5</td>
<td>43m per fund</td>
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<tr>
<td>Sweden</td>
<td>1,600 (2005)</td>
<td>67/32</td>
<td>0.2</td>
<td>total</td>
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<tr>
<td>Switzerland</td>
<td>165 (2006)</td>
<td>65/35</td>
<td>3.2</td>
<td>total</td>
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<tr>
<td>UK</td>
<td>1,120 (2007) 6,000 (2008/9)</td>
<td>70/30</td>
<td>10 to 15</td>
<td>44,000</td>
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<tr>
<td>USA</td>
<td>45,000 (2006)</td>
<td>77/23</td>
<td>44</td>
<td>34,824</td>
</tr>
</tbody>
</table>
USA: PBGC

Started in 1974 – now covers 44m workers, with 612,000 pensions in payment, up to $47,000 ceiling

Flat rate ($30 participant) and variable ($9 per $1000 underfunding) premiums $59bn invested ¾ in fixed income

Major funding problems
PBGC: Problems and Lessons

Concentrated exposure

ALM mismatch

Weak funding rules

Political interference

Mispriced Premiums
Ontario Canada: PBGF

- Set up in 1980 to cover 1m workers in DB schemes in Ontario, with a ceiling of CAD 12,000

- Premiums flat ($1) and risk based on underfunding

- Similar problems to PBGC (Ontario being the industrial heartland of Canada)
  Underfunding of CAD247bn in 2006

- Similar debate to Japan - currently only Ontario Federal DB only 5% of pension plans – few large schemes to difficult to spread risk
UK – PPF

- New scheme operating from 2005 covering 10-15 million in DB schemes 7,000 member of 10 schemes so far transferred to PPF
- Premium flat and 80% risk based (according to underfunding and insolvency risk of employer)
- Majority of GBP 750m assets in fixed income
- Lessons Learnt from PBGC

*Political Independence*
*Risk-based Levy*
*Moral Hazard*
UK PPF Questions

- Is the levy ceiling too low?
Sweden: FPG

- From 1961, set up not by law but employment agreement - mutual insurance owned by members (acting like private insurance co)
- Covers c200,000 employees in Sweden’s major companies using book reserve system
- Flat rate premiums – key is the scheme can take a lien on plan sponsors assets (internal rating agency)
- Been able to give bonus to policy holders
Germany: PSVaG

- Since 1974, covering 9 million members of pensions operated under book reserve system (Germany and Luxembourg). 440,000 pensions in payment (up to €7,000 limit). PSVaG buys annuities (not direct payments).

- Previously operated on a PAYG basis - now moving to capitalized system (due to concerns that claims rise / fewer firms to cover charges / aim for stable premiums stable / returns from investments used to lower charges).
Switzerland: LOB Guarantee Fund

- From 1986 compensation for funds with unfavourable age structure as well as insolvency benefits.

- Flat premiums, which have been adjusted over time – with the scheme now in surplus (but still debating how large this should be)
Japan: Pension Guarantee Program

- Established by the Pension Fund Association in 1989 - covering 5 million workers in firms with EPFs
- Pension Fund Association and EPF reps on board, which decides if a claim is taken and/or reduced
- Does the scheme provide sufficient protection? (level of benefits covered small/claims can be rejected or reduced with members rather than sponsors or managers paying)
- Should it be extended to other DB schemes (2/3 not covered)?

![Processing the Applications - Decision on Guarantee Benefit (3)](image)