

Collapse of Pension Funds?

Five western countries will be affected by the collapse of the capital-based pension system

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In the case of hedge funds, at least it was only about the most “risky” investments! But pension funds did not expect at all that stock and housing assets would collapse the way they have in the past few months throughout the world. These categories of assets are losing between 30 and 70 percent of their value from 2007 to 2009, knowing that there is no alternative to financial markets for such big amounts. For instance, the 300 largest pension funds reached a cumulated value of 10,000 USD in September 2007 (1). If it is certain that commodities, energy, gold... prices are rising precisely because these pension funds are now desperately seeking profitable assets, nevertheless, collectively speaking, this quest is vain. The truth is simple: these funds are losing a lot of money (1,500 billion USD lost in January 2008 (2)) and they will lose a lot more in the months and years to come. We estimate that, despite the protection measures taken by these pension funds – when for instance they get rid of the most exposed investments, they will collectively lose at least another 3,000 billion USD in 2008 and their profits will drop down to 5 percent (inflation deducted) in the best case.

Meanwhile, dozens of millions of newly retired « baby-boomers » are beginning to call upon payback from these funds. According to our team, it is likely that, by the end of 2008, this crisis will be the dominant aspect of the current global financial crisis. It will also provoke a social crisis affecting pensioners, in particular in the US (45 percent of pension funds’ total assets in the world), in Japan (18 percent) and in various European countries depending heavily on capital-based pension systems, i.e. UK (7 percent), Sweden (1 percent), Denmark (1 percent) and above all, in the Eurozone, the Netherlands (6 percent of pension funds’ total assets in the world). Canada too, which represents 5 percent of these assets, will be affected (3). In the rest of the world, only accounting for 11 percent of these assets, pensioners will not be affected so much.

According to this list, pensioners in the US, Japan, UK, Netherlands and Canada, who counted on regular capital-based pension revenues, will find themselves in a difficult situation. At the end of 2008, as the global systemic crisis unfolds in the economic and financial sphere, LEAP/E2020 estimates that half of those pension funds will be confronted to a drastic decrease in their revenues and to a shrinking value of their capital. Regulators in the various concerned countries should rapidly take on this issue which is about to have dramatic consequences for millions of American, Japanese, Dutch and Canadian pensioners.

Notes:

- (1) Source: Pension&Investments, 09/03/2007
- (2) Source: Reuters, 01/30/2008
- (3) Distribution of pension fund shares of global assets, provided by Watson&Wyatt.

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