TRADE UNION ADVISORY COMMITTEE
TO THE ORGANISATION FOR ECONOMIC
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Global financial crisis hit pension fund assets by -20%, according to OECD – Policy priority must be given to pension security, adequacy and coverage.

Paris, 12 December 2008[1]

According to OECD figures, as of October 2008, the total assets of OECD-based pension funds had declined by over USD 3.3 trillion, or about 20% in real terms since December 2007, as a result of the deepening global financial crisis. If one adds individual retirement accounts in the United States (the "401(k)" plans) and other countries, this figure increases to about USD 5 trillion.

The impact of the crisis is most severe in Ireland, the US, the UK, Canada, the Netherlands, Australia, and Japan, all of which have sizeable pre-funded pension sectors, with total assets under management representing over 50% of national GDP. Other countries that are particularly hard hit include Hungary and Poland, two former 'transition countries' where the privatisation of the pension systems in the 1990s opened the door to Defined Contribution (DC) schemes as the main source of retirement financing.

In the latest edition of "Pension Markets in Focus" (December 2008, Issue 5[2]), the OECD acknowledges that "the full impact, however, will only be revealed when the annual reports for 2008 are submitted by pension funds to their supervisory authorities", given the "lack of clarity over the valuation of some illiquid assets" including the very same "structured products" that are at the root of the global financial crisis. Direct exposure to these toxic assets may be "as high as 3%" of pension funds' assets.

The impact of the crisis will be felt most by workers who are nearing retirement age and whose pensions fall under un-protected DC schemes (i.e., no guarantee for the final pension level, which is entirely dependent on the pension fund financial performance). DC schemes are widespread in many Latin American and Eastern European countries, where pay-as-you-go systems were dismantled and privatised in the 1990s. But other OECD countries, such as the US and the UK, have also seen a dramatic increase in un-protected DC pension schemes in recent years.

Workers under Defined Benefit (DB) and hybrid schemes, which guarantee some form of pension level, are "in principle unaffected by the changes in investment returns", the OECD notes. Yet, the expected rise in corporate bankruptcies and in underfunding of DB schemes that have conditional indexation of benefits, as exist in Northern Europe, might translate into a "fall in real terms" in the income of pensioners.

On lessons from the crisis, the OECD is quick to warn against a "backlash against private pension systems". In particular, the recent decision of the Argentinian government to re-nationalise its private pension industry and similar "talks" in Eastern European countries, are criticised for contributing to "the perception of panic" and failing "to acknowledge the

[1] This document is posted at the following URL: http://www.tuac.org/en/public/e-docs/00/00/03/9A/document_news.phtml
[2] This document is posted at the following URL http://www.oecd.org/dataoecd/42/19/41770561.pdf

achievements of private pension systems". The OECD is also keen to emphasise that public systems are "under tremendous stress", due to both demographic ageing and the increase in public debt incurred from managing the financial crisis.

Looking ahead, the OECD acknowledges the dangers of "pro-cyclical" pension fund funding regulation (such as strict liability ratios) and accounting rules (mark-to-market valuation), in very much the same way as rigid banking prudential ratios have been blamed for the past 12-month self-feeding asset depreciation that hit OECD banks front on. Designing "anti-cyclical" funding rules, which require the building of pension buffers during growth cycles, might become a key policy priority in the near future.

The emergency created by the global financial crisis and new talks about "hybridisation" – mix between DB and DC schemes – may also help to shift the long-standing position of OECD experts on the so-called virtues of DC schemes back to regimes that protect workers' right to decent pension. Fair risk-sharing and risk-based pension regulation should be aimed at improving coverage and pension security, not transferring ever more market and longevity risks onto working families: moving from DB to DC regimes, increasing retirement age, changing benefit indexation. So far the OECD proposals for redressing the fundamental weakness of DC systems in providing pension security, consist of a complicated combination of 'phased withdrawals' between the retirement age and 85, after which deferred annuities start paying benefits.

On the investment side, the crisis has shown the dangers of letting pension money invested freely in financial markets without proper government regulation of pension fund investment policies. In particular the OECD notes that pension funds "continue to embrace alternative investments in a herd-like way, seeking the higher returns promised by hedge funds and the like without fully understanding the underlying risks involved". Yet, the OECD still blames the weak governance of pension funds for their exposure to un-regulated funds and products. While the need to strengthen governance, accountability and risk management of pension schemes is self-evident, there is little doubt that the root of the problems with alternative and the 'structured finance' industries lies not in the pension funds themselves – which are by any standard sufficiently regulated – but with the light regulation and supervision that have benefited the private investment industry and their wealthy managers.

For trade unions, a nation-wide pension system should be judged on its capacity to deliver decent and adequate retirement to all workers as recommended by ILO Conventions No. 102 and 128. There is no single model to achieve these goals and indeed pre-funded schemes play an important role in the OECD economies. However, pay-as-you-go regimes also have advantages in delivering income adequacy and coverage, and mutualisation of risks within society and between generations. The current crisis is a dire reminder of that.

The TUAC calls for the OECD, and its relevant committees, to closely monitor government management of the impact of the crisis on pension schemes in the coming six months and to review its past policy recommendations so as to prioritise security and predictability of financing, as well as workers' rights to a decent and adequate pension.
In the follow-up to its recent position paper on financial re-regulation[3], the TUAC will work together with affiliated organisations, the ITUC, the Global Union Federations and the ETUC, to promote fair and sustainable pension systems across the OECD and beyond.

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[3] http://www.tuac.org/en/public/e-docs/00/00/03/91/document_doc.phtml