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## **2008 Global Pension Assets Study**

**Watson Wyatt Worldwide**

**January, 2008**



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## **2008 Global Pension Assets Study**

### **Executive Summary**

# Global Pension Assets Study 2008

## Key findings

### Increased pension assets provide some potential relief from adverse demographics

- The countries in our 'P11' Survey – the largest workplace pensions systems (characterised as 'second pillar savings' by the World Bank) - have grown their pension assets over the last 10 years at a compound annual rate of 7.1%, leading to pension asset pools of 82% of GDP, up from 64% in 1997. With the exception of France and Germany, these countries will expect these asset pools to provide some resilience to the effects of adverse demographics in which dependency ratios (workforce population/ total population) are set to rise significantly.
- The Funds in this survey are made up of workforce pensions arrangements and so in general do not include Sovereign Pension and Wealth Funds where the obligations of these funds have no explicit link to individuals. Sovereign Pension Funds by our estimates amount to a figure of around two and a half trillion US dollars at end 2007

### Pension fund asset allocation shows signs of becoming more defensive, but slowly

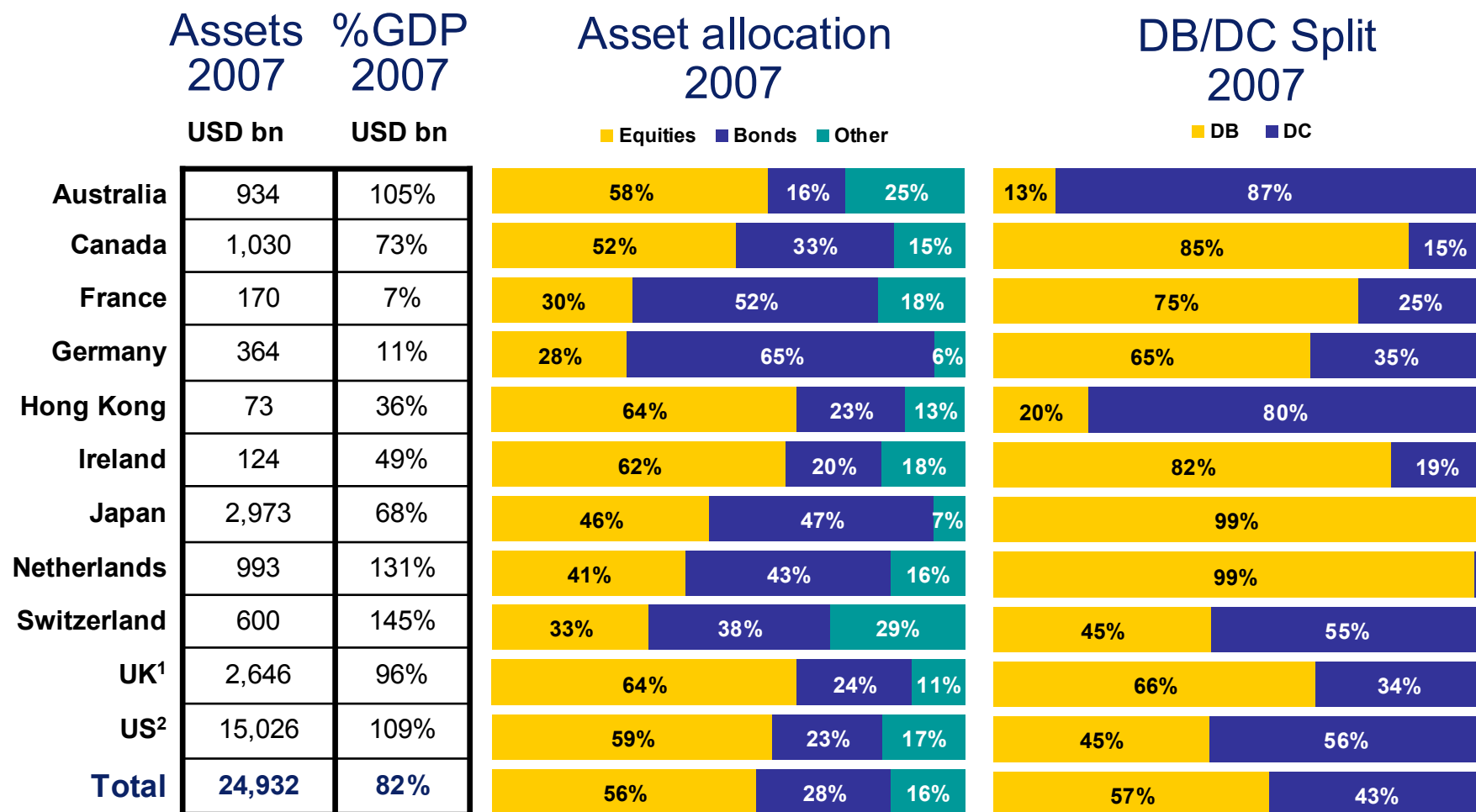
- Pension funds now have a global average around 56% equities, 28% bonds and 16% other assets (estimated at around 5% in cash and 11% in alternative assets). Funds carry around a 20 percent overweighting to equities and around a significant underweighting to bonds relative to global capital market opportunities. We see in the recent trends a levelling off in the growth of the equity content and anticipate a point of inflexion in which both bond allocations and alternative assets are set to grow. Factors driving this more defensive change include.
  - Improved funding positions allowing investment goals to be moderated
  - Changes to local regulation and accounting that previously favoured equities
  - Maturing liabilities - risk tolerance should naturally reduce as time horizons shorten.

### The mix of asset class (beta) and active management (alpha) risk taking is adjusting

- The current allocation to equities supports an investment goal of around 1.5%-2.0% per annum over bonds. Most funds have higher goals sourced from the premium return from active investment management. We suggest these goals have been increased recently and commonly would be in excess of a further 1% per annum. Pension funds must accept the significance of the zero sum game argument: that while excellent governance can deliver such a premium, in aggregate funds will not capture such a return, with increased investment costs making the picture rather more problematic.

# Global Pension Asset Study 2008

## Key Findings - Figures



Source: Watson Wyatt Worldwide and various secondary sources

<sup>1</sup> Excludes Personal and Stakeholder DC assets  
<sup>2</sup> Includes IRAs

# Global Pension Asset Study 2008

## Key Findings

### Pension Assets Year-End 2007

- In 2007 pension assets for the 11 countries under study were estimated at USD 24,932 bn, representing a 8.7% increase if compared to the 2006 value. Assets in 2006, measured in USD, grew at a rate of 12% in respect to the previous year<sup>1</sup>
- Over the last 10 and 5 years, average growth rates were 7.1% p.a. and 11.6% p.a., respectively
- The largest markets are US, Japan, UK and Canada. However, over the last 10 years, US and Japan have seen their share in global pension assets reduce due to slower growth rates (6.7% p.a. and 4.6% p.a. respectively) relative to their counterparts
- In 2007 the average asset allocation was 56.4% equities, 27.7% bonds and 15.9% other assets (including cash, property, alternatives)
- Investments in the category 'other assets' have grown steadily over the last 10 years, an evidence of the increased interest in alternative assets experienced in the last years
- Countries with a larger portion allocated in more risky assets are US, UK and Australia while the most conservative strategies – more bonds and less equities and alternatives – are followed in Japan and Netherlands<sup>2</sup>

### DB/DC Allocation Year-End 2007

- Over the last 5 years DC assets have grown at a rate of 13% p.a. while DB assets have grown at a rate of 11% p.a.
- Currently DC assets represent 44% of total pension assets<sup>2</sup> compared to 42% in 2002 and 34% in 1997
- The countries that show a larger proportion of DC assets are US, Australia and Switzerland while Japan and Netherlands are essentially 100% DB, although these are also showing some signs of shift to DC

### Changes in the Pensions Market

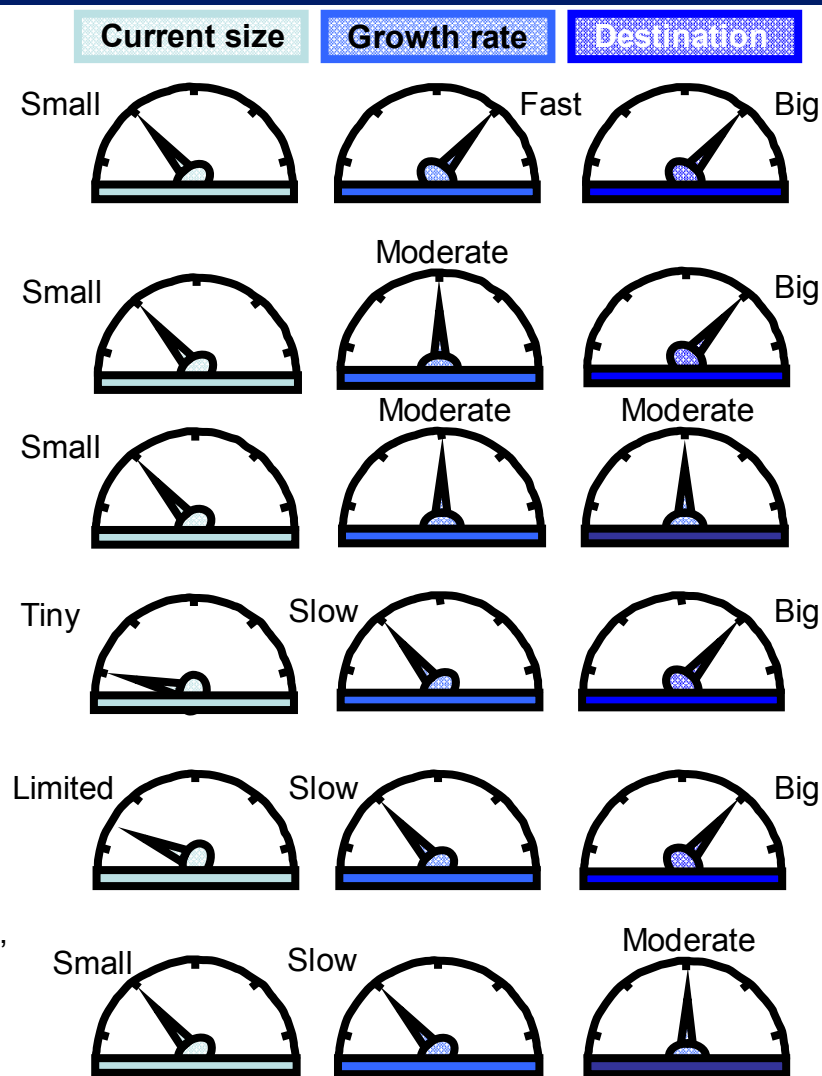
- Pension fund investment is subject to change on an unprecedented level (see overleaf). We highlight six changes that are affecting the industry materially. Four of these changes concern investment strategy of which the most prominent is LDI. The impact of technology, particularly with respect to knowledge on finance theory and best practice, is making the clock-speed of change tick substantially quicker than in any prior period in the industry.

<sup>1</sup> Asset figures in general were obtained for YE2006 and 2007 figures are estimates based on index movements

<sup>2</sup> Only considers Australia, Canada, Japan, Netherlands, Switzerland, UK and US (P7)

# The six faces of change

1. Increased use of LDI approaches
  - Improved range of products and protocols increase opportunities to manage risks
2. Increased use of absolute return mandates and alternative assets
  - Support for the diversity of strategy concepts, but implementation challenge
3. Alpha beta separation and integration
  - Some complexities and costs of this approach and problems arise unravelling the alpha and beta components when these are combined
4. Beta prime innovation (wealth-weighted indices among others), capturing systematic ‘alpha’ effects in index form
  - Acceptance of inefficiencies of cap–weights is growing, but confidence in new products is limited
5. Reducing DB funds’ risk budgets to match with sponsor covenant and risk appetite
  - The timing and pricing of this move is contentious
6. Increasing fund power to influence pricing and product design, particularly when there is collaboration
  - Funds can collaborate to effect change and create aggregate value in sustainable ways, effecting changes in fee structures, applying corporate engagement, etc



# Global Pension Asset Study 2008

## Survey Coverage

- The survey covers 11 markets, with total pension assets in these countries USD 24,932 bn (82% of the GDP of these economies - *IMF*)
- These 11 countries have the largest corporate workplace pensions systems and we use the shorthand 'P11' to denote them
- We analyse 7 countries in greater depth by excluding the four smallest markets of the P11 (France, Germany, Ireland and Hong Kong). We use the shorthand 'P7' to denote these countries. P7 assets are over 97% of P11
- Our analysis is divided into 3 sections
  1. Asset sizes including growth statistics, comparison of asset sizes with GDP and liabilities
  2. Asset allocation (P7)
  3. DB and DC shares of pension assets (P7)

P11



Australia



Canada



France



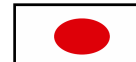
Germany



HK



Ireland



Japan



Netherlands



Switzerland



UK



US

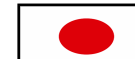
P7



Australia



Canada



Japan



Netherlands



Switzerland



UK



US

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## 2008 Global Pension Asset Study

### 1. **Asset sizes**

- i. Asset sizes and growth statistics
- ii. Comparison of asset sizes with GDP and liabilities

# Global pension assets

## Evolution 1997-2007 – USD Billion

P11

- Pension assets at the end of 2007 were USD 24,932 bn
- This figure represents a growth of 8.7% compared to 2006
- Over the last 10 years, global pension assets have doubled, growing at an average annual rate of 7.1%
- The largest amount of pension assets are held by US, UK, Japan and Canada which together account for 86.9% of total assets
- The smallest markets are Hong Kong, Ireland, France and Germany. Hong Kong has been showing signs of continued growth since its pension reform effective in 2000
- Relative sizes have slightly varied over the years

Country	Total assets (USD billion)	Total assets (USD billion)
	Year-end 1997	Year-end 2007e
Australia	193	934
Canada	517	1,030
France	72	170
Germany	192	364
Hong Kong	17	73
Ireland	37	124
Japan	1,901	2,973
Netherlands	365	993
Switzerland	294	600
UK <sup>1</sup>	1,050	2,646
US <sup>2</sup>	7,893	15,026
<b>Total (USD)</b>	<b>12,531</b>	<b>24,932</b>

Source: Watson Wyatt Worldwide and various secondary sources

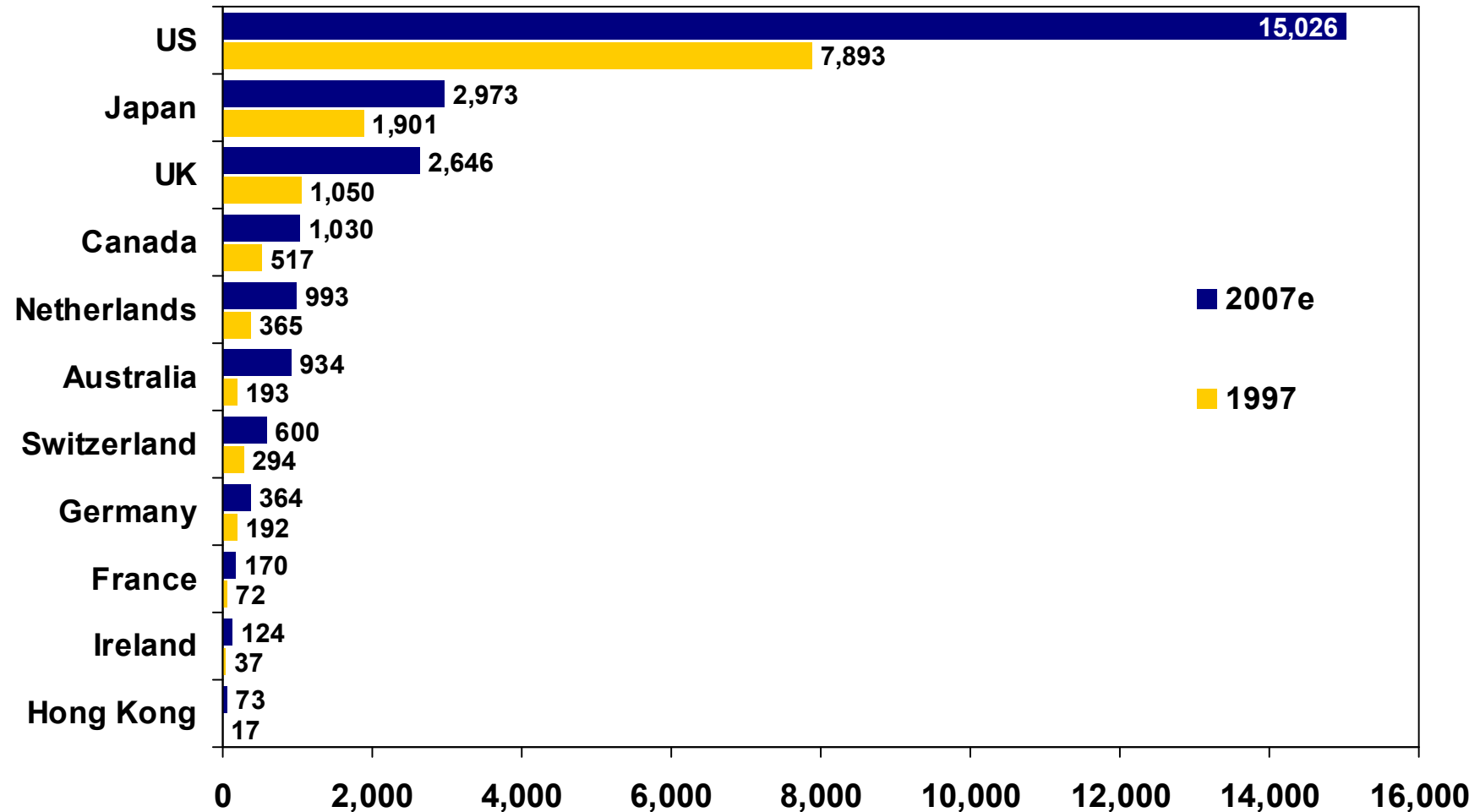
<sup>1</sup> Excludes Personal and Stakeholder DC assets

<sup>2</sup> Includes IRAs

# Global pension assets

## Evolution 1997-2007 – USD Billion

P11





















Source: Watson Wyatt Worldwide and various secondary sources

# Global pension assets

## Relative weights of each economy

P11  
P7

P7	End 1997	End 2007e
Australia	1.6%	 3.9%
Canada	4.2%	 4.3%
Japan	15.6%	 12.3%
Netherlands	3.0%	 4.1%
Switzerland	2.4%	 2.5%
UK <sup>1</sup>	8.6%	 10.9%
US <sup>2</sup>	64.6%	 62.1%
<b>P7</b>	<b>100%</b>	<b>100%</b>

P11	End 1997	End 2007e
Australia	1.5%	 3.7%
Canada	4.1%	 4.1%
France	0.6%	 0.7%
Germany	1.5%	 1.5%
Hong Kong	0.1%	 0.3%
Ireland	0.3%	 0.5%
Japan	15.2%	 11.9%
Netherlands	2.9%	 4.0%
Switzerland	2.4%	 2.4%
UK <sup>1</sup>	8.4%	 10.6%
US <sup>2</sup>	63%	 60.3%
<b>P11</b>	<b>100%</b>	<b>100%</b>

- In P7, US and Japanese pension fund assets in 2007 represent a smaller portion of total assets than in 1997
- 10 year CAGR in these countries has been lower than in the other economies of the same group, but not losing their 1<sup>st</sup> and 2<sup>nd</sup> position in the ranking

Source: Watson Wyatt Worldwide and various secondary sources

<sup>1</sup> Excludes Personal and Stakeholder DC assets

<sup>2</sup> Includes IRAs

# Global pension assets growth rates

## Compound Annual Growth Rates – Local Currency – 2007e

P11

- On average, the annual growth rate of pension assets measured in local currency terms has been 2.0% in 06/07. This is compared to 10.5% p.a. over the period 02/07 and 7.4% p.a. over the last 10 years
- When looking at a 5-year period, all countries have experienced positive CAGR, ranging from 2.6% in the case of France to 21.8% for Hong Kong
- Looking at a 10-year period, growth rates are also positive and go from 3.1% in Japan to 15.8% in Hong Kong
- Asset growth during 2007 in local currency terms was negative in the case of Canada, France, Germany, Ireland, Netherlands and Switzerland
- On the other hand, US, UK, Hong Kong and Australia have all shown positive rates of increase according to our estimates for 2007
- However, 2007 values in local currency terms are *estimates* based on index returns for different asset classes and result from a combination of returns and exchange rate variation, not accounting for special contributions, shifts in asset allocation, etc.

Country	Growth rates to 2007e (Local Currency)		
	1-year (31/12/06- 31/12/07)	5-year (31/12/02- 31/12/07) CAGR	10-year (31/12/97- 31/12/07) CAGR
Australia	3.9%	15.6%	13.7%
Canada	-0.9%	4.4%	3.2%
France	-3.3%	2.6%	5.8%
Germany	-1.5%	6.9%	3.5%
Hong Kong	17.2%	21.8%	15.8%
Ireland	-4.4%	20.8%	9.8%
Japan	0.1%	4.2%	3.1%
Netherlands	-2.0%	7.0%	7.3%
Switzerland	-1.9%	7.9%	4.7%
UK <sup>1</sup>	6.4%	13.8%	7.6%
US <sup>2</sup>	8.3%	10.9%	6.7%
<b>Average</b>	2.0%	10.5%	7.4%

Source: Watson Wyatt Worldwide and various secondary sources

<sup>1</sup> Excludes Personal and Stakeholder DC assets

<sup>2</sup> Includes IRAs

# Global pension assets growth rates

## Compound Annual Growth Rates – Local Currency – 2006 Actual

P11

- In this table we present growth rates in local currency terms derived from actual figures for pension assets up to December 2006<sup>3</sup>
- Looking at a 10-year period from 1996 to 2006, annual growth rates show a similar trend if compared to 1996-2007e rates. However, for the period 1996-2006, the rates are higher in all cases except for Hong Kong
- Over the last 5 years we have seen greater differences. In fact, growth rates over the period 2001-2006 are, on average, 2.7% lower than over 2002-2007
- Looking at yearly growth rates, we can find the largest differences. Except for Canada and Japan, yearly growth rates in 2006 are higher than those estimated for 2007
- When looking at previous years, the fall in assets measured in local currency terms is not as important as in 2007

Country	Growth rates to 2006 (Local Currency)		
	1-year (31/12/05- 31/12/06)	5-year (31/12/01- 31/12/06) CAGR	10-year (31/12/96- 31/12/06) CAGR
Australia	21.2%	14.2%	15.6%
Canada	-3.7%	-1.0%	5.7%
France	7.4%	5.4%	8.2%
Germany	7.2%	3.9%	4.5%
Hong Kong	18.3%	14.7%	9.7%
Ireland	12.7%	11.5%	13.4%
Japan	-1.3%	3.6%	3.7%
Netherlands	10.1%	7.0%	9.6%
Switzerland	4.5%	8.3%	7.0%
UK <sup>1</sup>	11.8%	11.4%	8.3%
US <sup>2</sup>	12.0%	7.4%	7.4%
<b>Average</b>	9.1%	7.9%	8.5%

Source: Watson Wyatt Worldwide and various secondary sources

<sup>1</sup> Excludes Personal and Stakeholder DC assets

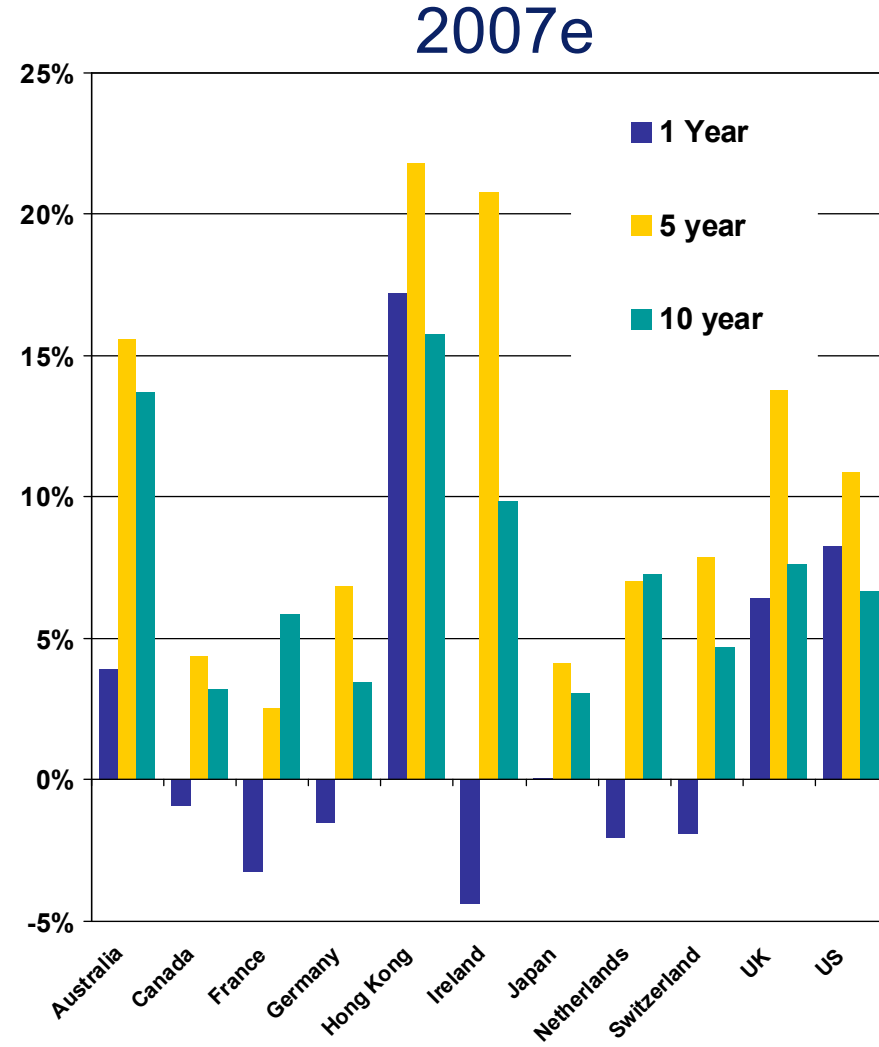
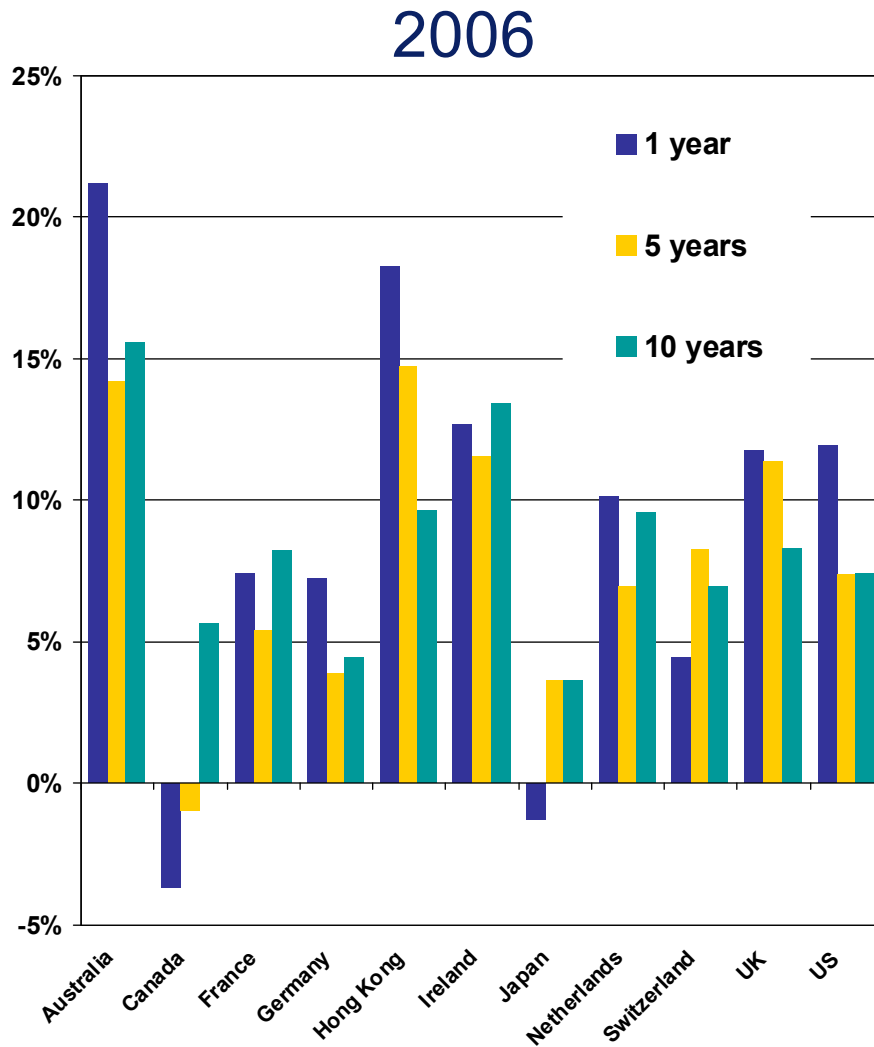
<sup>2</sup> Includes IRAs

<sup>3</sup> France and Switzerland are Watson Wyatt estimates

# Global pension assets growth rates

## Compound Annual Growth Rates – Local Currency

P11



Source: Watson Wyatt Worldwide and various secondary sources

# Global pension assets growth rates

## Compound Annual Growth Rates – USD

P11

- Total pension fund assets have grown 7.1% p.a. over the period 1997-2007 and even faster over the last five years, at a rate of 11.6% p.a.
- During 2007 pension assets grew at a rate of 8.7%, slightly over the 5-year CAGR
- Over the last 10 years, the countries that have shown the fastest growth in their pension assets in US dollar terms are Australia, Hong Kong and Ireland
- On the other hand, even though Japan and the US have the largest pension assets in the sample, the growth rates in both countries -- and particularly in Japan -- fell behind most of the other economies
- In all countries, except for Japan and Canada, growth rates during 2007 were lower than the 5-year average

Country	Growth rates to 2007e (USD)		
	1-year (31/12/06- 31/12/07)	5-year (31/12/02- 31/12/07) CAGR	10-year (31/12/97- 31/12/07) CAGR
Australia	15.5%	26.2%	17.1%
Canada	17.6%	14.7%	7.1%
France	7.9%	9.8%	9.0%
Germany	9.9%	14.4%	6.6%
Hong Kong	16.8%	21.8%	15.7%
Ireland	6.7%	29.3%	12.8%
Japan	6.1%	5.4%	4.6%
Netherlands	9.3%	14.6%	10.5%
Switzerland	6.2%	12.5%	7.4%
UK <sup>1</sup>	8.5%	18.8%	9.7%
US <sup>2</sup>	8.3%	10.9%	6.7%
<b>Total (USD)</b>	<b>8.7%</b>	<b>11.6%</b>	<b>7.1%</b>

Source: Watson Wyatt Worldwide and various secondary sources

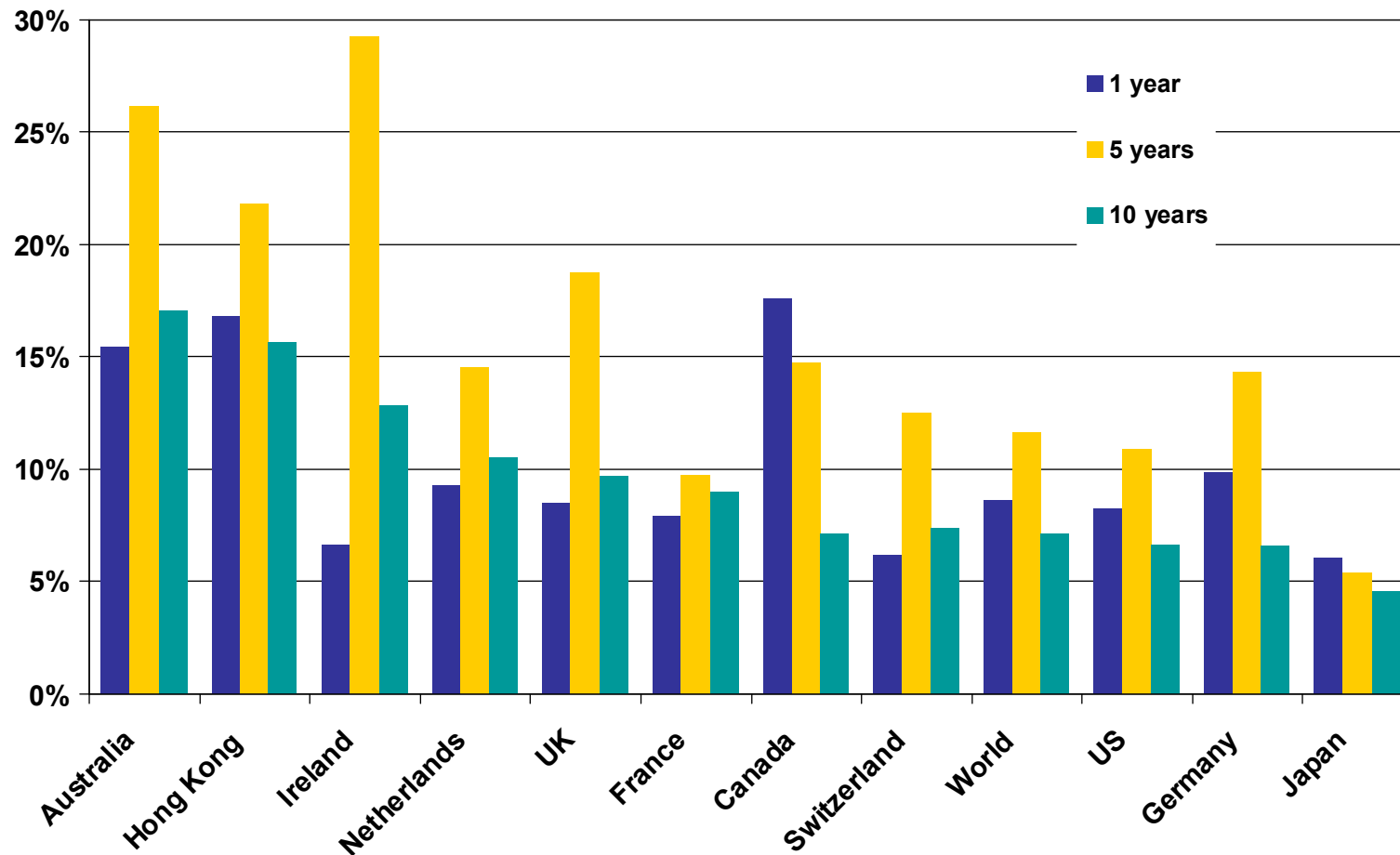
<sup>1</sup> Excludes Personal and Stakeholder DC assets

<sup>2</sup> Includes IRAs

# Global pension assets growth rates

## Compound Annual Growth Rates – USD

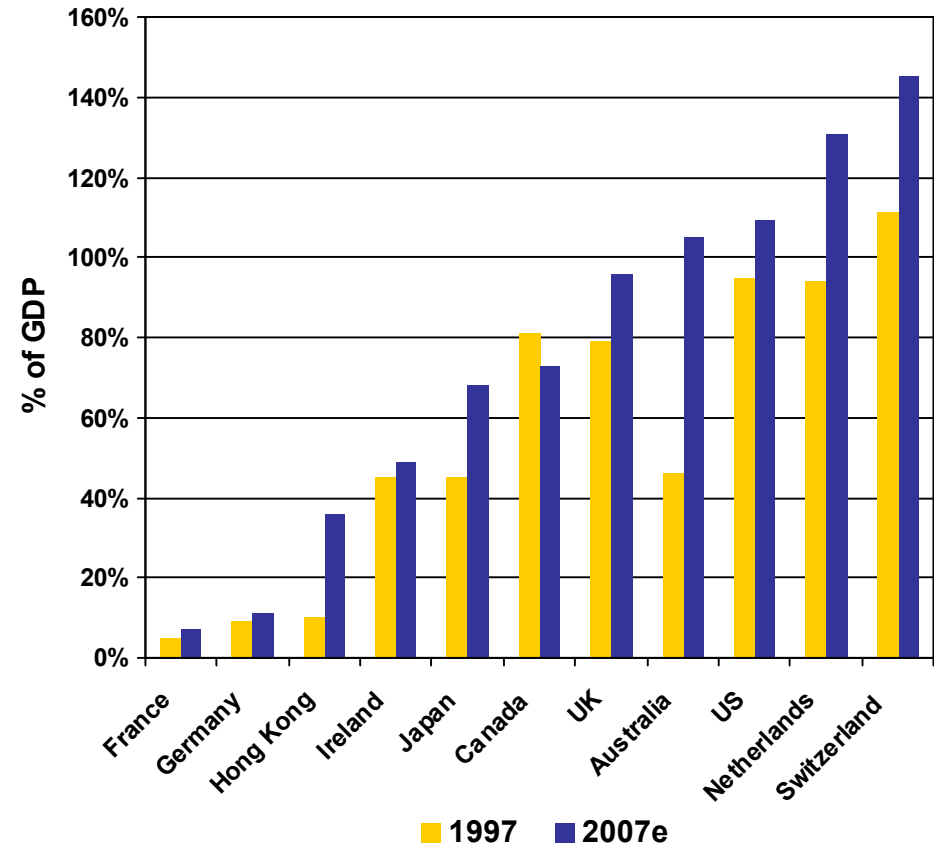
P11



Source: Watson Wyatt Worldwide and various secondary sources

# Global pension assets vs. GDP

	Pension assets as % of GDP		
	1997	2007e	Change
Australia	46%	105%	58.8%
Canada	81%	73%	-7.9%
France	5%	7%	1.7%
Germany	9%	11%	2.3%
Hong Kong	10%	36%	26.3%
Ireland	45%	49%	3.3%
Japan	45%	68%	23.8%
Netherlands	94%	131%	37.2%
Switzerland	111%	145%	33.9%
UK <sup>1</sup>	79%	96%	17.4%
United States <sup>2</sup>	95%	109%	13.9%
<b>Weighted average</b>	<b>64%</b>	<b>82%</b>	<b>17.1%</b>



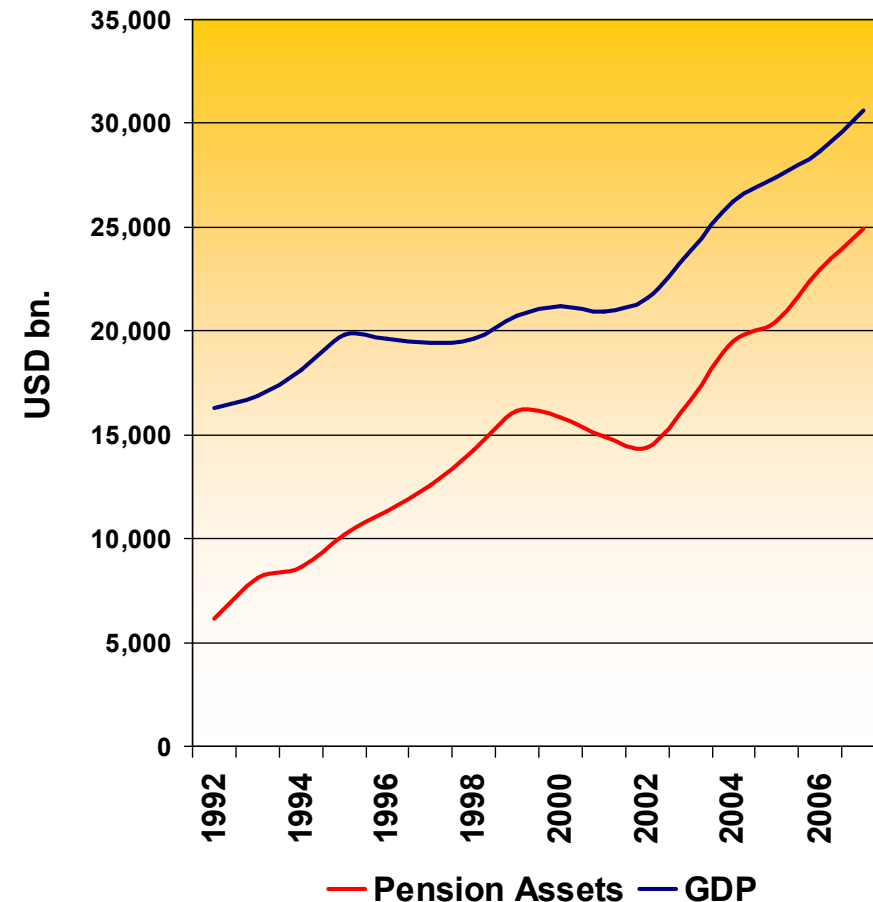
Source: Watson Wyatt Worldwide and various secondary sources  
 GDP values from IMF, taken in USD at current prices

<sup>1</sup> Excludes Personal and Stakeholder DC assets

<sup>2</sup> Includes IRAs

# Global pension assets vs. GDP

- Switzerland is the country with the highest proportion of pension assets to GDP, followed by Netherlands, US and Australia
- The countries where assets represent a lesser proportion of GDP are France (which has a tradition of pay-as-you-go schemes) and Germany
- The improvements in this index have been lead by Australia and Netherlands
- Considering the whole sample, while GDP<sup>1</sup> grew at a rate of 57% in the last 10-year period, pension assets doubled during those years



Source: Watson Wyatt Worldwide and various secondary sources

<sup>1</sup> GDP measured in current USD

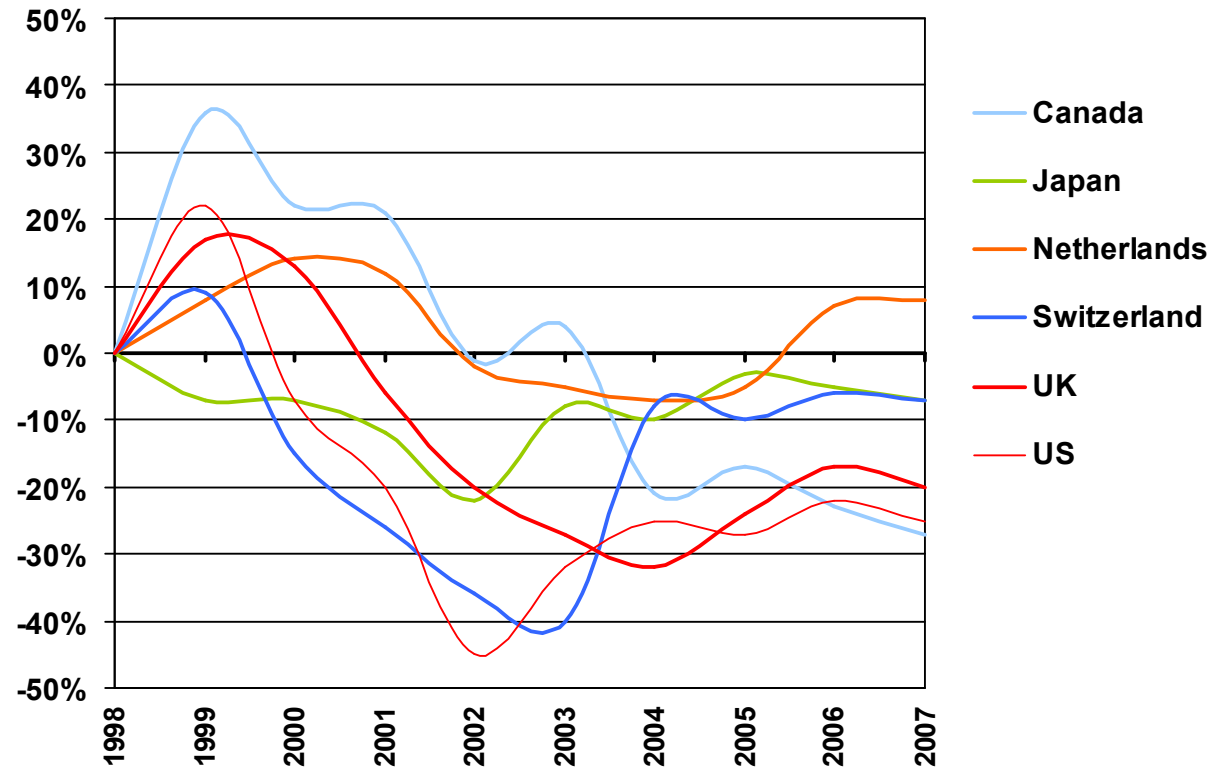
# DB asset/liability indicator – country basis

## Per cent change from 31 December 1998 (in local currency)

P7

- This indicator is based on estimated asset values and liability values derived from government bond discount factors, and does not allow for mortality changes
- In terms of trends, after a strong decrease until 2001, the index has shown a slow recover but not reaching the values of 1998
- During the period 2006-2007, there has been a generalized decrease in this indicator.

### Estimated Asset/Liability Indicator Value relative to 1998



Source: Watson Wyatt Worldwide, Bloomberg

DB assets only within asset totals

UK assets exclude Personal and Stakeholder assets

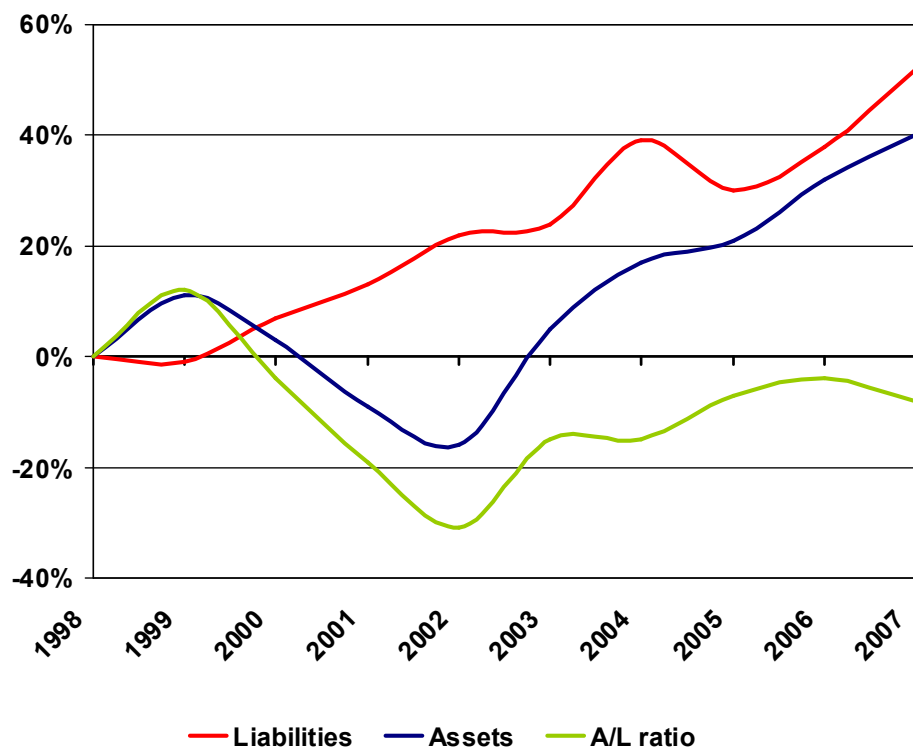
US assets include IRAs in all periods

Australia has been excluded from the graph as it is predominantly DC

# DB asset/liability indicator – global basis

## Per cent change from 31 December 1998 (in USD)

P11



Year end	Liability increases relative to end 1998	Asset increases relative to end 1998	Asset liability indicator - cumulative change relative to end 1998	Asset liability indicator - change in year
1999	-0.8%	11.0%	11.9%	11.9%
2000	6.9%	2.5%	-4.1%	-14.3%
2001	12.5%	-8.7%	-18.8%	-15.4%
2002	21.6%	-16.2%	-31.1%	-15.1%
2003	24.0%	5.3%	-15.1%	23.2%
2004	38.9%	17.4%	-15.5%	-0.5%
2005	29.8%	20.9%	-6.9%	10.2%
2006	37.5%	32.0%	-4.0%	3.0%
2007	52.4%	40.3%	-7.9%	-4.1%

Source: Watson Wyatt Worldwide, Bloomberg

DB assets only within asset totals  
 UK assets exclude Personal and Stakeholder assets  
 US assets include IRAs in all periods

Mortality changes are not incorporated in these figures

- Asset / liability ratios show a decrease in 2007, replicating the trends found on a country by country basis over the whole period
- A/L is 7.9% lower than in 1998 after falling at a rate of 4.1% compared to 2006 values
- Since 2000, the value of the A/L ratio has not reached the level of 1998

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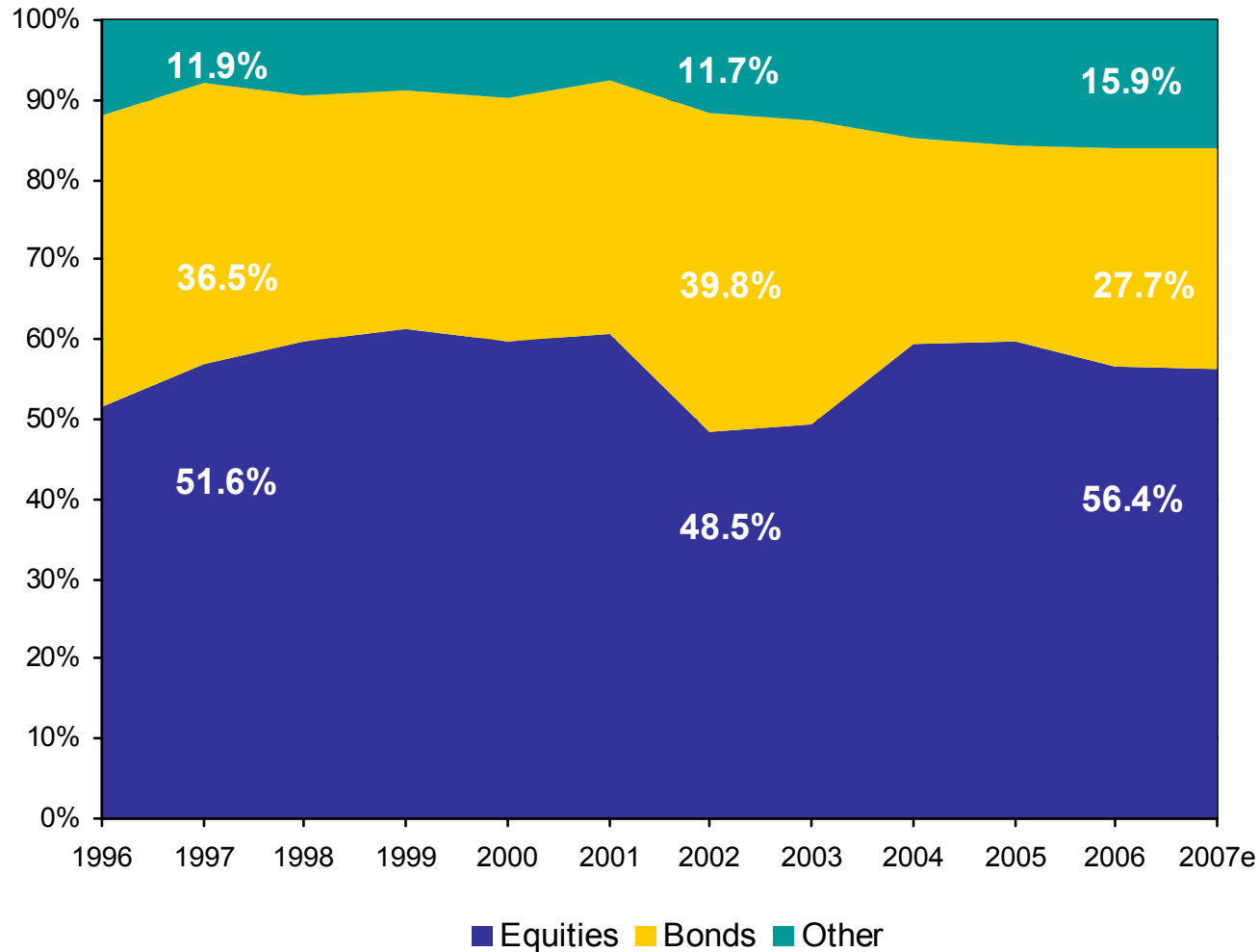
## 2008 Global Pension Assets Study

### **2. Asset allocation (P7)**

# Pension assets allocation

## Aggregate P7 asset allocation from 1996 to 2007

P7



- Asset allocation has shown significant variations in the last 11 years, although in the past three years we can observe stability in the dynamics of the three categories
- Nonetheless, we can observe that bonds have lost weight in the period under study while equities and other assets have seen their shares increase
- 'Other assets' have grown steadily over the period – particularly since 2003 –, evidence of the increased interest in alternative assets in the last years
- We estimate 'Other assets' to be in the proportions 30% cash, 70% alternative assets

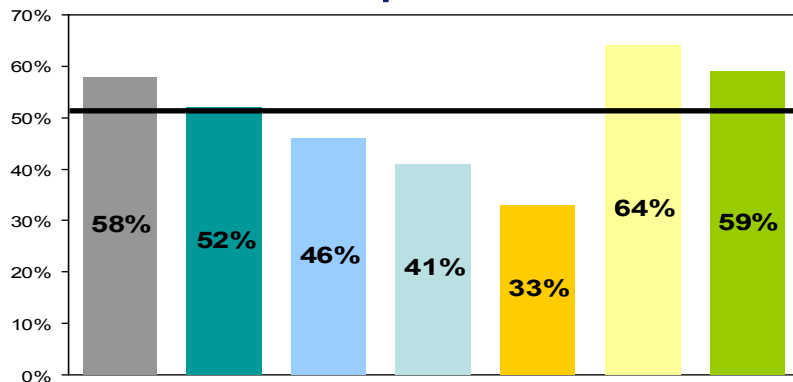
Sources: Watson Wyatt Worldwide and various secondary sources

# Pension assets allocation

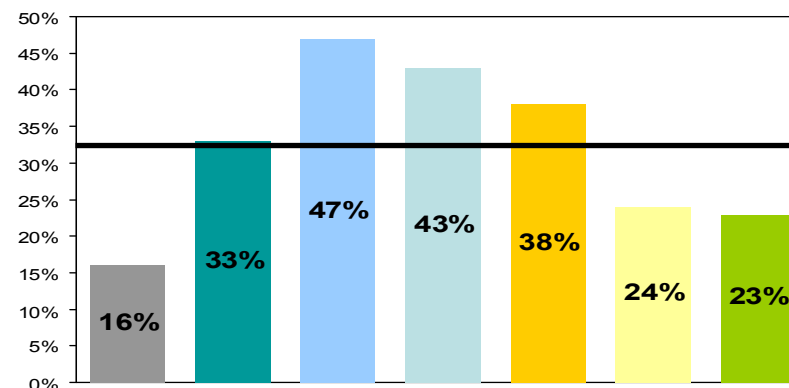
P7

## Asset allocation by category vs. Average by category 2007

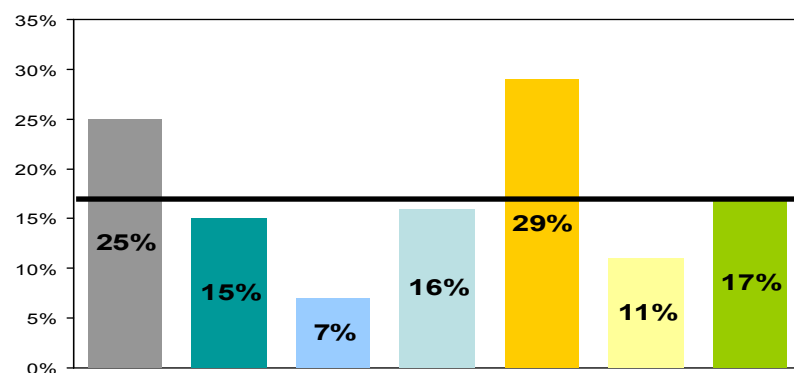
### Equities



### Bonds



### Other Assets



- While UK, US and Australia have an above-average allocation to equities and other assets, Japan and Netherlands are more likely to invest in fixed income products
- It is interesting to note that Switzerland has a relatively low allocation to equities, but has the largest allocation to other assets (particularly to Real Estate<sup>1</sup>)

■ Australia ■ Canada ■ Japan ■ Netherlands ■ Switzerland ■ UK ■ US

— Average for whole sample

Source: Watson Wyatt Worldwide and various secondary sources / 1 Credit Suisse "Swiss Pension Fund Index", 3Q 2007

# Pension assets allocation

P7

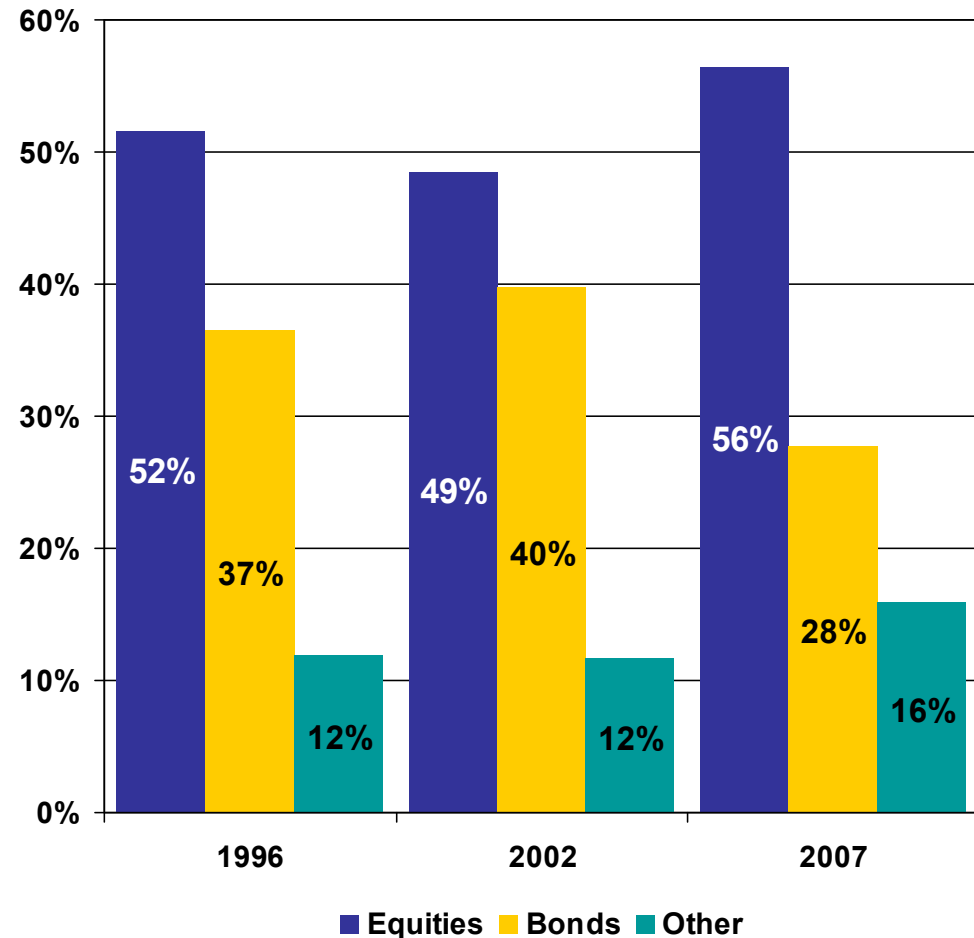
## Aggregate – end 1996 versus end 2002 versus end 2007

### Year-end 1996 versus Year-end 2002

- During this period we observe a decrease in the allocation to equities as well as an increase in the allocation to bonds. This behaviour is not observed in the following 5 years. Alternatively, the allocation to other assets remains stable

### Year-end 2002 versus Year-end 2007

- Over this period, the allocation to Equity and Other assets increase while allocation to Bonds decreases.
- The decrease in Bond assets is a common trend in all countries, specially in Japan were 76% of the assets were allocated in Bonds in 2002 while in 2007 the percentage was reduced to 47%

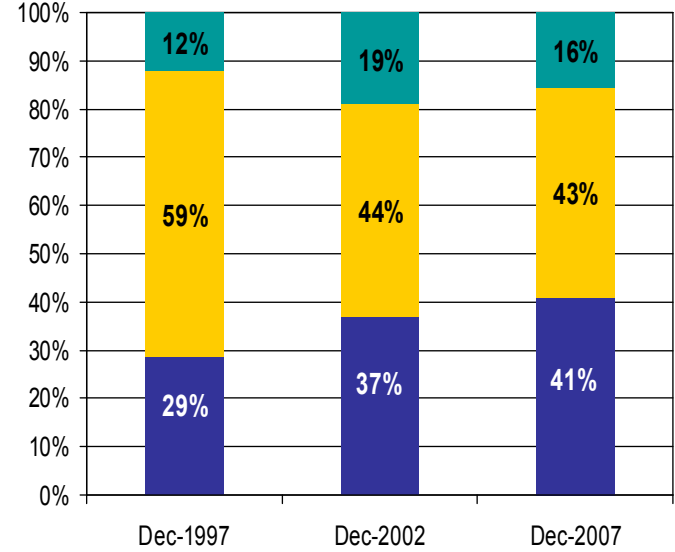
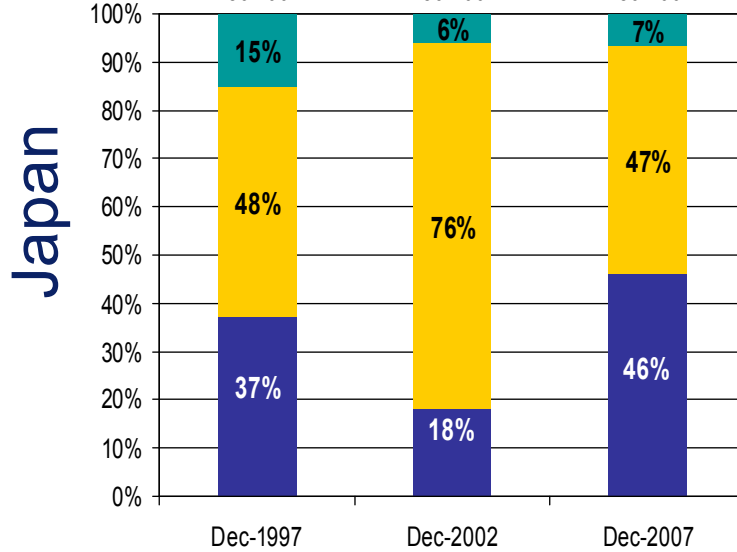
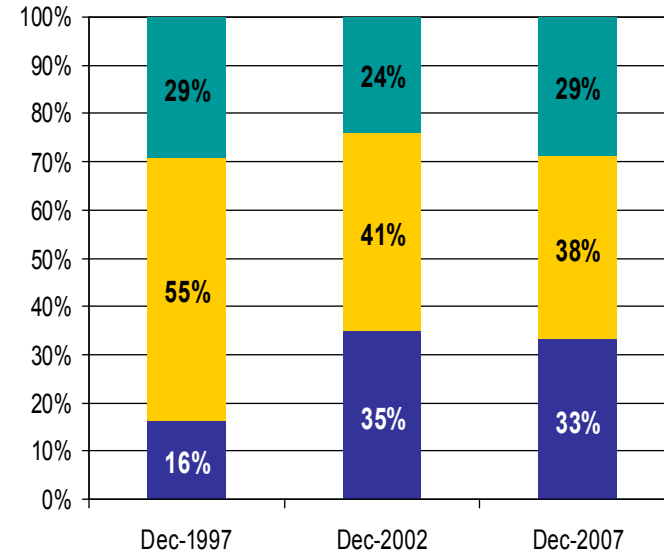
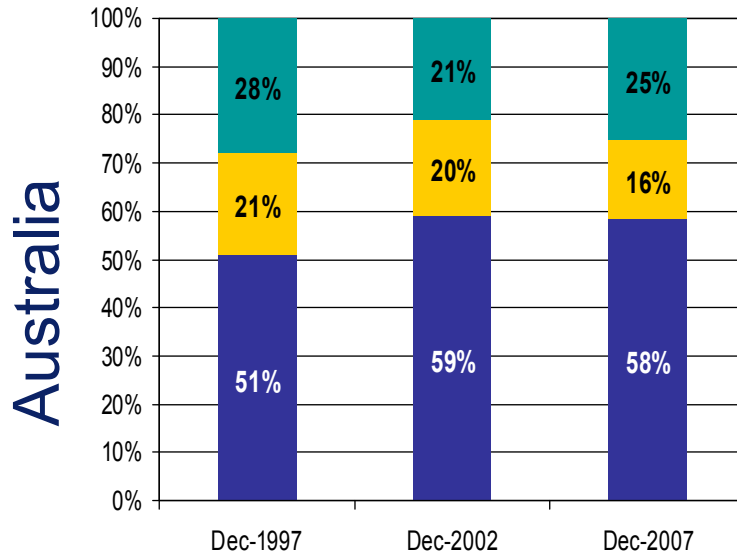


Sources: Watson Wyatt Worldwide and various secondary sources

# Pension assets allocation

Aggregate – end 1996 versus end 2002 versus end 2007

P7

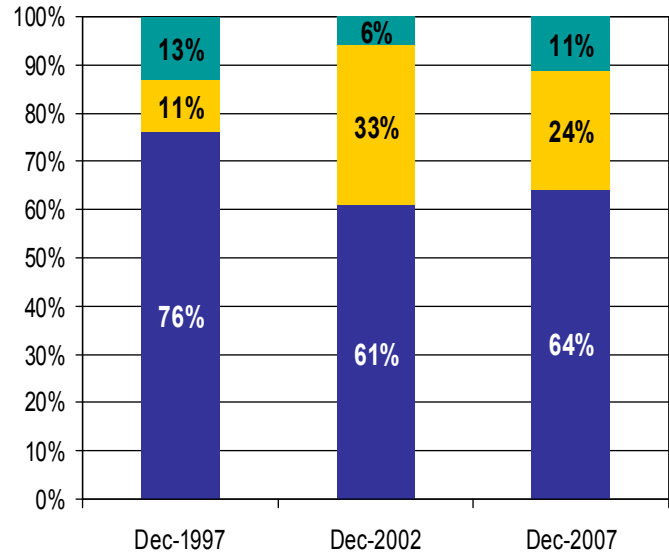


- Equities
- Bonds
- Other

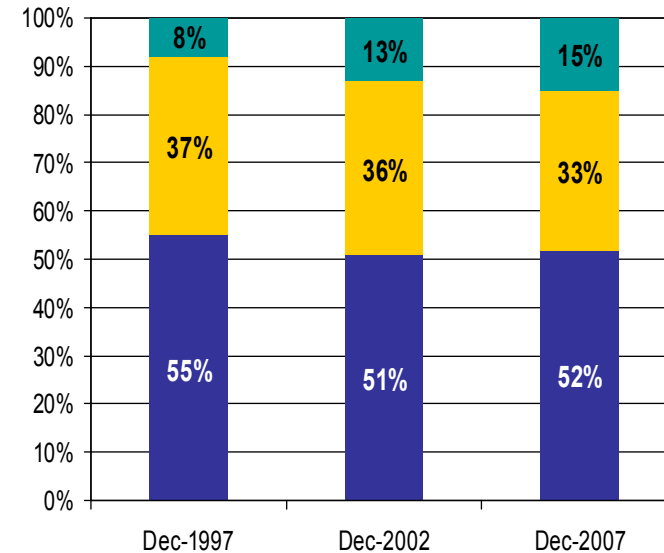
# Pension assets allocation

## Aggregate – end 1996 versus end 2002 versus end 2007

P7

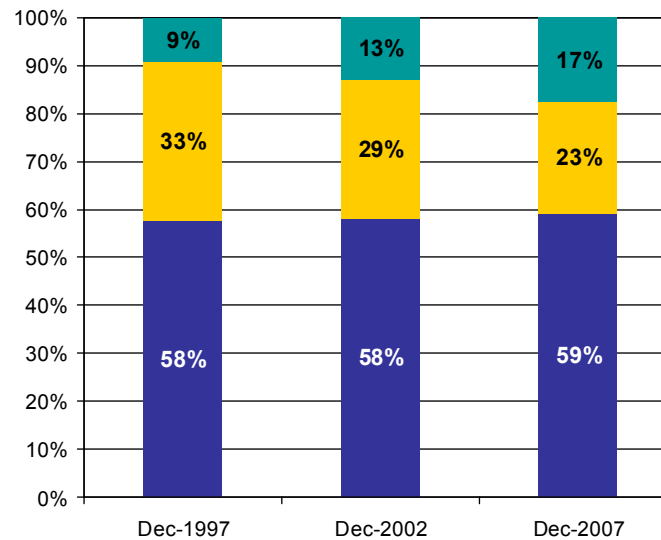


UK



Canada

- Equities
- Bonds
- Other



US

US DC assets include IRAs

Source: Watson Wyatt Worldwide and various secondary sources

# Pension assets allocation

## Comments

P7

- Australia, Canada, the UK and the US (the Anglo-Saxon nations) had the highest allocation to equities at the end of 1996, 2001 and 2007. Their equity allocations at year end 2007 were 58%, 52%, 64% and 59% respectively
- Japan, the Netherlands and Switzerland have traditionally had a higher exposure to bonds, although Japan has seen a shift to equities in asset allocation for the last years
- Switzerland, Australia and Netherlands have had the highest allocation to other assets
- There is some evidence of increasing interest in alternatives within the US in recent periods. The same increase is also observed for Canada
- Allocation to equities seems to have dropped slightly in 2006 and 2007 to around 56%, relative to its peak at 61% in 1999.

[watsonwyatt.com](http://watsonwyatt.com)



## 2008 Global Pension Assets Study

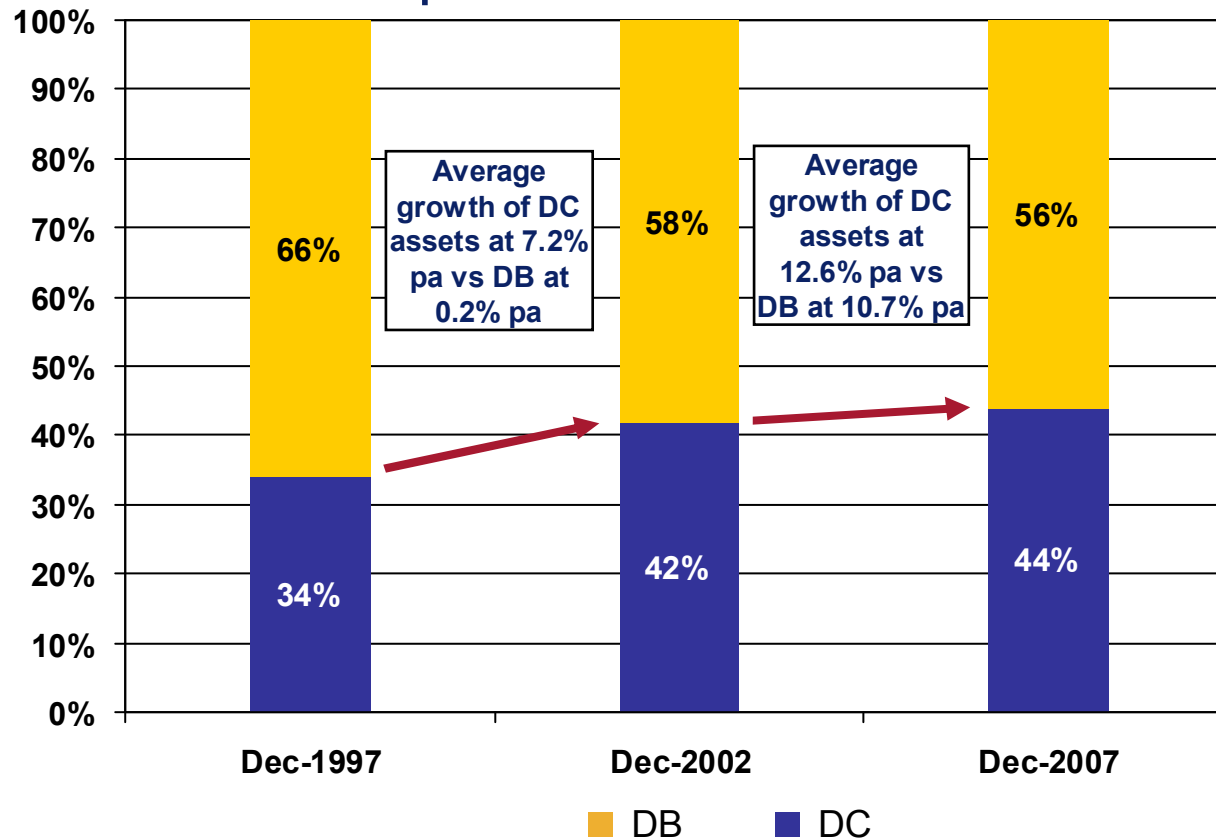
### 3. DB/DC allocations (P7)

# DB/DC asset split

## Change over the 10 years to the end of 2007

P7

### Defined contribution (DC) participation in total pension fund assets



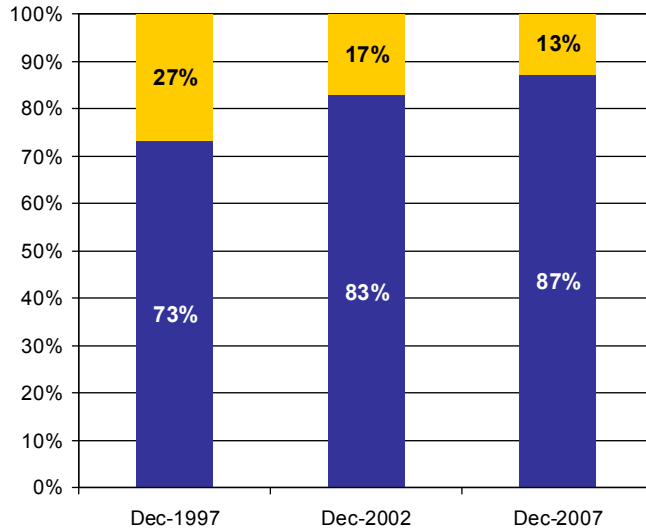
- During the ten-year period from the end of 1997 to the end of 2007, the average growth of DC assets (CAGR) was 10%p.a. against a rate of 5%p.a. for DB assets
- The variations in the proportions of assets in DC and DB reflect the trend of movement towards DC schemes, although DB assets continue to represent more than half of total assets
- However, during the 5-year period to the end of 2007, there is a decrease in the gap between average annual growth rates of DC and DB (12.6% and 10.7%, respectively)
- Notwithstanding, it should be noted that some new DC products have not been incorporated in this GPAS version, thus reducing total DC growth

Source: Watson Wyatt Worldwide and various secondary sources

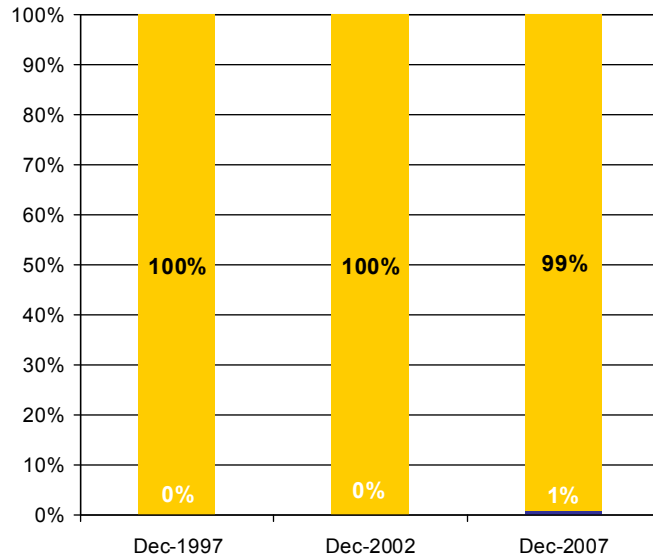
# DB/DC asset split

By country – change over the 10 years to the end of 2007

Australia

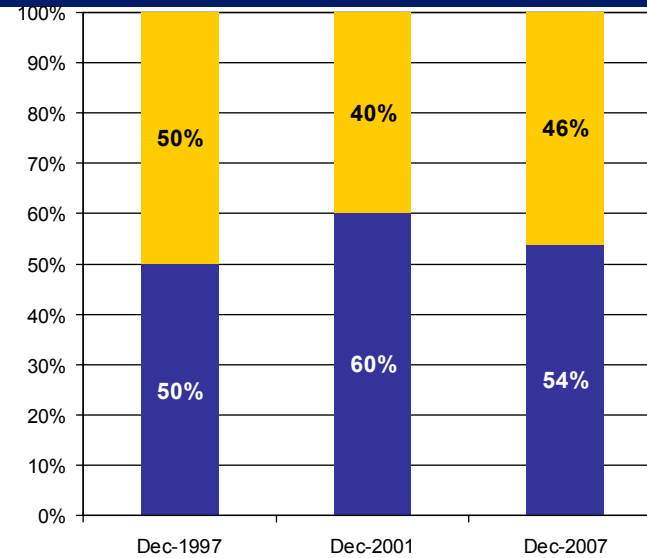


Japan

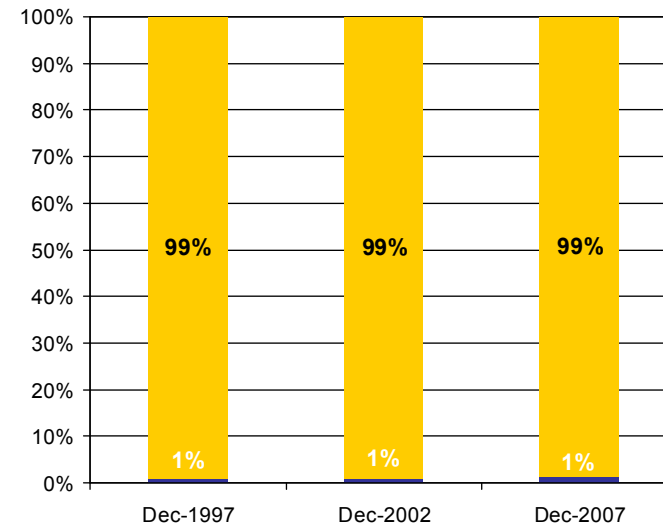


■ DB  
■ DC

Switzerland

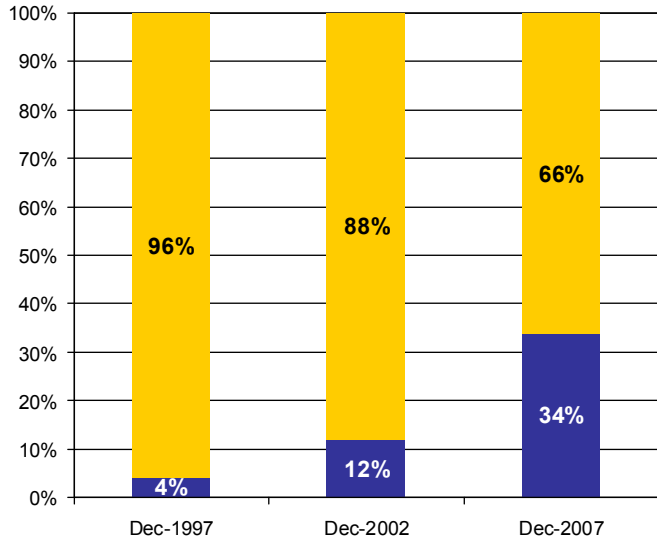


Netherlands

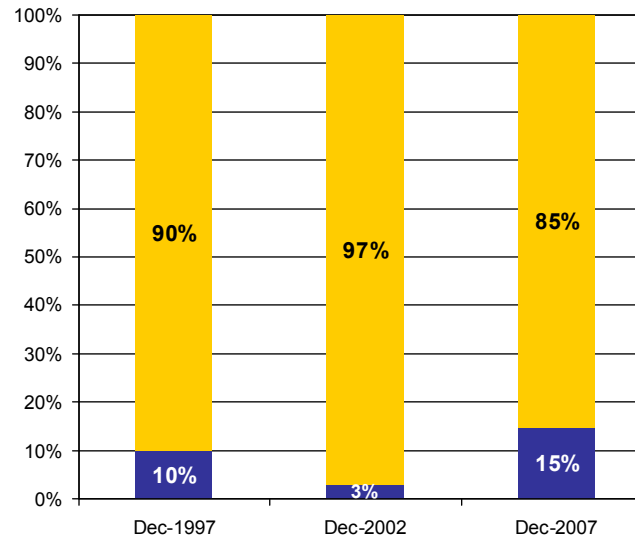


# DB/DC asset split

By country – change over the 10 years to the end of 2007

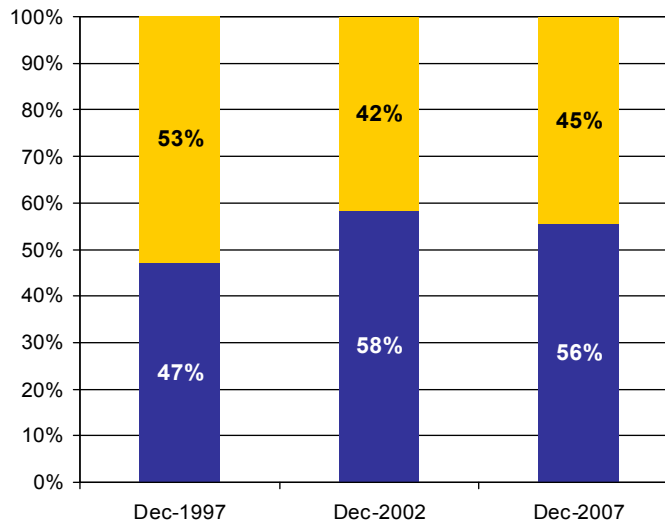


UK



Canada

■ DB  
■ DC



US

Source: Watson Wyatt Worldwide and various secondary sources

UK data does not include Personal and Stakeholder assets but includes insurance administrated vehicles. If the latter were excluded as well, proportion of DC assets would go down to 20%

US assets include IRAs

# DB/DC asset split

## By country – change over the 10 years to the end of 2007

P7

- Both at end of 1997 and 2007, Australia had the highest proportion of total pension assets in DC assets (73.4% to 87% in 1997 and 2007 respectively)
- Of the P7 nations, the US stands in second position in terms of total assets in DC at the end of 1997, with 47%. Over the years this proportion has grown to 56% in 2007
- The countries that have the lowest proportion of pension assets in DC are Japan and Netherlands followed by Canada and UK. Although for the last two countries this trend is changing and we can see that UK has increased the proportion of assets correspondent to DC from 12% in 2002 to 34% at the end of 2007.

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