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Defining the Direction of Defined Contribution in Europe: Results of an Expert Survey

Allianz Global Investors

Content

Defining the Direction of Defined Contribution in Europe: Results of an Expert Survey

Background

One of the most important developments in the retirement landscape over the past years is the global trend away from defined benefit (DB) plans towards defined contribution (DC) plans. This shift has taken many different forms and shapes around the world and is having an immense impact on public policy, the retirement industry, and the retirement income security of future retirees. In western Europe, where defined benefit plans have traditionally dominated pension markets, occupational defined contribution plans have also seen a strong upswing. However, the change is multifaceted, its scope varies from country to country, and its future direction is uncertain.

Given the ongoing transformation described above, the intention of this survey is to contribute to a better understanding of current trends; its primary focus is on the expected future evolution of DC in Europe. As the future is notoriously difficult to predict, we invited pension experts to share their views on how they expect the retirement landscape to develop. The theory here is that by drawing on the profound insights and expertise of the survey participants, a solid and well-founded snapshot will emerge of what we are likely to see in the future.

Participants in this survey include pension experts from pension funds, academia, regulatory agencies, consultancies, international organizations, asset management firms, insurance companies and associations; all in all, the survey incorporates the unique perspectives of 216 respondents. In geographical terms, the survey focuses on the six largest pension markets in western Europe – France, Germany, Italy, the Netherlands, Switzerland and the United Kingdom. The survey was a cooperative effort between Allianz Global Investors and the Centre for European Economic Research (ZEW), who carried it out. Before conducting this survey, we held intense discussions with a number of experts. Their input was invaluable, and their time and contribution are greatly appreciated. We are also extremely grateful to everyone who took part in the online survey. Without them, this report would not have been possible.

Key Points

- A vast majority of European experts are expecting occupational defined contribution schemes to continue to grow in their respective markets and they are able to confirm that the shift towards defined contribution plans is well underway. The majority of experts in most countries are even expecting defined contribution plans to dominate the future occupational pension markets. The key driver of this shift is cost calculability, with cost reduction playing a lesser role.

- Poor financial education is seen as the biggest obstacle to improved defined contribution plans. The regulation most likely to be introduced in the future is automatic enrollment.

- Lump-sum payments and mandatory annuitization are not considered to be suitable solutions for the payout phase of defined contribution systems. Among the other options available, inflation-indexed annuities receive the greatest support.

- The evolution of a pan-European pension market within the next 10 years is controversial, with experts split into almost equal camps. Most experts believe that a true European market will only be able to evolve once further changes have been made to existing social, labor and tax laws, and that these plans will be of the defined contribution type.

- According to the experts surveyed, the financial crisis will not lead to a political rollback of funded pensions. However, it is expected that the crisis will both accelerate the shift towards defined contribution plans and increase the importance of protection mechanisms. Investment strategies with built-in risk-management features are expected to see the greatest upswing.

Introduction

Pension systems are undergoing a fundamental transformation in western Europe, where public pension benefits in many countries have been reduced so that increased fiscal sustainability can be achieved in the face of future demographic pressures. At the same time, funded pension plans – in particular, occupational pension plans – are expected to fill this gap, thereby providing a substantial and increasing share of retirement income. To this end, a multitude of new schemes has been introduced over the past years*.

Many of the new occupational schemes are of the defined contribution (DC) type. Though DC schemes are becoming increasingly popular in western Europe, underlying this general trend are broad differences among the individual European countries in institutional design, regulation and investment strategies. Given that many of these differences are country-specific, it is difficult to make an accurate prediction of the future of DC in Europe.

In order to explore this issue more fully and get a glimpse of what the future might hold, this study focuses on how experts believe DC plans will develop in the biggest European retirement markets (France, Germany, Italy, the Netherlands, Switzerland and the United Kingdom) within the next five to 10 years. Participants were asked to specify whether they consider themselves experts in one of the national markets or in the pan-European market. Results of the pan-European experts are presented in the second part of this study.

The following eight issues were addressed in this survey:

1. The future development and significance of DC plans
2. Drivers of the trend towards DC
3. Obstacles to better DC plans
4. Future investment regulation
5. Future plan regulation
6. Design of the payout phase
7. Prospects of pan-European pensions
8. The financial crisis and its impact

* For more details, see Allianz Global Investors 2009, "Funded Pensions in Western Europe." (http://publications.allianzgi.com/en/PensionResearch/Documents/AllianzGI_Western_Europe_Study.pdf).

DC Pensions in Europe

In general, DC and funded pensions play different roles in the overall design of European pension systems. In countries such as the United Kingdom and the Netherlands, where public pension benefits are limited, funded pensions are indispensable components of retirement income. In countries such as Italy and France, public pensions are generous and replace a major portion of pre-retirement income. In Italy, for example, public pensions provide a replacement rate of 79% gross and 88% net. Therefore, the importance of funded pensions and the degree to which retirement income security is dependent upon them differs widely. In countries with generous state pensions, the need for funded pensions is lower – as are per-capita pension assets in general.

The way in which funded pensions are designed varies greatly across Europe. In Switzerland, occupational pensions are mandatory; in the Netherlands, they are quasi-mandatory. In Italy, employers must set aside a portion of each employee's salary for severance pay (as a result of reforms made in 2004, these contributions can now be transferred to a pension fund). In France and Germany, occupational pensions are mostly voluntary*. And though occupational pensions in

* Though mandatory occupational pensions do exist in France, these schemes (Arrco and Agirc) operate on a pay-as-you-go basis. Funded schemes are voluntary. In Germany, employees have the legal right to a deferred compensation scheme.

Table 1: Pension system characteristics

	Replacement rate from public pensions [gross]	Per-capita pension assets 2007 [EUR]	Pension assets 2007 [bn EUR]	Design of occupational pensions	DC design (of investigated schemes)
France	66	20,200	1,229	Voluntary	Individual accounts with investment choice
Germany	43	13,100	1,074	Voluntary	No investment choice and guarantee of paid-in capital
Italy	79	7,400	435	Mandatory*	Individual accounts with investment choice
Netherlands	30	56,000	923	Quasi-mandatory	No investment choice and risk-sharing between cohorts
Switzerland	58	63,800	482	Mandatory	No investment choice and prescribed rate of return
United Kingdom	17	51,300	3,092	Voluntary	Individual investment choice in most schemes

** Contributions to the severance pay scheme (TFR) are mandatory and can be transferred to a pension fund.*

Source: Allianz Global Investors 2009, "Funded Pensions in Western Europe"

Defining "defined contribution"

With the different types of defined contribution plans being offered in Europe, the delimitation between DB and DC is often not obvious and the understanding of what constitutes a defined contribution plan can differ from country to country. For the purpose of this survey, we had to come up with a common definition of what should be understood under DB and DC plans. In doing so, we based our definitions on work carried out by the OECD.

Defined contribution (DC) occupational pension plans are pension plans under which benefits to members are based on the amount contributed to the plan by the sponsor and/or member plus the investment return thereon. In a pure DC plan, the sponsoring company has no legal or constructive obligation to pay further contributions to an ongoing plan in the event of an unfavorable plan experience.

Defined benefit (DB) occupational pension plans are pension plans where benefits are linked through a formula to the members' wages or salaries, length of employment or other factors. The financial and longevity risks are borne by the plan sponsor.**

the United Kingdom are also voluntary right now, a new occupational scheme beginning in 2012 foresees auto-enrollment for anyone who does not have an occupational pension plan. Table 1 provides a short overview of the key differences between the western European pensions systems addressed in this study.

Not only does the design of funded pensions differ, the extent of the shift towards DC and the shape of DC plans themselves do as well. Whereas France, Germany and the Netherlands are overwhelmingly DB markets, the shift towards DC in the United Kingdom, Italy and Switzerland is further advanced. A critical feature of DC plans is how they are regulated (several countries put investment limits on pension funds) and who takes investment decisions. For instance, French, Italian and British plans foresee individual choice; while other countries studied (Germany, the Netherlands and Switzerland) leave the pension fund to take investment decisions on behalf of its members.

As the unique specifics of existing pension plans in the individual countries make it difficult to assign broad definitions of DB and DC to them, it had to be decided which of the existing plans could best be described as DC plans. The guiding and pragmatic principle here was to select plans that come closest to the abovementioned definition of DC plans. While the PERCO plans in France, the pension funds in Italy and the DC plans in the United Kingdom fit the general definition of DC plans above, the plans in Germany, Switzerland and the Netherlands include some characteristics of DB plans. For example, either the plan or plan sponsor guarantees a minimum return (Switzerland) or paid-in capital (Germany), or there is some form of redistribution and risk-sharing (Netherlands)***. Country-specific plans considered to be DC plans for the purposes of this survey are shown in the following table.

** See OECD, "Private Pen–sions: OECD Classification and Glossary," 2005 (www.oecd.org/dataoecd/5/4/2496718.pdf). In countries such as Germany, the sponsor is obliged to cover possible shortfalls so that these shortfalls have a balance sheet impact.

*** Details on the respective systems and plans can be found in Allianz Global Investors 2009, "Funded Pensions in Western Europe" (http://publications.allianzgi.com/en/PensionResearch/Documents/AllianzGI_Western_Europe_Study.pdf).

Table 2: DC plans in western Europe

Country	DC Plan
France	PERCO (Plan d'épargne retraite collectif)
Germany	DC plan with minimum benefit guarantee (Beitragszusage mit Mindestleistung)
Italy	Closed and open pension funds (Fondi pensione negoziali / fondi pensione aperti)
Netherlands	Collective defined contribution schemes
Switzerland	DC plans with minimum guarantee (Beitragsprimat)
United Kingdom	Trust-based and contract-based DC plans

As a result, the past growth of European DC plans covers several national models with differing characteristics and mirrors the existing fundamental differences in the European retirement landscape. Western Europe is currently a long way from being a homogenous retirement market. The following chapters explore what common trends we are likely to see going forward and how the European DC landscape is likely to develop.

Survey Results

1. The future development and significance of DC plans

Over the last years, DC pensions have become established retirement tools in western Europe and are showing strong growth rates; especially when compared to DB pensions. This is particularly true in the United Kingdom, Italy and Switzerland. However, DC schemes in Germany, France and the Netherlands currently reflect only a small segment of a market otherwise dominated by DB schemes*. The survey shows that a vast majority of European analysts are anticipating a continued growth in occupational DC schemes in their respective countries and are able to confirm that there is an ongoing shift from DB to DC. In fact, DC is expected to dominate the pension market in most countries in the future. In comparison, the future expectations for hybrid plans are much more modest.

Future growth of DC schemes/shift from DB to DC: The overwhelming majority of pension experts surveyed (89% on average) expect to see growth in the occupational DC market. In France, the Netherlands and Switzerland, 90% or more believe there will an increase or even a very strong increase in DC pension schemes over the next five years. In Italy, Germany and the United Kingdom, 85% to 87% agree. It is widely held (81% of all experts) that there is an ongoing shift in occupational pensions from DB to DC. This seems to be particularly pronounced in Switzerland and the United Kingdom, where 93% of Swiss analysts agree that a shift is occurring as do 97% of their British peers. The exception is France, where significantly fewer experts (46%) have noticed a shift towards DC plans**.

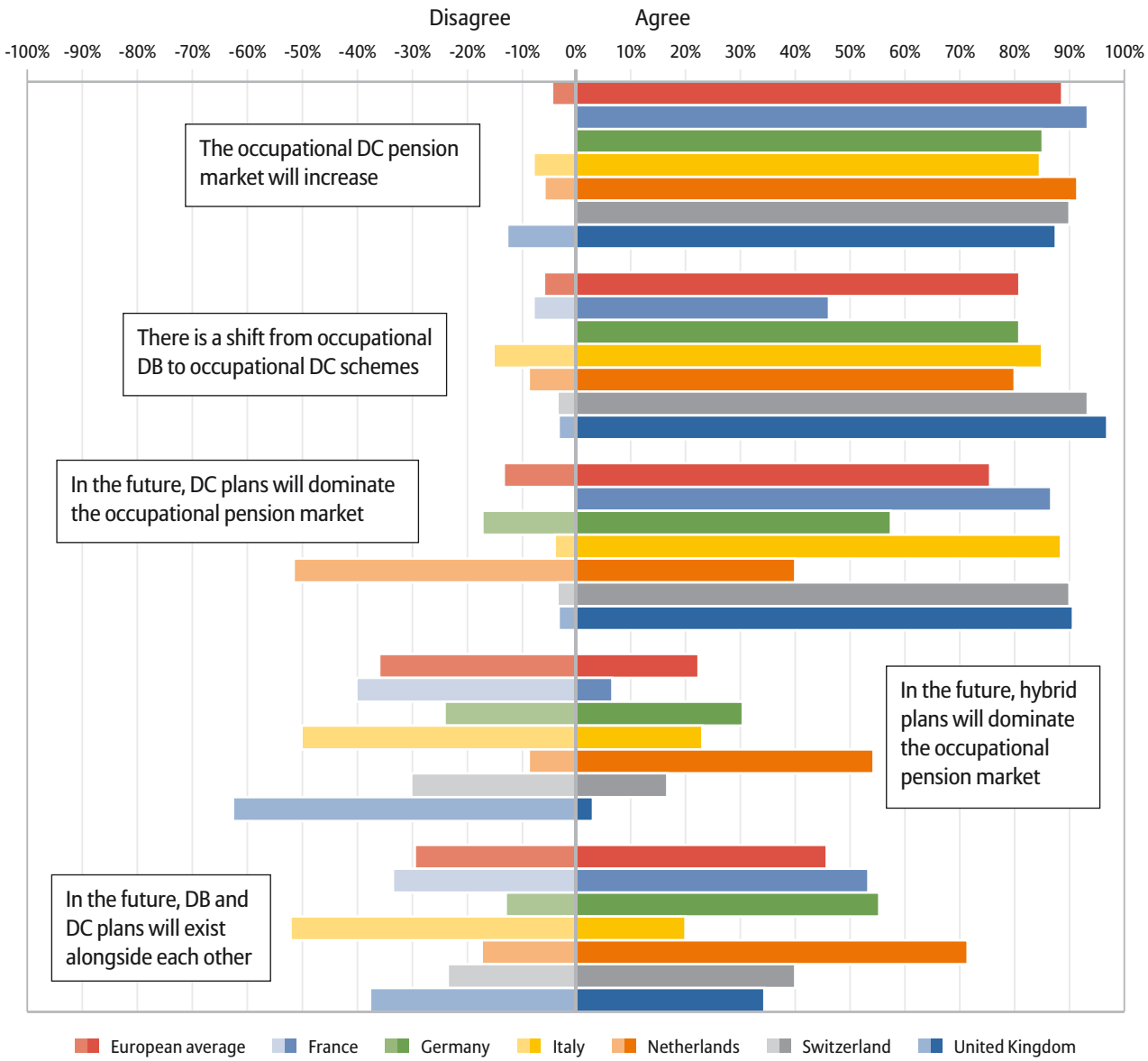
Dominance of DC/hybrid pensions: Pension experts in all the countries surveyed – with the exception of the Netherlands – are predicting occupational DC plans to dominate their domestic pension markets. In Switzerland and the United Kingdom, 90% of respondents expect to see a dominance of DC pensions in their respective countries. The same is true for almost 90% of their counterparts in Italy and France. In Germany, 58% expect DC pension plans to dominate the marketplace. Consistent with the market structure in the Netherlands and its strong DB orientation, Dutch experts disagree with the notion of DC dominance, despite their conviction of DC growth. Instead, they expect hybrid pensions to dominate. The Netherlands is the only country in which hybrid plans are expected to dominate in the future.

Coexistence of DB and DC: Consistent with the above results, Dutch experts were the most likely to foresee the possible coexistence of DB and DC plans (71%). German respondents came in next, with 55% agreeing. The majority of Italian respondents do not expect DB and DC to coexist, while results of the other countries are varied. On average, 45% expect to see the coexistence of DB and DC in the future.

* It must be kept in mind that, thanks to a long history and corresponding asset accumulation, the majority of assets is often still in DB schemes – even in those countries with a strong shift towards DC.
** Most countries also expect to see strong growth in 3rd pillar pension savings. 93% of the experts in France, 89% in Germany, 83% in Italy, 66% in the Netherlands, 63% in Switzerland and 42% in the United Kingdom agree that there will be an increase or even a strong increase in this type of plan.

The shorter the colored bar, the more respondents took either a neutral stance, did not know, or considered the question not applicable.

Figure 1: Future development and significance of DC plans



Questions: From today's point of view, how do you expect the following pension plan types (measured in plan members) to develop within your country over the next five years? To what extent do you agree with the following statements regarding your country?

2. Drivers of the trend towards DC

In order to understand the future evolution of DC, it is not only important to evaluate how the DC market is expected to grow, it is also important to determine the factors driving that growth. One way to address this question is to ask experts what they believe are the advantages of DC plans over DB plans from the employer's perspective. The survey shows that cost calculability is considered to be the biggest asset of DC plans. Experts differ in how important they believe DC advantages are in their respective markets, suggesting that different goals are being pursued in the shift towards DC plans. Lower investment and longevity risk are important drivers, but their significance varies from country to country. The impact accounting standards are having on the shift towards DC also varies widely across Europe.

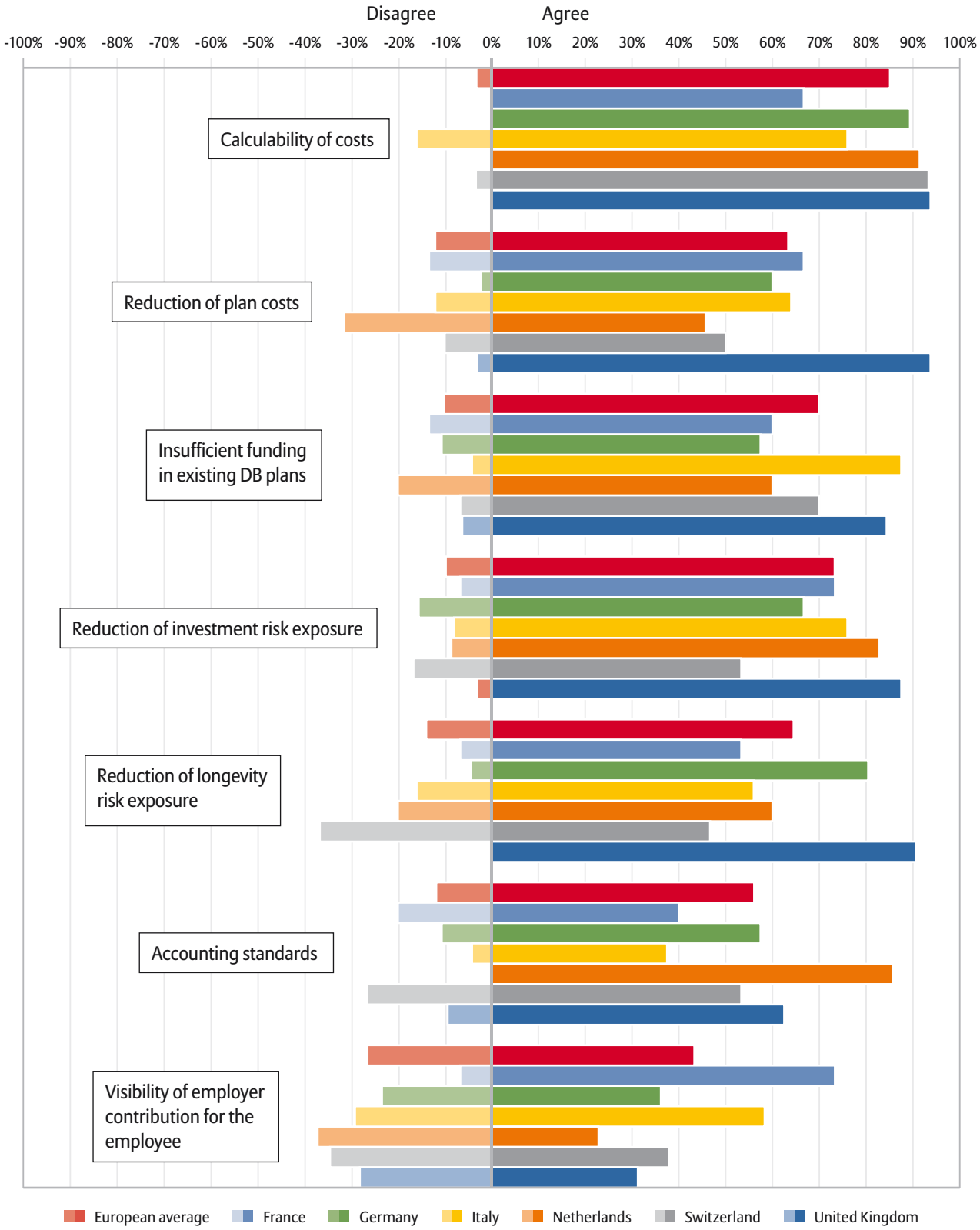
Cost calculability and cost reduction: The most significant advantage of DC plans seems to be their cost calculability. Of the experts surveyed, over 90% in the Netherlands, Switzerland and the United Kingdom, exactly 90% in Germany, and a strong majority in the remaining countries agree that this is a crucial factor driving employers to choose DC plans over DB plans. Cost calculability ranks much higher than cost reduction. Only 50% or slightly less of the pension experts in the Netherlands and Switzerland agree that reducing costs is one of the advantages of DC schemes over DB schemes. In Italy, France and Germany, this percentage is in the 60%+ zone. The picture is quite different in the United Kingdom, where over 90% agree that cost reduction is one of the advantages of DC, suggesting that British firms are using DC plans to pursue different goals than their counterparts in continental Europe.

Insufficient funding of existing DB plans: In the United Kingdom and Italy, 85% and 88% respectively agree that insufficient funding in existing DB plans is a major factor triggering the shift towards DC. In Switzerland, 70% of the respondents agree. Of the other countries surveyed, insufficient funding is seen as an important though not crucial driver of this shift.

Reduction of investment and longevity risk: Reducing an employer's investment risk seems to be a major factor influencing DC over DB plans. On average, 73% of all experts agree; around 80% agree in the Netherlands and the United Kingdom. This percentage is substantially lower in Germany and Switzerland, where local regulations stipulate that DC plans also guarantee paid-in capital (Germany) or a certain minimum return (Switzerland). Reducing the longevity risk to the employer is particularly important in the United Kingdom, where 90% believe it is a driving factor of DC schemes. At 80%, it is also clearly important in Germany. However, in other countries, reducing longevity risk is not considered crucial, least of all in Switzerland.

Accounting standards/visibility of employer contributions: The adoption of international accounting standards (IFRS and US-GAAP) and their associated mark-to-market accounting and balance-sheet effects is considered to be a reason for companies to move away from DB schemes. Almost 90% agree with this position in the Netherlands and around 60% in the United Kingdom, while in Italy and France, the role of accounting standards in driving the trend towards DC seems to be relatively minor. Another conceivable reason why employers are shifting to DC schemes is that their financial contribution to the pension plan is easily visible and so has a stronger motivational impact on employees. This is especially true in France, where 73% of respondents believe it to be an important factor. However, all the other countries believe contribution visibility plays a minor role in motivating employers to choose an occupational DC plan.

Figure 2: Drivers of the trend towards DC



Question: If employers choose an occupational DC plan over an occupational DB plan, which factors could motivate them in their decision?

3. Obstacles to better DC plans

There is a broad consensus on the main obstacles to developing better DC plans. Topping the list is poor financial education, with inadequate advice coming in second. While factors such as insufficient participation and insufficient contributions are important, not all markets agree to what extent. In comparison, hotly contested topics such as tax incentives, costs, investment choice, diversification or general regulation are considered to be largely unimportant, though there are country-specific variations.

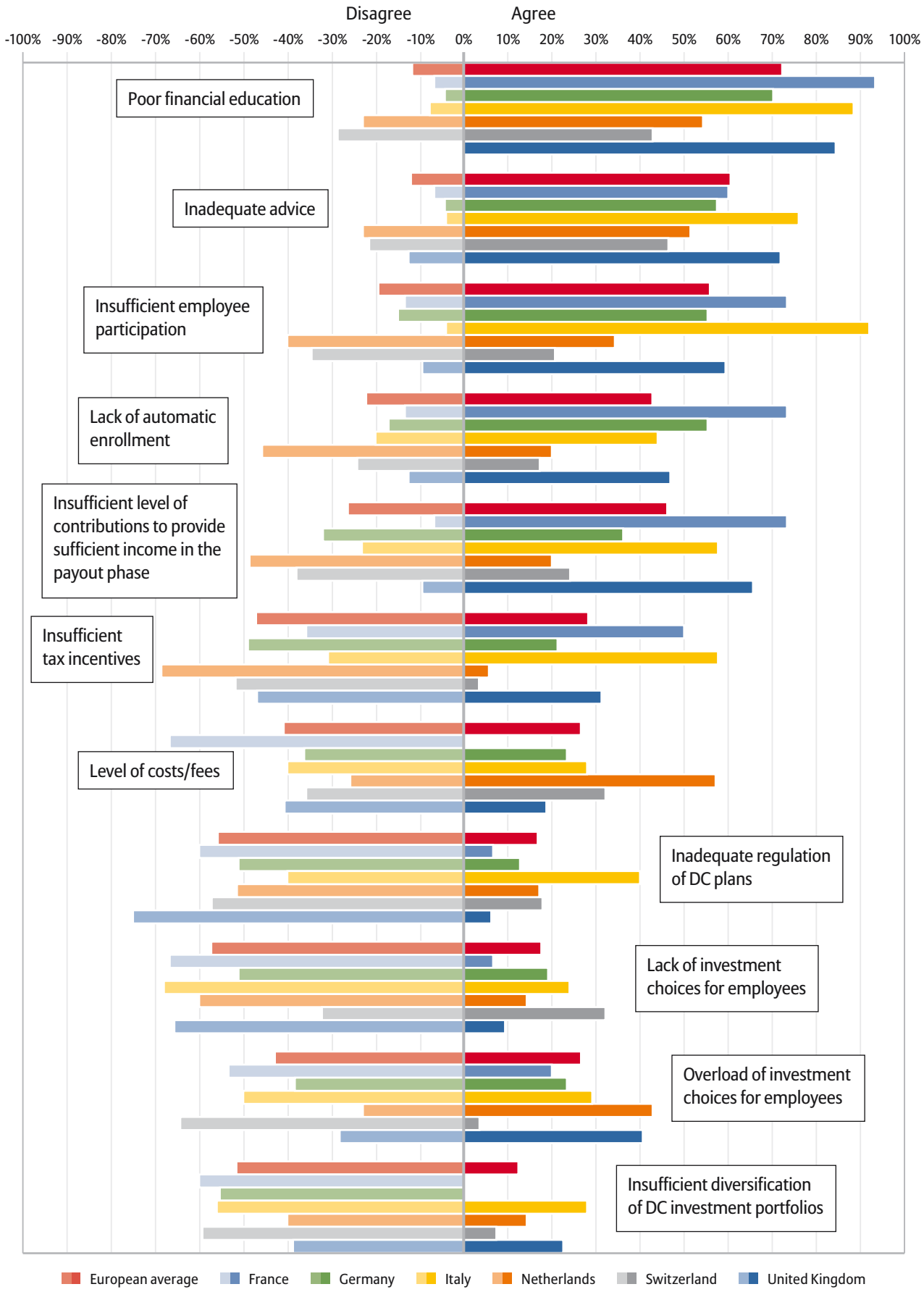
Poor financial education/inadequate advice: The vast majority of respondents – 93% of French, 88% of Italian and 84% of British – believe poor financial education is among the most important obstacles to improved DC schemes. Given that, it is not considered a pressing problem in the Netherlands and Switzerland, where there is no investment choice for employees. A similar pattern can be observed when addressing the issue of inadequate advice, which is seen as a major obstacle mainly in Italy and United Kingdom.

Insufficient employee participation/lack of automatic enrollment/insufficient contributions: In voluntary DC systems, plan members can choose whether or not to participate and, if so, how much they would like to contribute. Therefore, short-sighted behavior can result in lower-than-needed retirement income. Italian experts believe that insufficient employee participation is a critical obstacle to the DC market in Italy, with 92% reporting that it is actually hindering the development of improved DC plans. This extraordinary level of agreement is very likely rooted in the Italian pension reform of 2004, which foresaw Italian employees voluntarily transferring their severance pay contributions into dedicated pension schemes, though fewer than expected actually did. Insufficient participation is also considered a problem in France. With the exception of France, the lack of automatic employee enrollment into a plan is generally not considered to be a major obstacle to improved DC plans. Insufficient contributions are considered to be a major obstacle to improving DC plans in France and the United Kingdom.

Insufficient tax incentives/level of costs/inadequate regulation: In general, insufficient tax incentives are not considered to be a major obstacle to DC plans. Though more than half of the pension experts in France and Italy believe insufficient tax incentives do present an obstacle, all the other countries disagree. The Netherlands was the only country to respond that the amount of costs and fees are of major concern. In general, there is widespread satisfaction with how DC plans are regulated. The pension experts strongly disagree that inadequate regulation poses an obstacle to the further development of DC. In fact, more than 50% disagree in France, Germany, the Netherlands, Switzerland and the United Kingdom, and 40% disagree in Italy.

Too few or too many investment choices/insufficient diversification: In theory, both too few and too many investment choices can hinder the acceptance of DC plans. However, neither possibility seems to be particularly relevant to European markets. A substantial majority of respondents does not believe a lack of investment choices will hinder DC market development. This applies equally to countries with and without investment options. It can therefore be inferred that the range of options is considered sufficient in countries that do offer a selection of investments and is a non-issue in countries where there is a lack of investment choice. Only a very small percentage (on average, 13%) agrees that the insufficient diversification of DC portfolios is a problem in their countries. Thus, from the expert's perspective, diversification in the investment of retirement assets seems to have become a guiding principle across Europe.

Figure 3: Obstacles to better DC plans



Question: What are the most important factors hampering the development of better occupational DC plans in your country?

4. Future investment regulation

In terms of investment regulation, the countries in our survey can be broken down into two groups. The first group uses quantitative investment regulations to regulate pension investments (Germany, Switzerland, Italy)*, while the second applies the prudent person principle (the Netherlands, the United Kingdom, France)**. The first principle can be considered tight regulation; the second loose. Results show that in half of the countries surveyed, tightened investment regulations are expected. It is generally considered unlikely that regulations will be relaxed and even more unlikely that they will be abolished altogether. The introduction or extension of investment guarantees is again an issue in half of the countries surveyed.

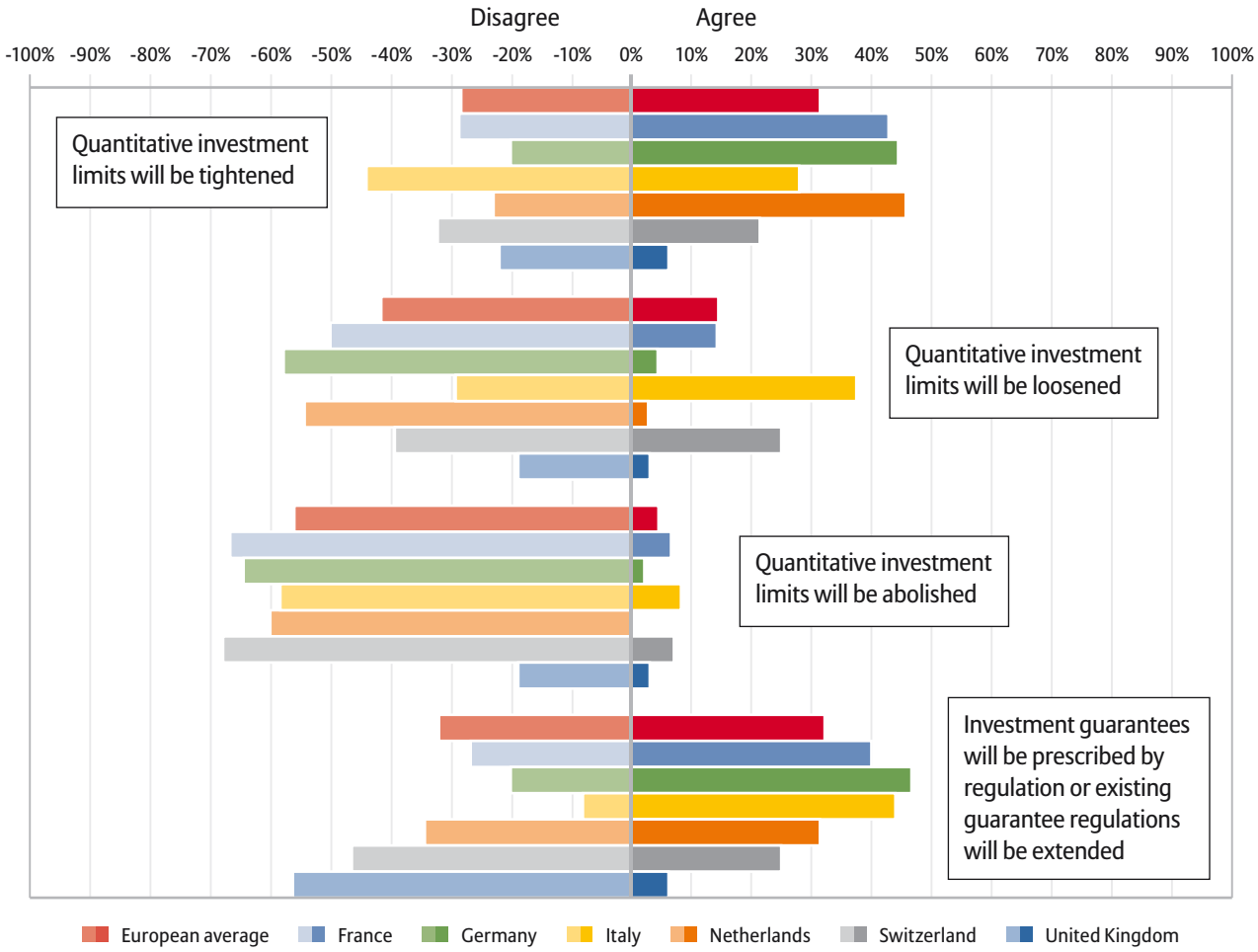
Development of quantitative investment limits: There is no clear support for the possibility of quantitative investment limits being tightened. For countries applying the prudent person principle, this would imply that quantitative limits would first have to be introduced. While a majority of respondents in France, Germany and the Netherlands expects to see a tightening of investment regulations, the opposite is true in other countries. That said, the proportion of undecided respondents is high. A majority of Italian analysts believe that quantitative investment limits will be relaxed (38% who agree vs. 29% who do not). In all the other countries, the clear majority believes they will not be relaxed. There is an even stronger consensus among respondents as to whether or not investment restrictions will be abolished. A strong majority in all countries does not expect this to occur.

Investment guarantees: In the wake of the financial crisis, the issue of investment guarantees has gained renewed popularity. Some of the countries surveyed already have various types of investment guarantees in place (Germany and Switzerland), so the question here is whether respondents in these countries expect such guarantees to be extended and whether their peers in the other countries anticipate investment guarantees to be introduced by law. Results show that 40% to 50% of the experts in France, Germany and Italy expect that there will either be an introduction or extension of guarantees. In fact, there were relatively few experts in Germany and Italy who disagreed. On the other hand, a large majority of British pension experts is convinced that investment guarantees will not be introduced in the United Kingdom.

* Though Italy applies some investment restrictions, it does not set any limits on bond and equity investments in OECD countries.

** The prudent person principle is qualitative in nature and is based on the premise that pension funds or asset managers are obliged to invest the same way a prudent investor would invest for himself, particularly with regard to diversifying assets. In the French PERCO system, union and employer representatives preselect several funds, at least three diversified funds among them, from which the employees can then choose.

Figure 4: Future investment regulation



Question: From today's point of view, how do you expect the regulatory protection mechanisms of the domestic occupational DC market to develop within the next five years?

5. Future plan regulation

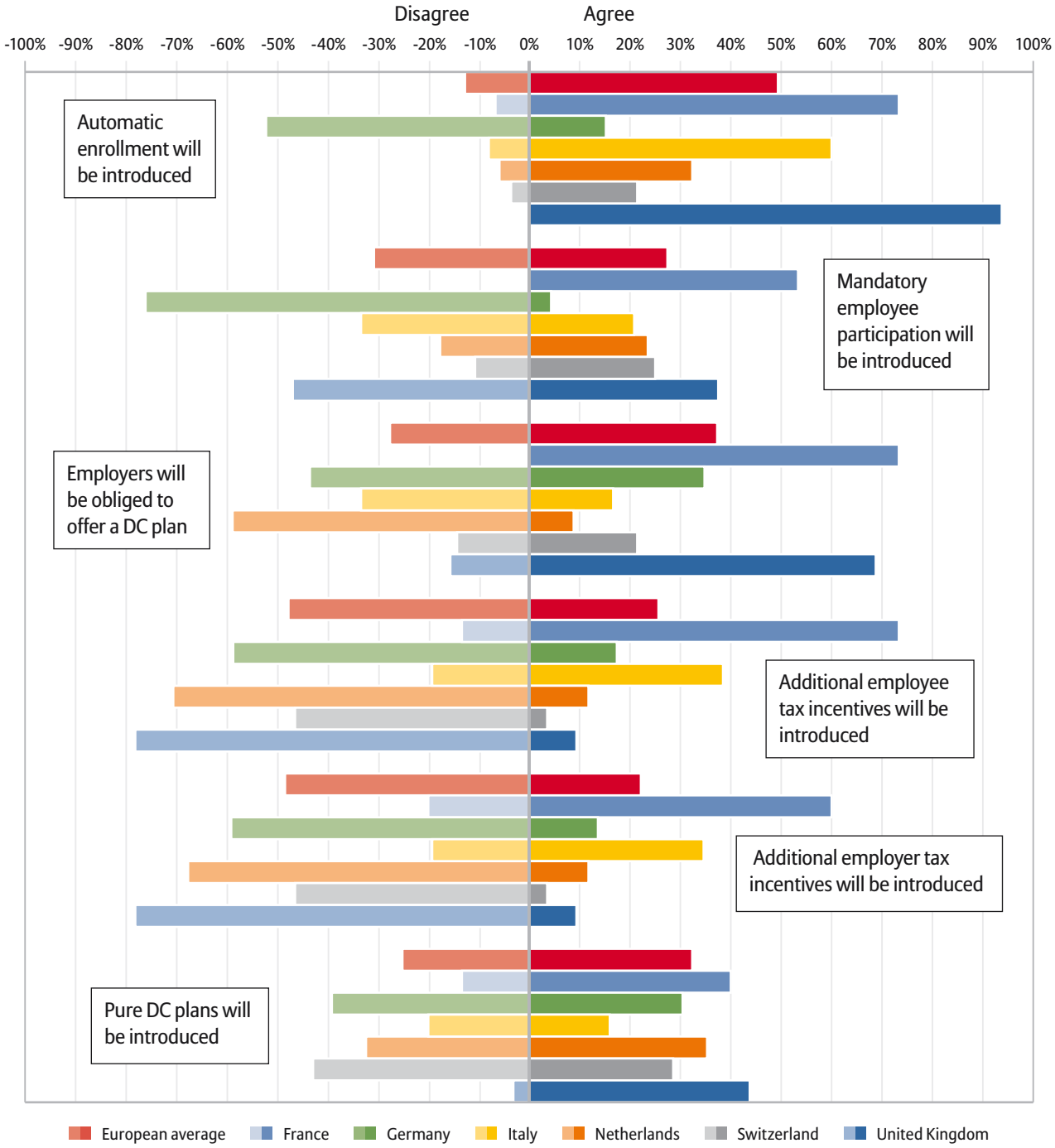
To a large extent, future regulation will determine the development of the occupational DC market and several ideas are currently being discussed. According to results of this survey, automatic enrollment is considered to be the most likely regulation to be implemented. In comparison, the introduction of mandatory employee or employer participation is considered less likely. Of the countries surveyed, all but France found it unlikely that further tax incentives will be introduced. The prospects for pure DC plans are also considered improbable.

Automatic enrollment/mandatory participation and offering: Automatic enrollment is considered to be the most likely regulation to be introduced. It should come as no surprise that 94% of analysts surveyed in the United Kingdom, which is introducing automatic enrollment as of 2012, are expecting it. In France and Italy, where insufficient employee participation is an issue, a sizable majority of the respondents also expect to see such a regulatory move. In the (quasi-) mandatory markets of Switzerland and the Netherlands, obviously very few agree. Surprisingly, experts in Germany do not see automatic enrollment to be on the agenda in Germany; over 50% do not believe it will be introduced and only 15% believe it will. Mandatory employee participation is even more strongly disregarded in Germany. At 53%, France showed the highest expectation that mandatory employee participation will be introduced. A similar picture emerges when experts were asked whether they expect it to become mandatory for employers to offer DC plans. Again, France had the highest percentage of agreement (73%). The only other country expecting to see mandatory employer participation is the United Kingdom, with a majority of 68%.

Tax incentives for employers and employees: In general, most countries do not expect to see an extension of tax incentives for DC and occupational pensions in the next five years. Again, only the French pension experts strongly expect to see additional tax incentives introduced for both employers (60%) and employees (73%). In Italy, a slight majority expects to see additional tax incentives introduced, with most of the respondents taking a neutral position. Respondents in all the other countries surveyed do not believe tax incentives will be introduced, with the United Kingdom, the Netherlands and Germany being particularly pessimistic.

Pure DC plans: The prospect of introducing pure DC plans, which imply individual investment choice and individual accounts, are quite modest in Europe. In countries where they do not already exist (Switzerland, Germany and the Netherlands), experts are not sure whether or not they will be introduced. In fact, a slight majority in Germany and Switzerland does not expect them to be introduced, while the opposite is true in the Netherlands.

Figure 5: Future plan regulation



Question: From today's point of view, how do you expect regulations regarding the design of your domestic occupational DC market to develop within the next five years?

6. Design of the payout phase

The rise of DC has crucial ramifications for the pension payout phase. In a DB world, retirees do not have to worry about the payout phase because benefits are defined and known beforehand. However, in a DC system, the question of how to convert assets into retirement income is critical. In a pure DC system, retirees would receive their accumulated assets in hand and then have to decide how to invest their money. In principle, there are several drawdown combinations and solutions ranging between the opposite poles of lifelong annuities and lump-sum payments*. The question in the survey, therefore, was not geared towards expected developments, but was normative and addressed how the payout phase should be organized. It turns out that the inflation-indexed annuity is highly popular among European experts. Though lump-sum payments are not considered a good solution across the board, there is no unanimous support for any other type of annuity.

Lump-sum payment/withdrawal plans: Most experts agree that lump-sum payments are not a desirable solution for the payout phase. In every country except France, where experts are almost equally divided, the percentage of experts who disapprove of lump-sum payments is much larger than the percentage of those who approve of them. On average, only 22% of respondents are in favor of lump-sum payments. Withdrawal plans enjoy greater though still modest acceptance, with around 50% of all respondents in the United Kingdom and Switzerland considering them to be a good solution for the payout phase. In France, the number of proponents is greater than the number of opponents, while in the Netherlands and Italy, respondents are almost equally divided. Withdrawal plans have more opponents than supporters in Germany.

Combined payout solutions: The popularity of annuity and withdrawal combinations largely depends on the country in question. More than half of the experts in Germany and Italy consider a combined payout solution (withdrawal plan for the first 10–15 years of retirement followed by an annuity) to be a good idea. This idea was met with more limited approval in the other countries. Swiss experts would enthusiastically welcome a combination of partial immediate annuity and partial lump-sum payment. In fact, 75% of the Swiss analysts surveyed are in favor of this solution as were around 50% in the United Kingdom, Italy and Germany. However, this particular mix would meet very strong resistance in the Netherlands.

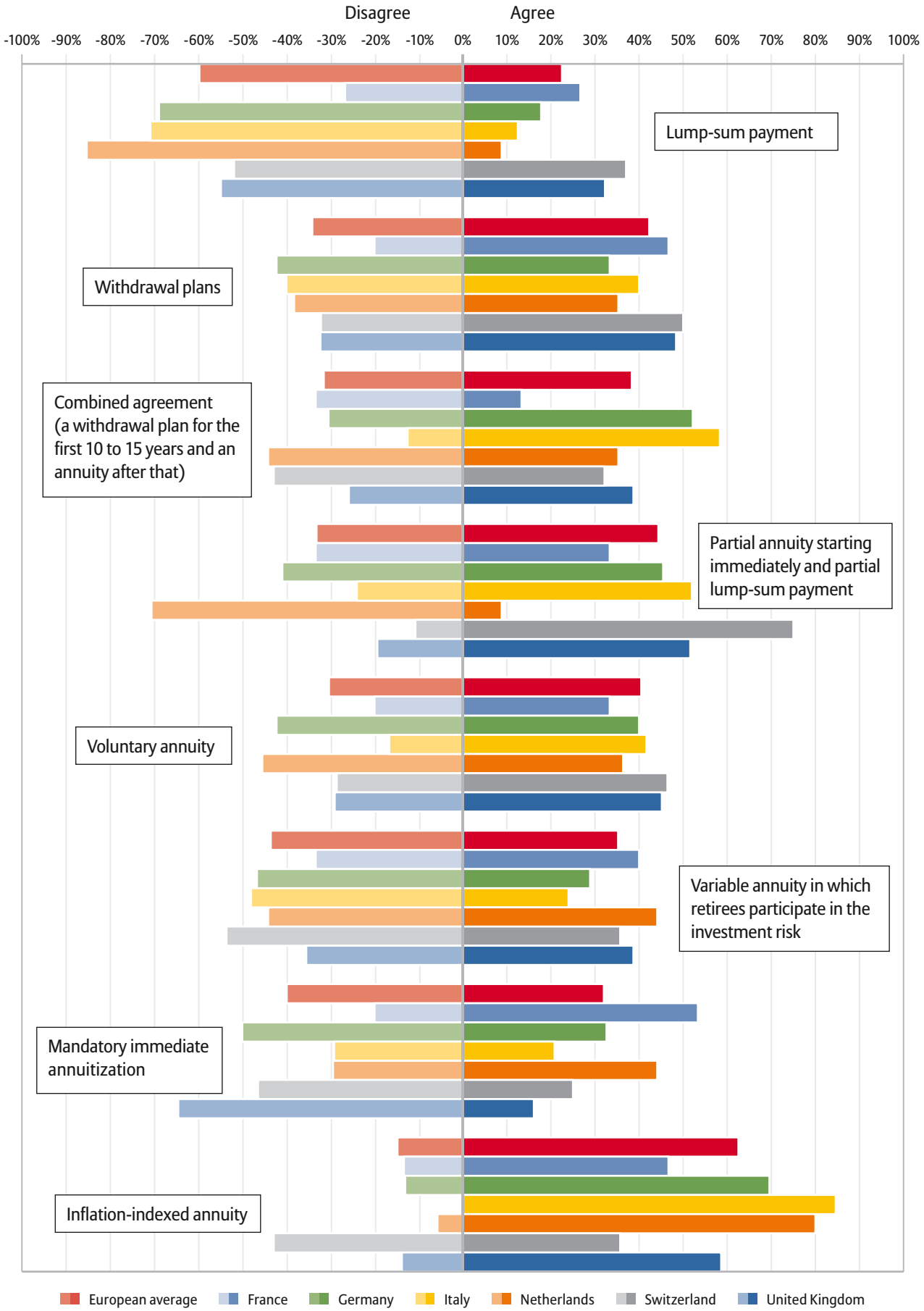
Annuities: Feedback on the various types of annuities differed widely**. Leaving the decision to retirees and relying on voluntary annuities is not very popular among European pension experts. The likeliest is in Switzerland, where 45% would welcome this solution. The same is true of variable annuities (in which retirees participate in investment risk and opportunities), which found no more than 44% support in any country (Netherlands). Mandatory immediate annuitization (in which accumulated capital is converted into a life-long annuity) is also not very popular. Though 54% of French respondents are in favor of it, their German, Swiss and British counterparts aren't; the British, quite strongly.

As it turns out, the most popular type of annuity is the inflation-indexed annuity. 84% of Italian, 80% of Dutch and 67% of German respondents believe it to be a suitable solution. Inflation is considered to be such a tremendous risk, that it should be specifically factored into retirement investing. With its history of low inflation, Switzerland is much less in favor of inflation-indexed annuities. However, the current financial crisis and possibility of higher inflation in the future is likely driving this concern among other countries.

* For an overview of the situation in Europe and alternative regulatory solutions, see Maurer, Raimond; Somova, Barbara 2009, "Rethinking retirement income strategies – How can we secure better outcomes for future retirees?" (www.efama.org/index.php?option=com_docman&task=cat_view&gid=261&Itemid=-99).

** For the purpose of this survey, we defined annuities as financial products that convert an employee's capital into a lifelong income. In the case of his/her death, a bequest is not possible.

Figure 6: Design of the payout phase



Question: In your opinion, how should the payout phase of occupational DC systems be organized?

7. Prospects of pan-European pensions

There is a long-standing political ambition to create a pan-European occupational pension market and, to this end, the EU adopted the IORP (Institutions for Occupational Retirement Provision) Directive in 2003*. However, transnational pensions in Europe are a complex matter and introducing them is not simply a question of EU regulation. National social, labor and tax laws play a crucial role as does the willingness of companies to take on such plans. This section of the survey explores the prospects of a pan-European pension market in general, its drivers and likely regulatory developments. The results show no clear picture of whether a pan-European pension market will develop, but if it should, DC plans are likely to prevail. According to respondents, in order to create a European market, additional legislative changes would have to be introduced. There is cautious optimism as to whether such changes will actually be introduced on a European and national level.

Prospects and drivers of demand: There is no consensus as to whether or not a pan-European pension market will emerge within the next 10 years. The pension experts surveyed are almost equally divided on this matter. On average, 42% agree and 40% disagree, with Dutch and French respondents being more optimistic than their British counterparts. However, there is a broader consensus on what is driving the demand for pan-European pensions. Our experts believe it is due to large multinational companies and not a more mobile workforce. Overall, 72% of the respondents believe that the demand for cross-border schemes will be driven by companies; the idea that increasingly mobile workers will stimulate the development of European pensions receives a significantly lower rating.

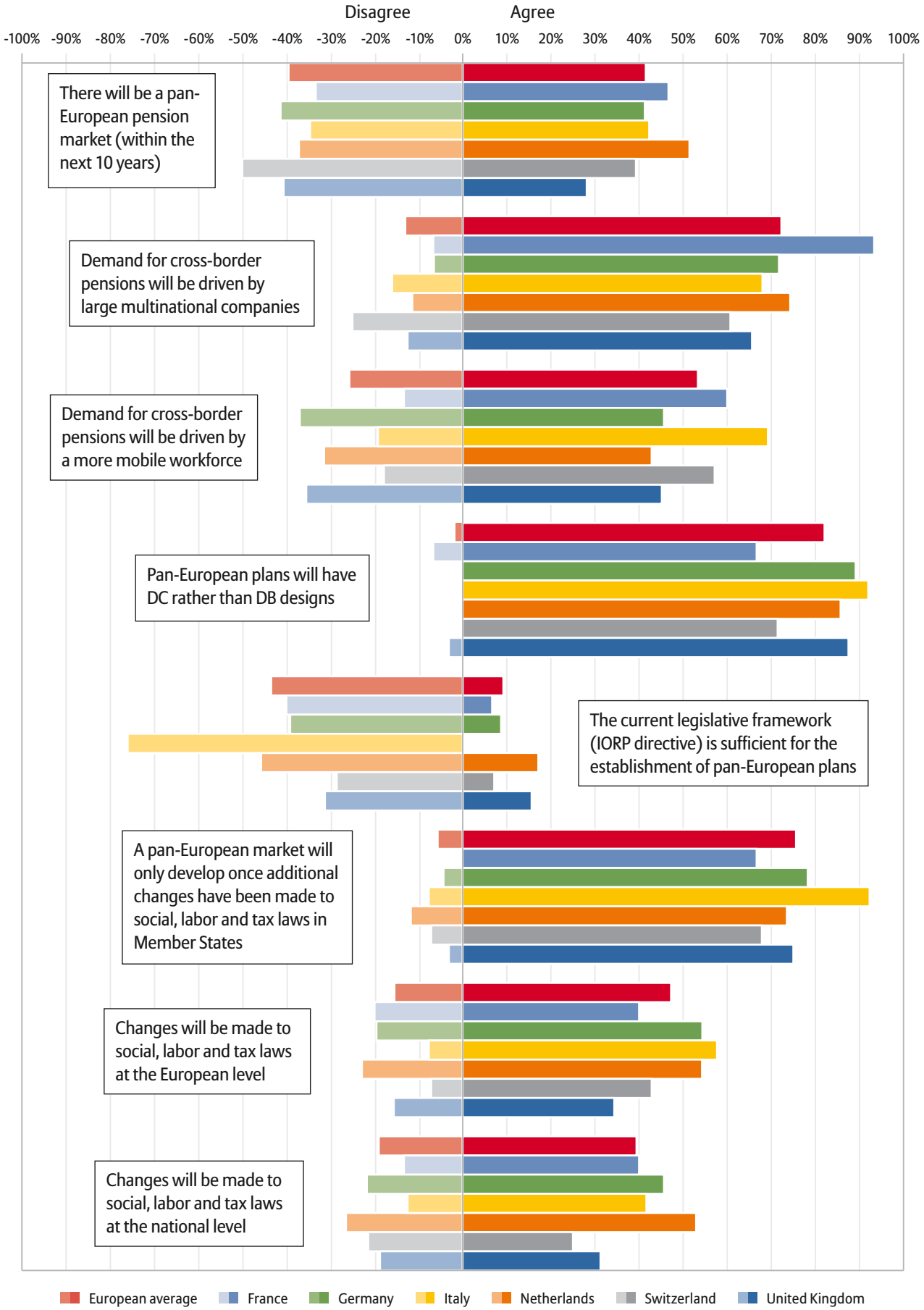
Should there be a pan-European market one day, there is a broad consensus on how it will be designed. The vast majority of all analysts surveyed (82%) believe that pan-European plans will be DC rather than DB. The largest percentage of analysts of any one country not agreeing was in France, but even at that, it was only 7%.

Regulation of pan-European pension plans: There is an ongoing debate as to whether the IORP Directive provides a sufficient framework for mandating a pan-European pension market. On the surface, the results seem to be quite clear. Of the respondents prepared to take a position one way or the other, most of them believe the IORP Directive is not sufficient (76% in Italy and 43% on average). However, most of the respondents either took a neutral position or did not consider the question applicable to their individual countries.

On the other hand, there is a clear consensus on what would be required to build a pan-European market and the results imply that much remains to be done on the national level. The vast majority believe that a pan-European market will only emerge once additional changes have been made to social, labor and tax laws within the Member States. This opinion is shared by 76% of all respondents. However, it is not certain whether legislative changes in that direction will ever be made. On average, 47% of the experts surveyed expect there to be changes initiated at the European level. However, a large proportion didn't take a position one way or the other. The same is true of expected changes on a national level, which is currently the crucial level for changes in social, labor and tax laws. Again, there is modest agreement (Dutch analysts are the most optimistic, followed by their German counterparts) with a large number undecided.

*This directive provides the framework for establishing pan-European pension funds. Such pan-European pension funds are regulated by the home country alone. The prudent person principle of investment regulation applies.

Figure 7: Prospects of pan-European pensions



Question: To what extent do you agree with the following statements?

8. The financial crisis and its impact

The financial crisis is very likely to have a significant impact on the future development of DC plans and funded pensions in general. Its scale and depth are causing regulators, plan sponsors and pension funds to review their approaches towards retirement savings and investment. It is possible to conceive several different outcomes ranging from a general rollback of funded pensions to the introduction or strengthening of protection mechanisms in DC plans. The survey shows that the crisis is likely to accelerate the shift from DB to DC, while a rollback of funded pensions is generally not expected. Protection mechanisms – particularly risk-management investment strategies – are anticipated to play a greater role in DC plans. However, several countries also expect to see changes in asset allocation and the establishment or expansion of formal investment guarantees.

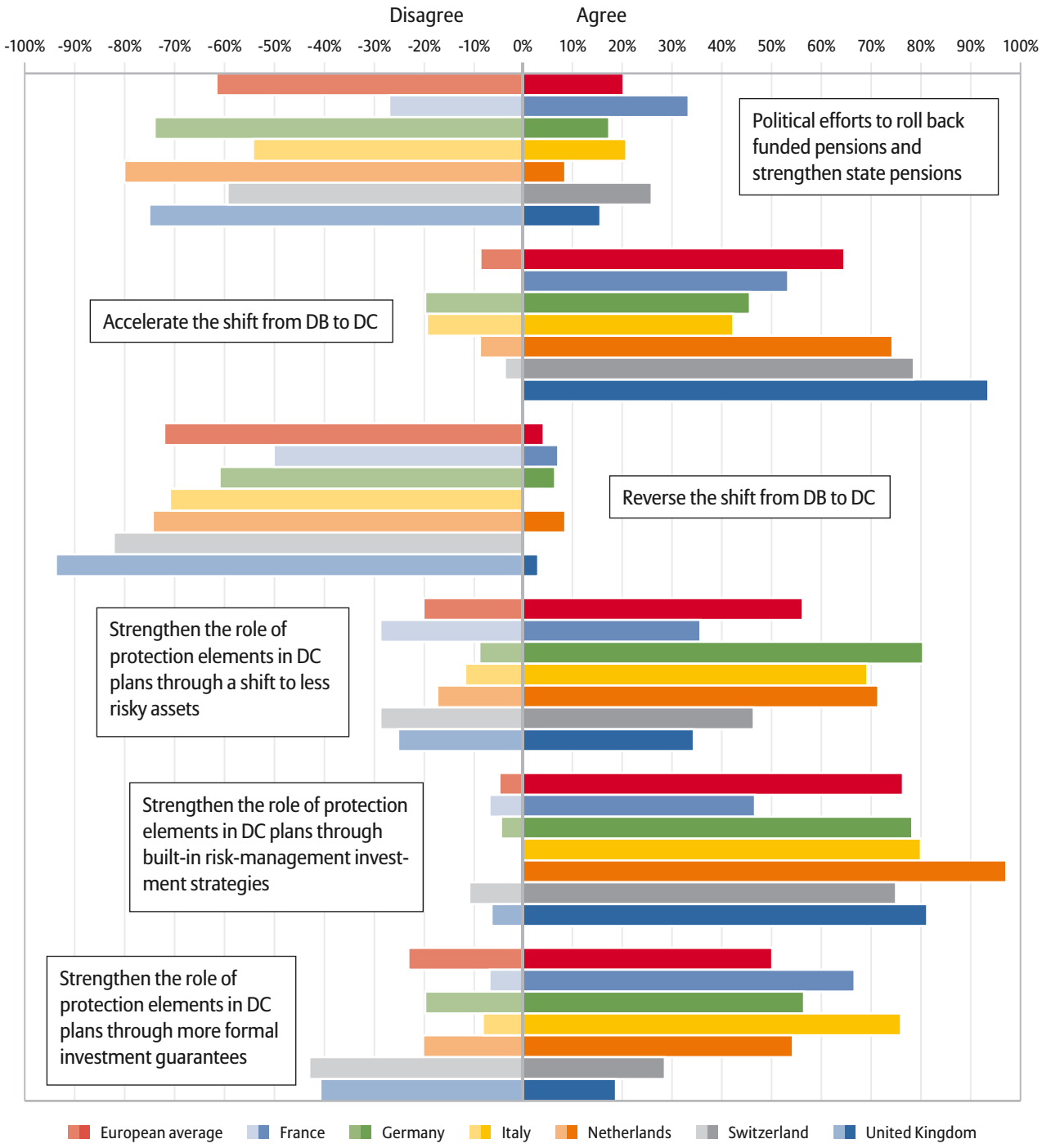
Rollback of funded pensions: A possible effect of the crisis is the rollback of funded pensions and a strengthening of state pensions. This might happen if citizens were to lose confidence in the ability of the financial markets to provide reliable retirement income and so demand a reorientation of pension policy, or if politicians would exploit the uneasiness about financial markets to promote greater reliance on public pensions. However, almost all the experts surveyed believe this will not be the case. 74% to 80% of experts in the Netherlands, the United Kingdom and Germany do not believe there will be a rollback of funded pensions. The same is true of about 60% in Switzerland and 55% in Italy. In France, 27% of respondents disagree, while 34% expect to see backsliding from funded pensions.

Accelerating or reversing the shift from DB to DC: The survey paints a very clear picture of the impact the financial and economic crisis is having on the shift from DB to DC. Every country expects the crisis to accelerate the shift. On average, 64% across Europe agree, with the British recording over 90% agreement and their counterparts in the Netherlands and Switzerland recording over 75%. Though the number of respondents who agree is substantially lower in France, Germany and Italy, the number who disagree is very low and a large number of respondents are undecided. It is considered extremely unlikely that the financial crisis will have the opposite effect (i.e., a reversal of the shift from DB to DC). No more than 9% in any country expect such a scenario to occur – not even in quintessential DB markets such as the Netherlands. 74% to 94% in the Netherlands, Switzerland, Italy and the United Kingdom do not expect a reversal; in France and Germany, 50% to 60%. Based on these results, it can be argued that the financial crisis will not stop the shift from DB to DC; quite the contrary. One possible reason is that the crisis has painfully underscored the importance of investment risk, considered one of the main reasons for the shift (Question 2). This naturally strengthens the incentive of plan sponsors to change pension plan designs.

Protection mechanisms in DC plans: What the crisis is likely to change is the importance protection mechanisms play in DC plans. In this context, protection refers to mechanisms put in place to protect pension plan members to some extent from capital market swings. The main approaches are changing asset allocation to less risky assets, building risk-management strategies into DC plans, and having the plan's sponsor or regulation introduce formal investment guarantees. The vast majority of pension experts surveyed are convinced that such protection mechanisms will play a greater role. Germany (80%), the Netherlands (72%) and Italy (67%) highly expect to see asset allocation changed to less risky assets. While its proponents still overweigh its opponents, this expectation is considerably lower in Switzerland, France and the United Kingdom.

That built-in risk management investment strategies (e.g. life-cycle, outcome-oriented or inflation-protected strategies) will gain importance is accepted almost unanimously, with 97% of Dutch experts agreeing, around 80% in the United Kingdom, Italy and Germany, and 75% in Switzerland. Though only about 50% of French experts agree, only 7% disagree. Several countries expect more formal investment guarantees to be introduced, but the rate of approval tends to be lower as in the case of risk-management investment strategies (50% vs. 76% on average). While a fair share of experts (54% to 76%) in the Netherlands, France, Germany and Italy expect to see more formal investment guarantees, the overall mood in Switzerland and the United Kingdom is much more pessimistic.

Figure 8: The financial crisis and its impact



Question: From today's point of view, what are the possible consequences of the financial crisis for the further development of DC occupational pension schemes in your domestic market over the next five years?

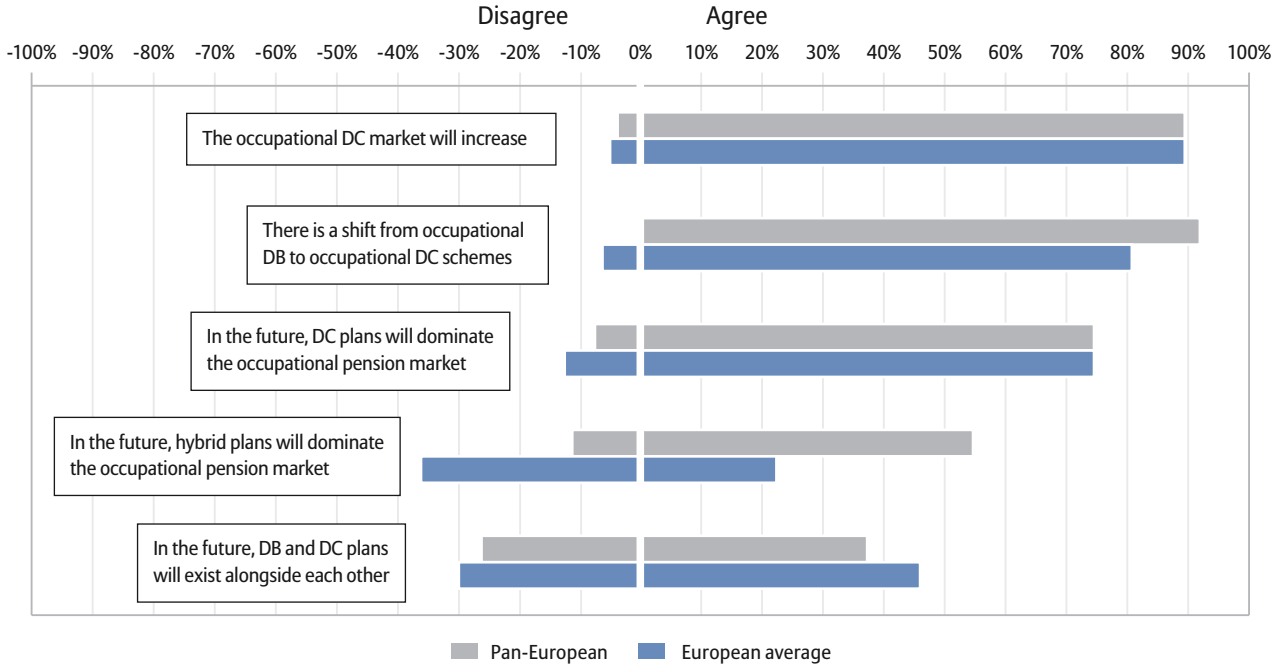
The Pan-European Perspective

This survey not only includes the opinions of experts about their respective countries, respondents had the option to decide whether they wanted to give a country-specific perspective or take a pan-European approach. A pan-European approach implies making an overall assessment of the entire European market and is particularly suited to pension experts whose area of expertise is transnational trends. The aggregate perspective of these pan-European experts can provide a bird's eye view of European DC developments. The following sections compare their answers to country averages.

The future development and significance of DC

Regarding the future growth of the European DC market, both national and pan-European pension experts agree that there is a shift from occupational DB to DC plans in Europe and that DC is likely to grow and dominate the European pension market. However, pan-European experts are much more optimistic about the future of hybrid plans. Compared to over 50% of the pan-European pension experts, only slightly more than 20% of the national experts on average expect hybrid plans to dominate the occupational pension market in the future.

Figure 9: Future development and significance of DC plans

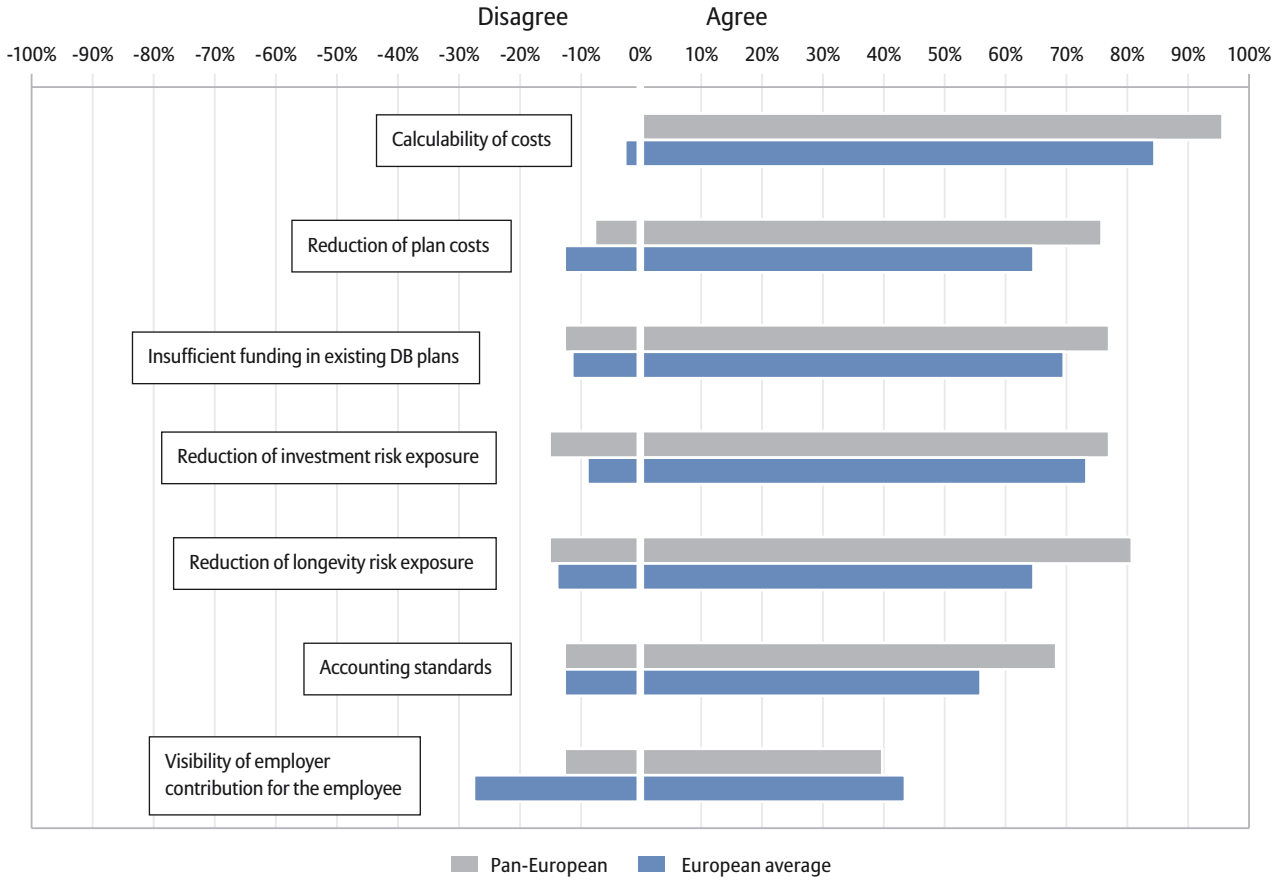


Questions: From today's point of view, how do you expect the following pension plan types (measured in plan members) to develop within your country over the next five years? To what extent do you agree with the following statements regarding your country?

Drivers of the trend towards DC

The two groups of respondents showed similar results when asked whether cost calculability is the main driver of the shift from DB to DC. 95% of the pan-European experts agree. As compared to country averages, the pan-European experts ranked the reduction of plan costs and longevity risk exposure significantly higher. Insufficient DB funding and the reduction of investment risk exposure are considered to be more important drivers by the pan-European group than the country average, however the differences are not substantial.

Figure 10: Drivers of the trend towards DC

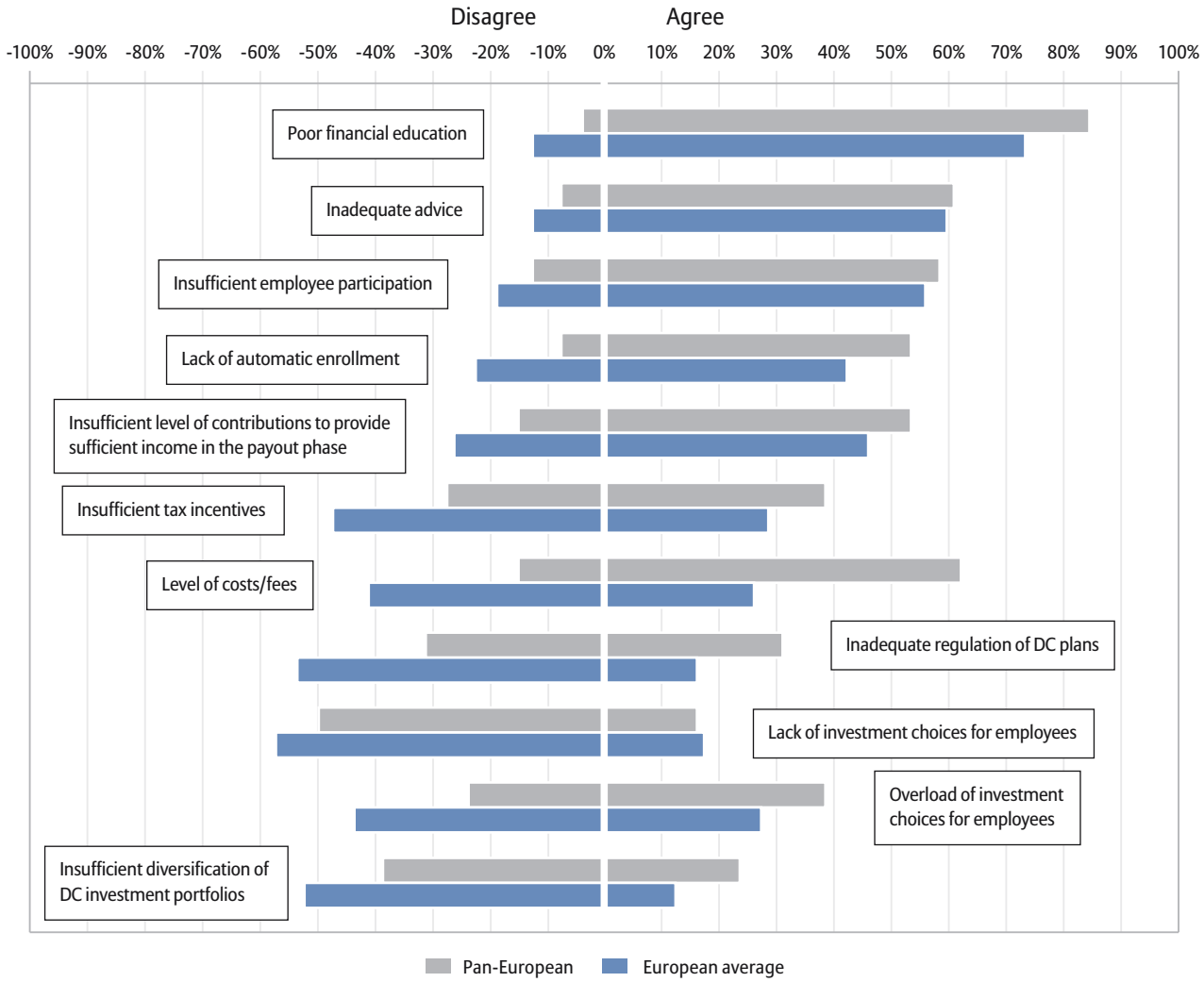


Question: If employers choose an occupational DC plan over an occupational DB plan, which factors could motivate them in their decision?

Obstacles to better DC plans

National and pan-European experts agree that poor financial education is the biggest obstacle to improved occupational DC plans. The rate of approval is even higher among the pan-European respondents (83%). The same is true for the possible obstacles "lack of automatic enrollment," "inadequate regulation of DC plans," and – in particular – "level of costs/fees." A much larger percentage of pan-European experts (62%) believe the latter is a critical hindrance to the development of improved DC plans. Though the reason for this big discrepancy is not obvious, it might be due to their different perspectives. Whereas national experts took existing fee structures in their respective markets into account, the pan-European experts may have been forecasting the kind of fees a pan-European market might have should it be introduced.

Figure 11: Obstacles to better DC plans



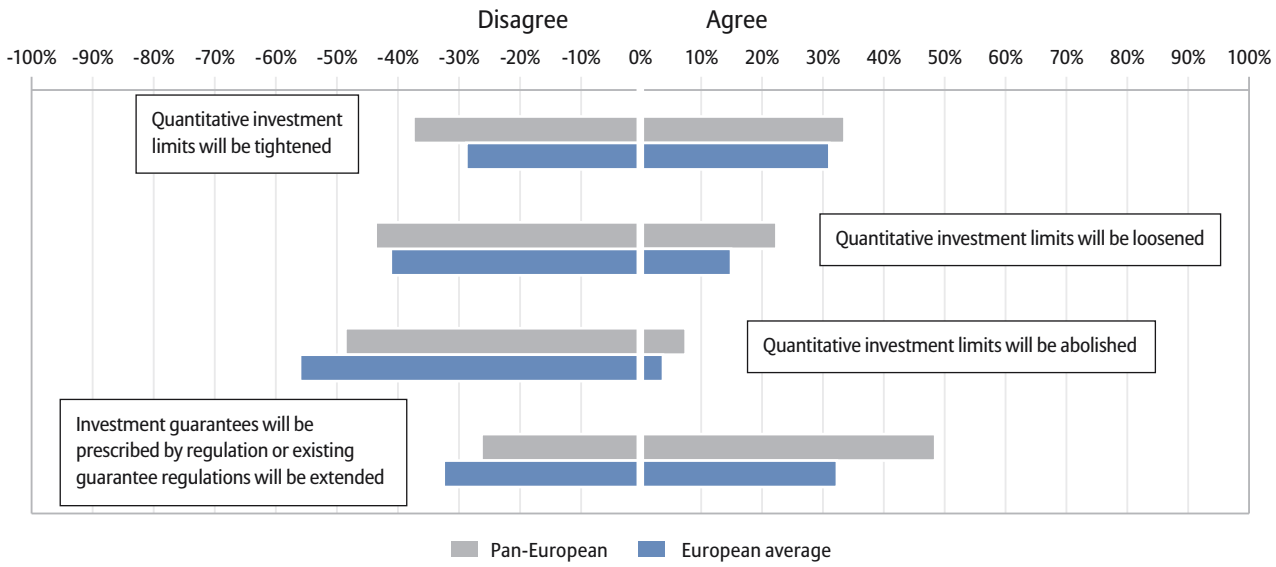
Question: What are the most important factors hampering the development of better occupational DC plans in your country?

Future investment regulation

When asked about the future development of quantitative investment limits, the differences between pan-European and national respondents are minimal. Neither expects them to be either relaxed or abolished. Regarding a possible tightening of investment limits in the future, no clear picture emerged.

The two groups of respondents differed in their expectation of whether investment guarantees would be introduced or extended. Almost 50% of the pan-European experts believe this will happen; the average among national experts is 32%.

Figure 12: Future investment regulation

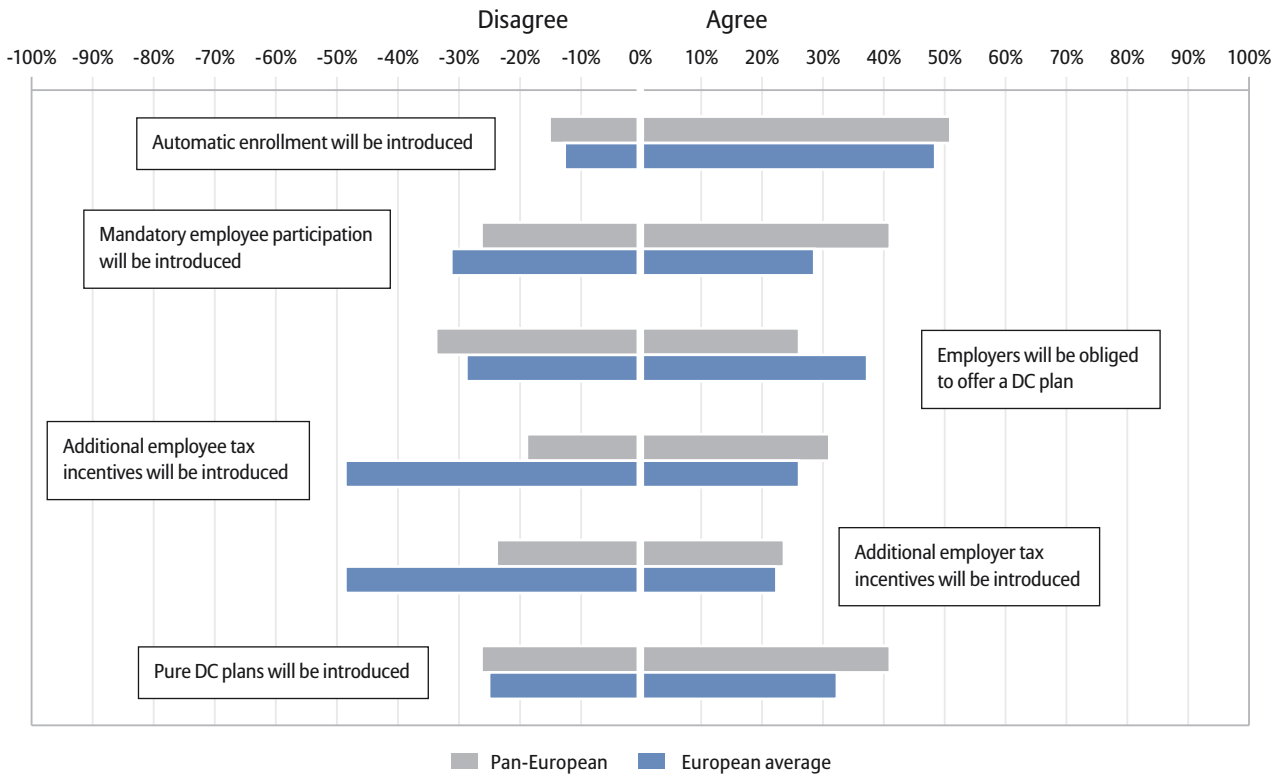


Question: From today's point of view, how do you expect the regulatory protection mechanisms of the domestic occupational DC market to develop within the next five years?

Future plan regulation

Pan-European experts agree with their national colleagues that automatic enrollment is the most likely change to occur in future plan regulation. Slightly more than 50% are expecting it and 40% believe we will see the emergence of pure DC plans as well as the introduction of mandatory participation for employees. Though the pan-European analysts are more optimistic than their national counterparts about both of these scenarios, they are more pessimistic that employers will be obliged to offer mandatory DC plans.

Figure 13: Future plan regulation

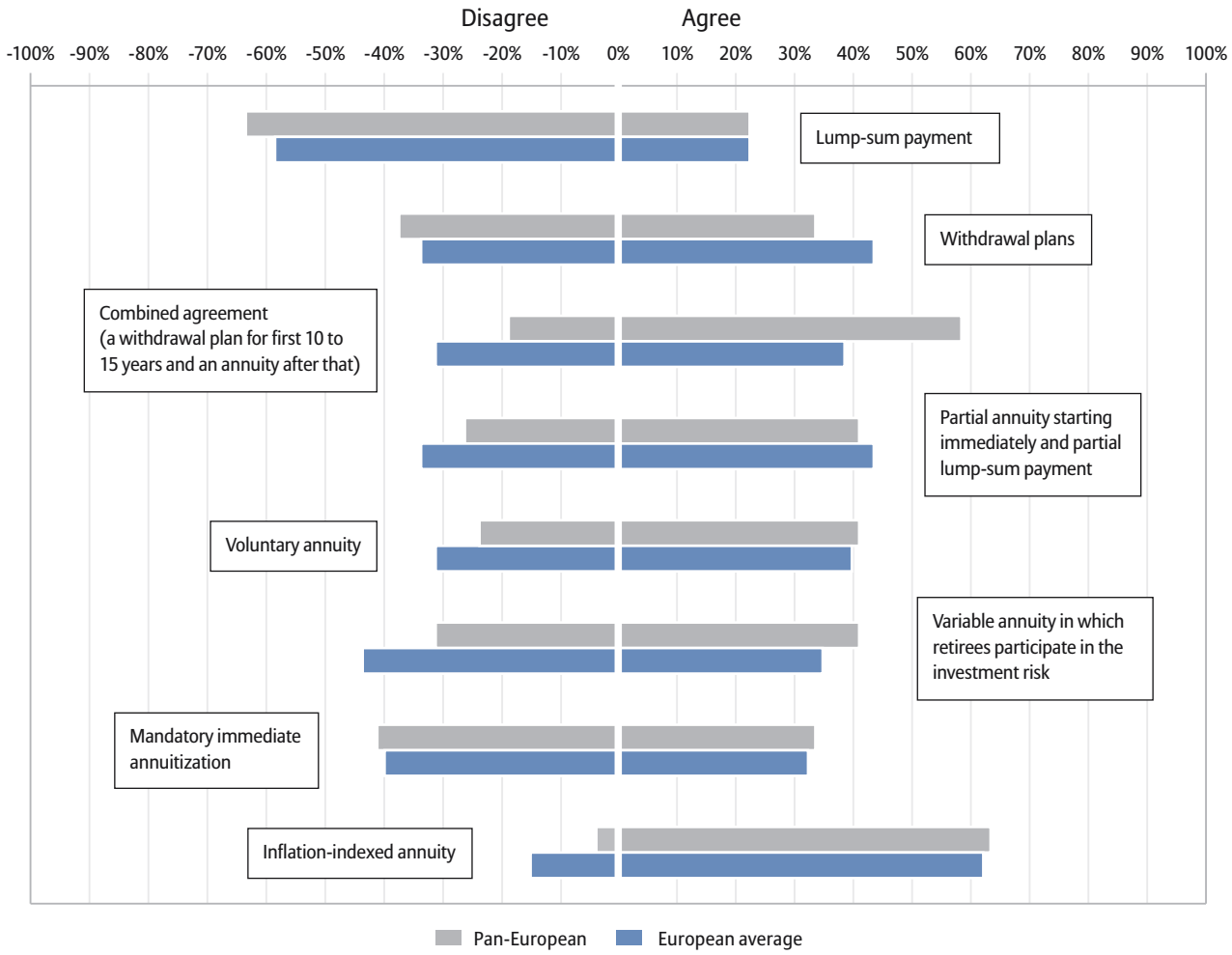


Question: From today's point of view, how do you expect regulations regarding the design of the domestic occupational DC market to develop within the next five years?

Design of the payout phase

There is a broad consensus on how the payout phase of occupational DC schemes should be organized. Lump-sum payments are strongly rejected as is, to a lesser degree, mandatory annuitization. Both groups agree that inflation-indexed annuities are the most appropriate financial instrument for the payout phase. A major difference can be observed in how the combination of withdrawal plans in the first 10–15 retirement years followed by annuities is assessed. Though some 60% of pan-European experts believe this to be a sensible solution, national experts are much less convinced (39%).

Figure 14: Design of the payout phase

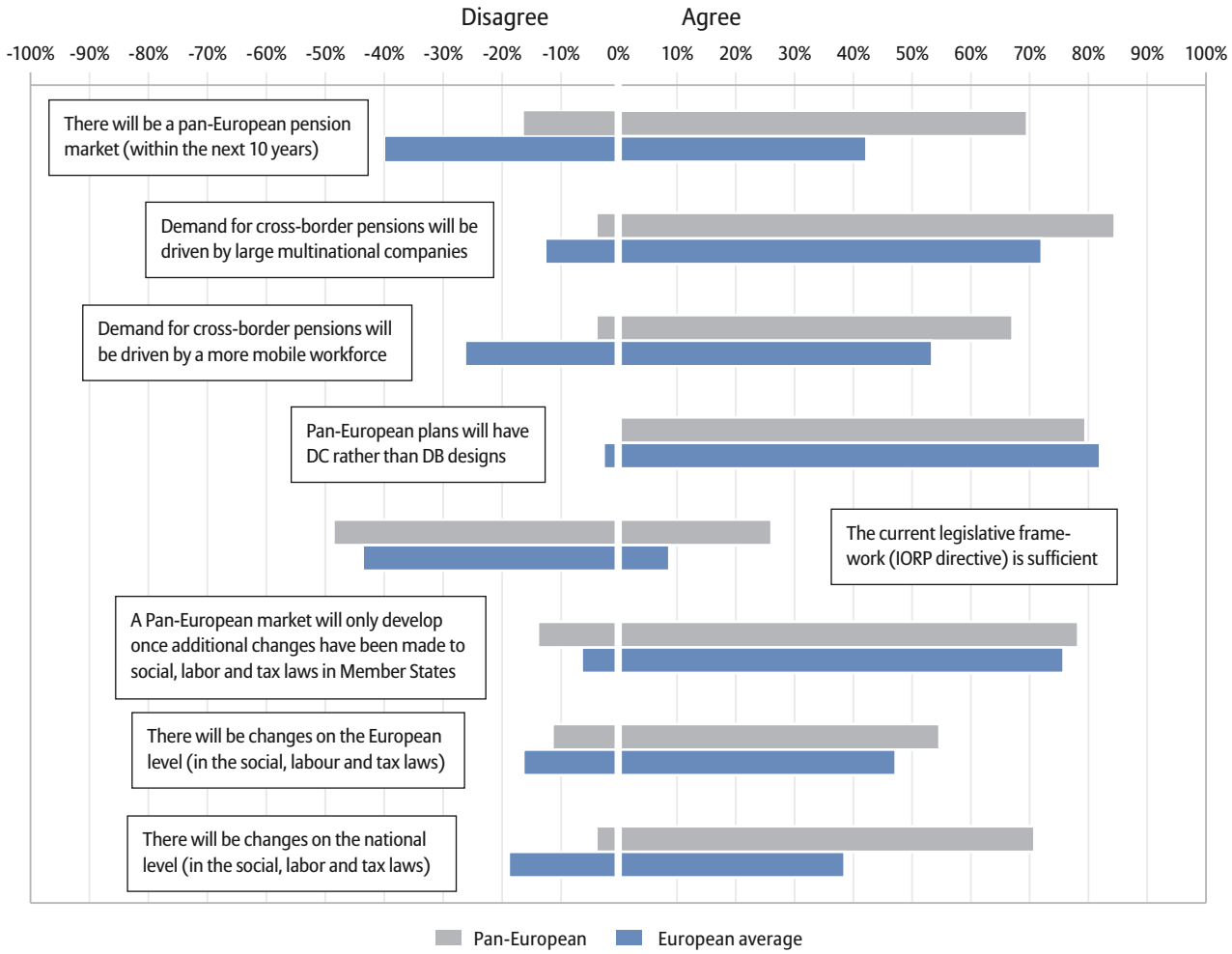


Question: In your opinion, how should the payout phase of occupational DC systems be organized?

Prospects of pan-European pensions

National and pan-European analysts have different takes on several aspects of the future development of a pan-European pension market. Generally speaking, the pan-European experts adopt a more optimistic view. One major point of contention concerns the question of whether there will be a pan-European market within the next 10 years. While 42% of national analysts believe this will happen, almost 70% of their pan-European colleagues are expecting this to transpire. The pan-European experts are also more optimistic than their national counterparts that there will be changes in both national and European legislation that will favor a pan-European market. While both groups of experts are generally skeptical that the IORP Directive provides a framework sufficient for establishing pan-European plans, again the pan-European experts are more optimistic. However, there is a broad consensus that a pan-European market will only be introduced once additional changes have been made to social, labor and tax laws, and that European-wide plans will have DC rather than DB designs.

Figure 15: Prospects of pan-European pensions

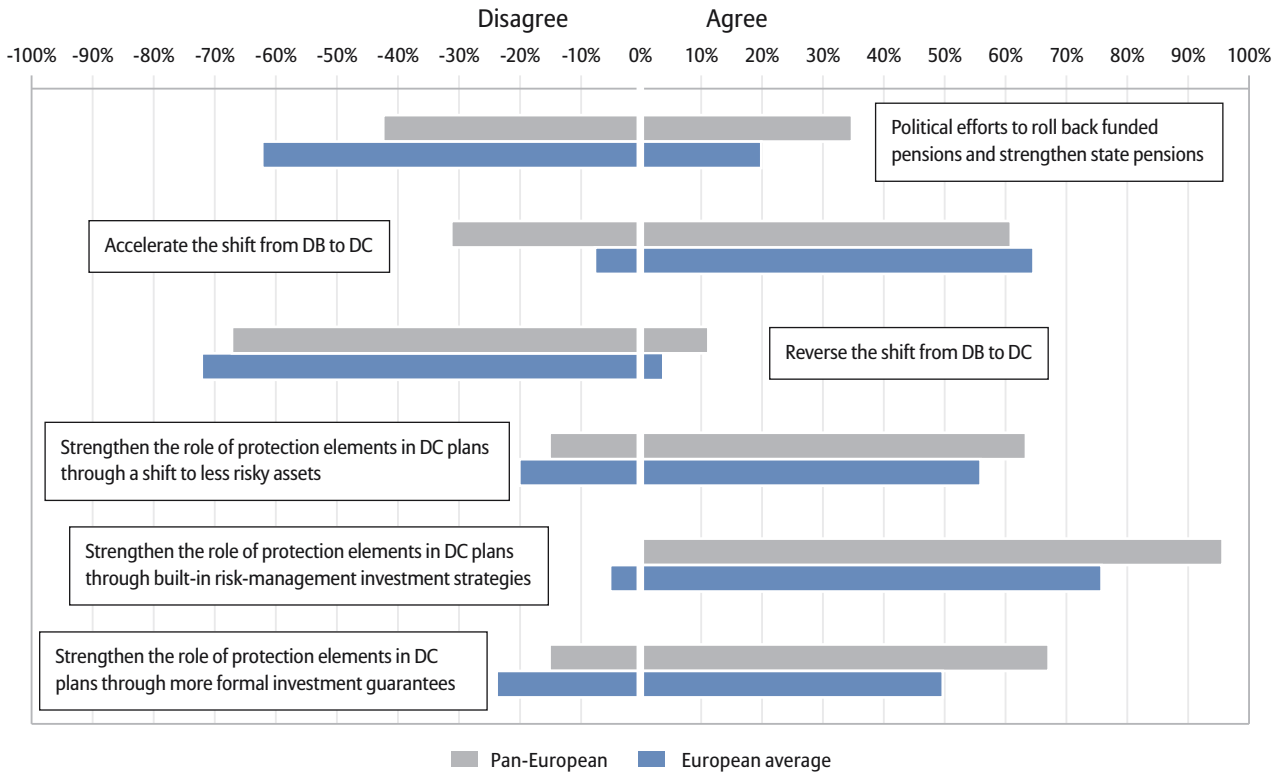


Question: To what extent do you agree with the following statements?

The financial crisis and its impact

Both national and pan-European respondents strongly agree that the financial crisis will accelerate and not reverse the shift from DB to DC. Their differences lie in whether they believe funded pensions will be rolled back and state pensions will be strengthened. The majority of national experts does not expect this to happen while the pan-European experts are split into two almost equal camps. Both groups agree that the crisis will lead to strengthening protection mechanisms in DC plans by changing asset allocation to less risky assets, by building in risk-management strategies and by introducing formal investment guarantees. Built-in risk-management strategies is considered to be the most important mechanism and the feedback from pan-European experts is extraordinarily high (96%).

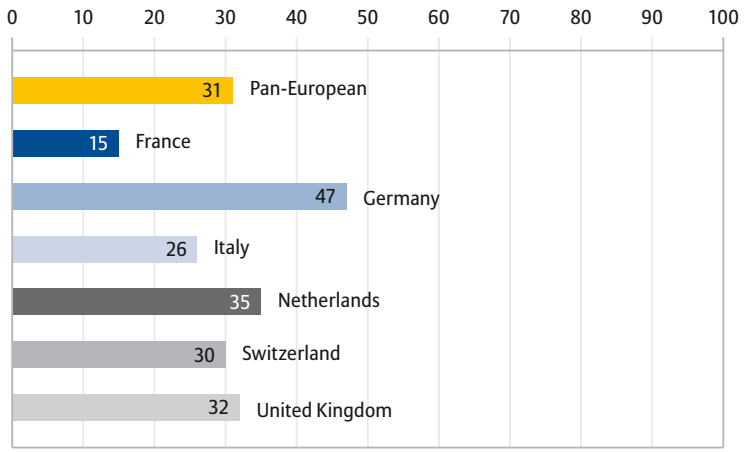
Figure 16: The financial crisis and its impact



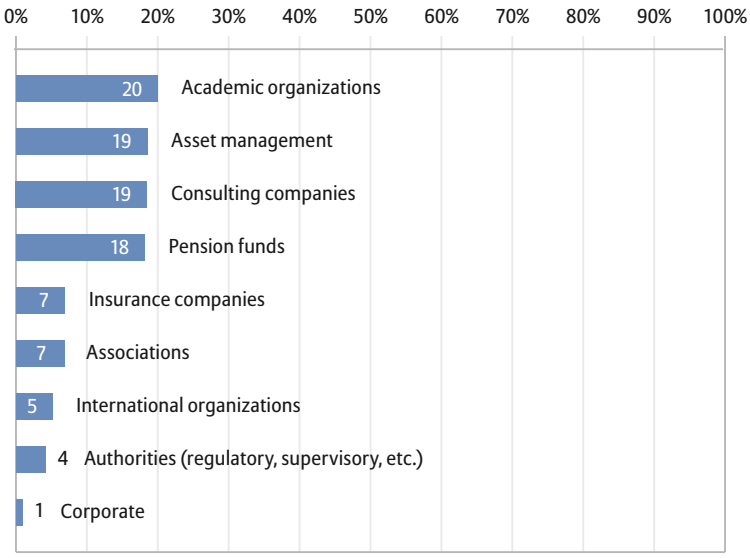
Question: From today's point of view, what are the possible consequences of the financial crisis for the further development of DC occupational pension schemes in your domestic market over the next five years?

Sample Demographics

Number of participants



Professional background of participants [%]



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Allianz Global Investors AG
International Pensions
Seidlstr. 24-24a
80335 Munich, Germany