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Outlook for the pension market

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INCREASING PRIVATE RETIREMENT PROVISIONS WILL OPEN A MARKET OF MORE THAN € 500BN BY 2010. GREAT OPPORTUNITIES CAN BE FOUND BY ASSET MANAGERS AND ADVISORS IF THEY FOCUS ON THE RIGHT STRATEGY AND THE RIGHT COUNTRIES.

With the state pay-as-you-go (PAYG) system of pension provision on the verge of collapse across Europe, new research from the EU Commission showing that more than 60% of Europeans do not worry about their pension comes as an unpleasant surprise. Market insiders know that a change to a more individual provision system can save the PAYG system from collapsing and, sooner or later, a wholescale shift towards this system must occur.

When it does, this revolution in the pension system would represent an enormous push for the fund industry – and provide a valuable new source of revenue in the current strained market situation. Forecasts from Allianz Dresdner Asset Management (ADAM) suggest that by 2010, € 510bn is expected to flow into investment based pension schemes. Some markets such as France and Germany promise perhaps as much as € 100bn. This will lead to a market growth of 7% annually for the investment based tools. “Retirement provision is definitely the next big challenge for the fund industry,” says Rudolf Symmank, Managing Director at DWS with responsibility for the European pension market. However taking a slice of the pension pie is not entirely straightforward, it requires a tailored, country-specific growth strategy which recognises the differences between countries in the European Union. Each European country offers growth potential for

Photograph: Getty Images

Market by market

The market

The three main pillars of the system in %[1]:

State pensions | Occupational pensions | Individual pensions

The facts

1. Number of employees [2]
2. Average annual income [2]
3. Total value of all pension assets under management [3]
4. Assets under management as a % of the country's GDP (mostly occupational) [3]
5. Predicted net sales by 2010 for investment-based pension schemes [1]
6. Annual market growth in % and in comparison to EU average growth of 7% [1]
7. Market share of non-domestic managers [3]

The potential

Potential scale is based on market size, maturity, penetration and growth [4]

asset managers and almost all of them have a reform of old-age provisions on their agendas. The common goal is to strengthen the second and third pillars, which are occupational and private provisions. Alongside company pension funds, most countries encourage private pensions by offering tax incentives or direct grants. But the pace of reform differs significantly from country to country. Some markets, such as the UK and the Netherlands, are almost there, on the way to a long-term stable pension sys-

Europe*

The market

The European market is characterised by a large spectrum of different pension systems. Some countries have built their retirement provision on three equal pillars while others are still heavily dependent on the state system.

State	Occupational	Individual
73	16	11

The facts

1. Employees: **160m**
2. Annual income: **€ 30,928**
3. Value pension AUM: **€ 3.9trn**
4. AUM in % of GDP: **10.4%**
5. Net sales 2002-2010: **€ 510bn**
6. Market growth by 2010: **7% p.a.**
7. Share of non-domestic AM: **30%**

The potential

low middle high

Austria

The market

The second pillar is voluntary and not widespread. Since the tax reform in 2000, employees receive tax incentives for occupational and private provisions. The market is predicted to grow similarly to the European average.

State	Occupational	Individual
88	8	4

The facts

1. Employees: **3.7m**
2. Annual income: **€ 33,003**
3. Value pension AUM: **€ 30.8bn**
4. AUM in % of GDP: **14%**
5. Net sales 2002-2010: **€ 6bn**
6. Market growth by 2010: **>7% p.a.**
7. Share of non-domestic AM: **20%**

The potential

low middle high

Belgium

The market

Just 35% of employees qualify in Belgium for occupational pensions. Therefore, the government plans to strengthen the second pillar. Special tax advantages give incentives to investors for individual provision.

State	Occupational	Individual
80	5	15

The facts

1. Employees: **4.1m**
2. Annual income: **€ 38,535**
3. Value pension AUM: **€ 30.6bn**
4. AUM in % of GDP: **12%**
5. Net sales 2002-2010: **€ 10bn**
6. Market growth by 2010: **7% p.a.**
7. Share of non-domestic AM: **55%**

The potential

low middle high

* EU (excluding Greece, Luxembourg) plus Norway, Switzerland

1) Allianz Group Economic Research, EuroFund calculations; 2) Eurostat; 3) Mercer's European Fund Managers Guide 2002, EuroFund calculations; 4) EuroFund calculations

Photograph: Getty Images

PROMISING FUTURE: Countries such as France and Germany offer great potential for asset managers

tem. They hold more than 100% of their GDP as assets for provisions (see boxes).
Instead, the systems provide a more balanced retirement provision between all three main pillars, the state, the occupational and the personal pensions. This modern pension system implicates a competitive environment on the pension market and lower growth rates for the future. That is why for some asset managers, these highly advanced markets are less attractive for their pension business.

In contrast, opportunities emerge where employees still mainly rely on the PAYG system. France with 7%, and Germany with 14% of assets as a percentage of GDP both have remarkably more accumulated needs. "Together with the large number of employees, these are the most challenging markets for the future," says Dorothee Fleischer from ADAM. To gain ground in a country the asset manager must adapt his products as far as possible to the existing state incentive structures within that particular country.

Denmark

The market
The Danish pension system is rather advanced. About 80% of employees are entitled to occupational pensions. Fund providers can expect average growth for specialist mandates.

65	24	11

The facts

1. Employees: **2.7m**
2. Annual income: **€ 37,269**
3. Value pension AUM: **€ 187bn**
4. AUM in % of GDP: **107%**
5. Net sales 2002-2010: **€ 4bn**
6. Market growth by 2010: **7% p.a.**
7. Share of non-domestic AM: **11%**

The potential
low middle high

France

The market
France is the largest growth market for pension funds by 2010. The government has announced significant and broad reforms, including financial promotion of certain products, from this summer.

51	34*	15

The facts

1. Employees: **23.4m**
2. Annual income: **€ 37,269**
3. Value pension AUM: **€ 105bn**
4. AUM in % of GDP: **7%**
5. Net sales 2002-2010: **€ 136bn**
6. Market growth by 2010: **>7% p.a.**
7. Share of non-domestic AM: **14%**

The potential
low middle high

* Compulsory PAYG system

Germany

The market
Since the reform in 2002, the German government promotes occupational and individual provisions in different ways. The pension market will count for the second highest growth in absolute terms by 2010.

85	5	10

The facts

1. Employees: **36.3m**
2. Annual income: **€ 34,437**
3. Value pension AUM: **€ 295bn**
4. AUM in % of GDP: **14%**
5. Net sales 2002-2010: **€ 103 bn**
6. Market growth by 2010: **>7% p.a.**
7. Share of non-domestic AM: **20%**

The potential
low middle high

In many countries the insurance element of the pension system has a different value and the legislator derives investment rules for funds. The result is that there is a wide variation in the way pension products are structured across the various countries.

For example, the stocks component of pension funds in the UK is at 70% whereas the few Italian employee funds have a stock component of around 10%. A uniform, European-wide product solution is not yet possible. Another difficulty is that domestic managers have the undisputed advantage as they possess the necessary distribution structure for the sale of their products. "Retirement products are often asked to be packaged with administrative services which foreign managers are often not willing to provide if this is not their core business," says Peter König, Executive Director of Morgan Stanley Investment Management. And in a lot of countries, a large proportion of provision products is distributed by insurance companies. The total market for the second pillar, for instance, is split approximately in half between life insurances and asset management com-

Italy

The market
The legal framework for pension funds has been set, but the new products have not hit high demand so far. Nevertheless, Italy will be among the most attractive pension markets within the next few years.

The facts

1. Employees: **20.9m**

2. Annual income: **€ 28,192**

3. Value pension AUM: **€ 256bn**

4. AUM in % of GDP: **22%**

5. Net sales 2002-2010: **€ 41bn**

6. Market growth by 2010: **>7% p.a.**

7. Share of non-domestic AM: **71%**

The potential

The Netherlands

The market
The very advanced pension market does not promise significant growth. The second pillar is extensively set up with a high value of assets under management with the market shares already allocated.

The facts

1. Employees: **7.9m**

2. Annual income: **€ 36,101**

3. Value pension AUM: **€ 624.2bn**

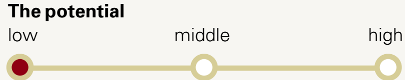
4. AUM in % of GDP: **160%**

5. Net sales 2002-2010: **€ 60bn**

6.Market growth by 2010: **<7% p.a.**

7. Share of non-domestic AM: **42%**

The potential



Portugal

The market
The occupational provision is practically non-existent and therefore promises high growth potential. Government offers some tax incentives for the third pillar which is based on voluntary participation.

The facts

1. Employees: **4.9m**

2. Annual income: **€ 13,610**

3. Value pension AUM: **€ 13.1bn**

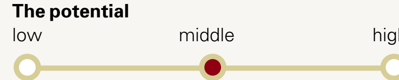
4. AUM in % of GDP: **12%**

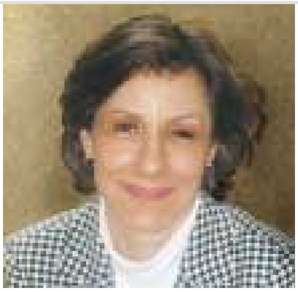
5. Net sales 2002-2010: **€ 9bn**

6. Market growth by 2010: **>7% p.a.**

7. Share of non-domestic AM: **43%**

The potential





"Foreign asset managers will profit from specialist mandates"

Julia Hobart
Head of Manager Advisory at Mercer

panies. Group life insurances are a widespread version of the second pillar in many countries such as Germany or Spain.

However, foreign providers still have good opportunities. Morgan Stanley does not offer pension fund vehicles in Germany, but instead concentrates on its core business, which is asset management and the realisation of asset liability studies. Mercer Investment Consulting in London regardless sees a trend towards specialist mandates, that is, management of a single-asset class as opposed to multi-asset, and therefore sees good opportunities for high quality foreign managers. "The driving changes are for greater transparency, more specialist management and, in turn, greater use of foreign managers with demonstrable track records," says Julia Hobart, Head of Manager Advisory Services at Mercer.

Another chance for asset managers emerges from the reduction of high internally financed book-reserves that some companies have built for pension schemes. In Germany for instance this is the most wide-spread occupational pension plan with 59% of

Spain

The market
The Spanish government plans to promote occupational provision and has set the legal framework for fund-based solutions. Especially small and medium sized companies are facing accumulated needs and will push the market growth.

92 | 4 | 4

The facts

1. Employees: **14.5m**

2. Annual income: **€ 21,699**

3. Value pension AUM: **€ 30.8bn**

4. AUM in % of GDP: **14%**

5. Net sales 2002-2010: **€ 6bn**

6. Market growth by 2010: **>7% p.a.**

7. Share of non-domestic AM: **20%**

The potential
low middle high

Sweden

The market
The Swedish market will see an increasing importance of investment solutions for occupational provisions. Up to now, already more than 90% of employees qualify for the second pillar. Special mandates will be required.

65 | 25 | 10

The facts

1. Employees: **3.7m**

2. Annual income: **€ 33,003**

3. Value pension AUM: **€ 39.1bn**

4. AUM in % of GDP: **7%**

5. Net sales 2002-2010: **€ 12bn**

6. Market growth by 2010: **>7% p.a.**

7. Share of non-domestic AM: **11%**

The potential
low middle high

UK

The market
The UK pension market is broadly saturated. Growth will be mainly seen by the existing businesses. Asset managers might be attracted by special mandates for bond management since the share of equities is traditionally very high.

65 | 25 | 10

The facts

1. Employees: **27.7m**

2. Annual income: **€ 29.864**

3. Value pension AUM: **€ 1658.4bn**

4. AUM in % of GDP: **131%**

5. Net sales 2002-2010: **€ 20bn**

6. Market growth by 2010: **<7% p.a.**

7. Share of non-domestic AM: **18%**

The potential
low middle high

the market. Up until 2002, only 27 % of pension agreements in Germany were funded, according to the ADAM survey. The outcome is a volume of € 150bn which could be externally financed. The International Accounting Standards (IAS 19) allows the spinning of such pension obligations in trust solutions. Aside from Germany, France and Italy have the most unfunded pension liabilities and therefore potentially the highest demand for asset management services.

Mercer's Julia Hobart sees pension fund managers adjusting their strategy to the challenges ahead (see also table). "The continuing uncertainty in equity markets has forced managers to rethink their business models. The game is now less dependent on pure asset growth and is more driven by product mix and profitability," she says. The pension expert has noticed emerging signs that suggest there is a lot

Top 10 European pension fund managers

The big players manage € 800bn

Manager Name	European Pension Assets (Euro bn)
Barclays Global Investors	140.8
Deutsche Asset Management	97.1
Legal & General	93.6
Credit Suisse Asset Management	80.8
Merril Lynch Investment Managers	79.1
UBS Global Asset Management	73.0
Schroder Investment Management	67.0
Hermes Pensions Management	64.3
State Street Global Advisiors	57.0
F & C Management Limited	50.0

*Source: Mercer's European Pension Fund Managers Guide 2002

more change to come in the industry. Even the European Occupational Pensions Directive that was adopted this year, has left many obstacles (see also article on page 30). The labour and social legislation and in particular the tax legislation was largely excluded from the Directive, as the perceptions and the starting situation of the individual countries were substantially different. "It will take at least ten more years before we can speak of a united European pension market to some degree", says DWS's Rudolf Symmank. And while a united European pensions market remains far off, asset managers are better off concentrating on strategies and products designed with specific countries in mind.

One thing is certain however, and that is the growing recognition of the importance of private provision. State-funded pensions look increasingly unstable and the population will look increasingly towards asset managers and private pension provisions to provide a viable alternative.

TAILOR-MADE SOLUTIONS: As a united European pension market is not yet in sight, appropriate strategies for each country are in demand

Photograph: Getty Images

“Experience around the world”

Interview with Paul Manduca, DeAM’s CEO in Europe

Who will benefit from the development of the pension markets – asset managers or insurance companies?

It seems certain that the mutual fund industry will have a significant role to play because investors require transparency and value for money. Investors will be even more cost conscious than today, whereby investment funds have clear advantages because they are more transparent, which is an aspect investors are increasingly sensitive to.

What opportunities do you see for DeAM?

Good performance and client service have always been given requisites. In addition risk is now discussed much more frequently. We see the move to specialist managers continuing and a growing demand for international equity, hedge fund, real estate and private equity products. DeAM is structured to fully meet the requirements of both institutional and retail investors. Our goal is to set new standards in the areas of performance and client service. In addition to a well organised network of international resources at our disposal, we are number two in the UK pension fund business and are also third largest institutional asset manager in Germany.

And the retail business?

Our retail arm DWS is the market leader in Germany, with a 25% market share of funds under management, and is the largest mutual fund manager in Europe. We have operations in 10 European countries, including fund management teams. All our investment specialists are connected via a global research platform. We are in a position to offer tailor-made products instead of ‘off the shelf’ products and our products are specially designed to meet local pension requirements in different countries.

What are the biggest challenges in penetrating the market on a pan-European basis?

Deutsche Asset Management and DWS are pan-European investment companies. Our clients benefit not only from our local European presence, but also our substantial investment resources and experience around the world. I split the week between London and Frankfurt and travel to other European locations as often as possible. It is an interesting challenge to lead a pan-European Asset Management company. Our performance and financial strength suggest we can expand our European market leadership.

■ **Paul Manduca**
is CEO Europe of Deutsche Asset Management (DeAM)

Visit www.eurofund-magazine.com for the full interview.