

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"
3. "Guidelines on Pension Fund Asset Management"

- **Policy analysis**

Focus shifting from DB to DC related issues

- **Cooperation with non-OECD countries**

Involved pension reform in Chile, China, India, S. Africa

Pension Protection Schemes

- After the 'Golden Age' of 1990's, 'Perfect Pension Storm' since the Millennium saw thousands of pensioners in OECD countries lose 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 becomes bankrupt whilst the pension plan 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

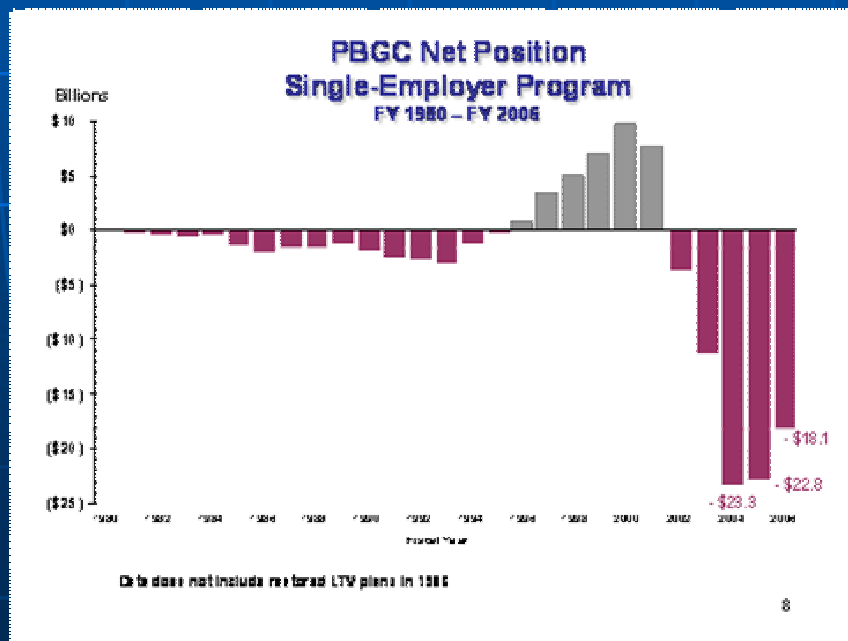
Country	Assets (€m)	Asset Allocation (% Fixed Income / Equities)	No. Members Covered (million)	Maximum Pension (€)
Canada	154 (2005)	100/0	1	8300
Germany	963 (2005)	84/16	9	7245
Japan	183 (2007)		5	43m per fund
Sweden	1,600 (2005)	67/32	0.2	total
Switzerland	165 (2006)	65/35	3.2	total
UK	1,120 (2007)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

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
3/4 in fixed income*

Major funding problems



PBGC: Problems and Lessons

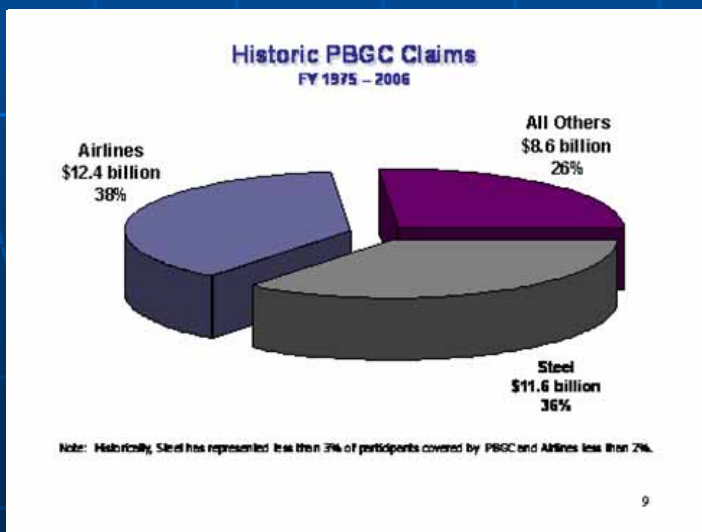
Concentrated exposure

ALM mismatch

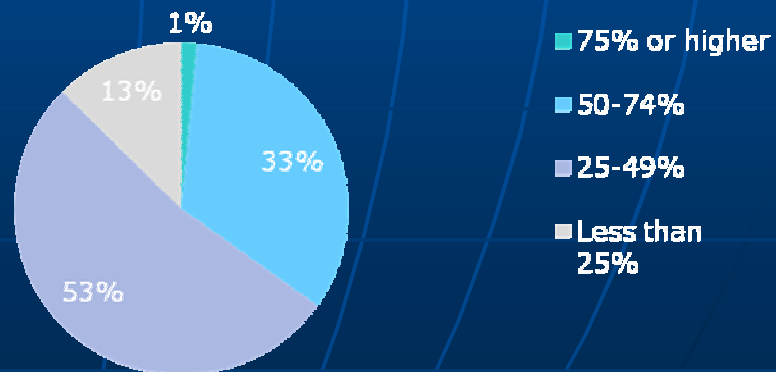
Weak funding rules

Political interference

Mispriced Premiums



PBGC Claims by Funded Ratio 1975-2005



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

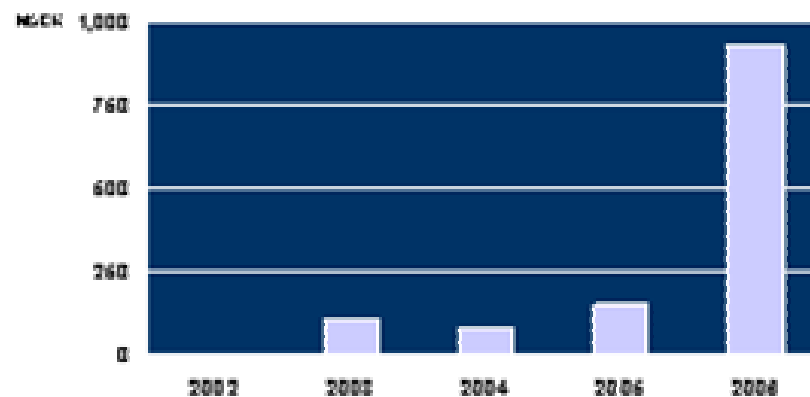
Risk-based Levy

Moral Hazard

Sweden: FPG

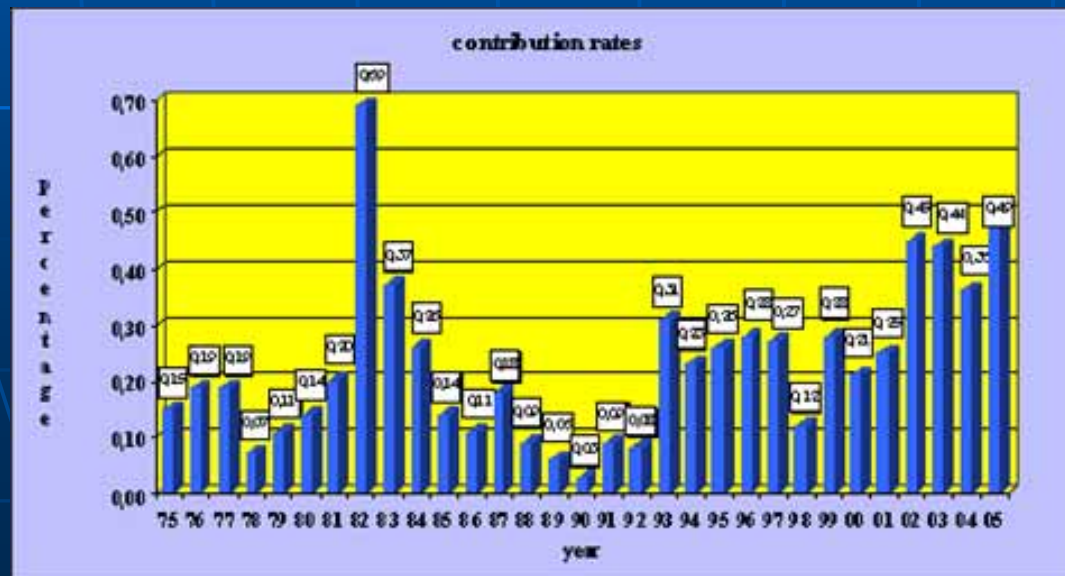
- From 1961, set up not by law but employment agreement - mutual insurance owned by members (acting like private insurance co)
- Covers c200,000 employees in Sweden's major companies using book reserve system
- Flat rate premiums – key is the scheme can take a lien on plan sponsors assets (internal rating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

Policyholders' bonus 2002 – 2006



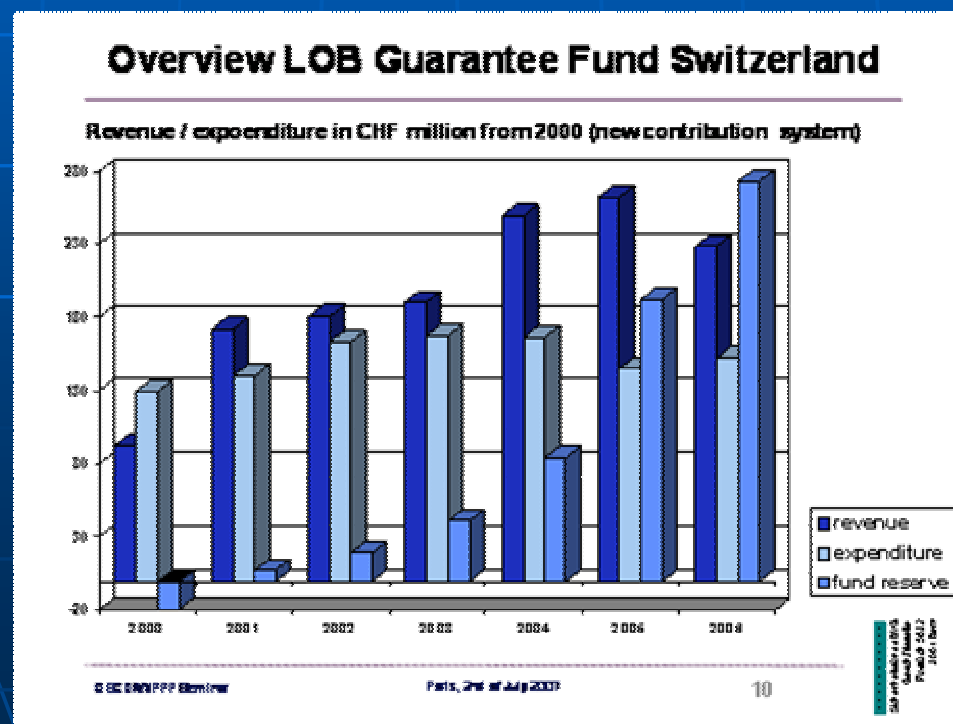
Germany: PSVaG

- Since 1974 , covering 9million 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 5million 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)

- **Final Guarantee Amount**
 - ◆ Decision process of final guarantee amount
 - ★ starting with the amount of coverable benefit
 - ★ reduction according to inappropriate conducts
 - ◆ Reduction standards:
 - ★ breach of law or negligence of fiduciary duties by board member (max=20%)
 - ★ mismanagement of EPF (max=30%)
 - ★ (remaining asset) < 50% of (guaranteed limit of benefit)

reduction rate = $1 - \frac{1}{2(1 - \frac{L}{L_0})}$
where L = amount of remaining assets and L₀ = guaranteed limit of benefit

- ★ sharp decline of reserve fund due to its mismanagement after dissolution or criminal conducts of sponsors (max=30%)

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