

Opening address Frontiers in Pension Finance and Reform

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Speaker: Mr. D.E. Witteveen, executive director, de Nederlandsche Bank

Ladies and Gentlemen, On behalf of Netspar, IOPS and DNB I extend you a warm welcome to Amsterdam! During the next two days we will explore ways to improve the efficiency and resilience of pension systems. Key words in this respect are: long-term, trust and stability. These are the real issues and challenges.

There is growing agreement that traditional actuarial techniques are mispricing true pension costs and risks. If you discount a future pension liability at 6% while market interest rates are 4%, you clearly underestimate the true cost. Fair value reporting gives a market consistent snapshot of the current financial condition of pension funds. For that matter, I would like to welcome you again to the Netherlands. Indeed, marked-to-market valuation, in combination with risk-based solvency requirements, has already been fully implemented by Dutch law as the new financial yardstick for pension funds.

But fair value accounting is not the final stage as pension issues require a long-term approach as well. Although, as conference organizers, we are not in the business of fortune telling, we have to leave no stone unturned to prepare our pension system for the unknown future the best we can. Theoretic progress is essential for that. But sometimes also the reverse question should be posed. If something seems to do well in practice, does it make sense in theory?

As an illustration of structural preparation I would like to mention the Chilean case in the early eighties of the last century. In addition to a political reform, this included a transition from a pay-as-you-go to a fully funded and privatized retirement system that is, moreover, largely mandatory. Although, like in the Netherlands, there's still debate on improving the system, thus far, the Chilean system has been financed without seriously disrupting fiscal policy, the participation rate of employees is high and real returns in the system have been above average. Another key point of this pension reform is that it made Chileans involved in preserving the real value of money, and thus, made them adopt a more long-term approach. This resulted in, on the whole, structural decreasing inflation since 1990 and, thus, brought stability and trust.

Investment restrictions for pension funds on the one hand and their increasing market power on the other hand is an issue with the potential of undermining stability and trust. When I announced on

September the 12th 2005 that the introduction of the new financial assessment framework for pension funds was postponed by 1 year, long term euro interest rates instantaneously increased several basis points. That is what a supervisor in a small country can bring about. The largest pension fund in the world, the Government Pension Investment Fund of Japan with over \$1 trillion of assets, has to operate under strict limitations. Suppose what would happen to Japan and global financial markets if this fund was to invest with the freedom of investment policy of ABP and CalPERS overnight?

Today's workers face far more challenges than baby boomers. In fact, worldwide, societies will encounter the combined effect of increased life expectancy and lower fertility rates over the next decades. We are all aware that also China is in danger of growing old before it gets rich. With China's prominent position in the world economy, effects on the rest of the world are not inconceivable. Again, long-term, trust and stability are the key challenges ahead of us.

Having said that, I'm optimistic about what the return on this conference will be. Today's first session will cover global currency management, fair value accounting and enterprise risk management. These topics are amongst the core principles of pension finance. In the afternoon, we will proceed with the institutional design of pension systems. Bringing pension theory into practice, so to say. Then, tomorrow will start off with a session on supervision, pension governance and innovations in risk sharing. These insights will shed light on ways to buttress the sustainability of pension systems. The Vice-President of the ECB, Lucas Papademos, will wind this session up with a keynote speech on aging, financial markets and monetary policy. Finally, a panel will reflect on the ground we have covered during the conference and on the future direction of pension reform.

I would like to encourage you to take active part in the discussion following each item. Transforming an old saying: 'many brains make light work', I am convinced that we will be able to push forward the frontiers in pension finance and reform during these two days. I now call upon John Ashcroft, the chairman of today's first session, to speak. As President of IOPS and strategic policy director of the UK Pensions Regulator, he is a pension expert par excellence. But at this start, let Netspar, IOPS and DNB thank you for joining us and wish you all an inspiring conference.