

APFF Caucus Meeting

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Paper 7-A

Summary note - APFF Special Session on Retirement Income and Longevity

ABAC III meeting, Melbourne

10 August 2015

Introduction

The session was well attended with around 80 participants from regional private sector organisations, including Australian and foreign business groups, officials and academics. The session was the first of two sessions – the second dealing with Asia Region Funds Passport – and was opened by Mr. Robert Milliner, ABAC Australia. Hiroyuki Suzuki, chair of the APFF and the member for ABAC Japan made introductory remarks, and the session was moderated Professor Kevin Davis, Research Director, Australian Centre for Financial Studies moderated the session. The program is attached to this summary.

The central focus of the session was to consider: i) the role of the private sector in accelerating coverage and in being a conduit to meet the challenges of longevity and income in retirement in regional economies within a national framework, ii) ways to increase coverage of individuals who may not currently have access to retirement income systems, and iii) the appropriate financial services to deliver relevant outcomes.

Principles of a retirement system

A senior partner of Mercer outlined work on “An ideal retirement system” published recently by Mercer and the CFA Institute. There are 10 broad principles; there is no one single solution to the best retirement system and while countries must take account of their own economic, cultural, political and historic capital market development there are common principles that economies may apply to create better outcomes. They are:

1. Clear objectives for the whole retirement income system.
2. A minimum level of funding for all workers with contributions by employers, employees and the self-employed.
3. A cost effective and attractive default arrangement before and after retirement.
4. Administrative and investment costs should be disclosed with some competition present to encourage fair pricing.

5. Flexibility as individuals' personal and financial circumstances vary and retirement will occur at different ages and in different ways across the population.
6. Benefits provided at retirement should have an income focus but permit some capital payments without adversely affecting overall adequacy.
7. Contributions (or accrued benefits) at the required minimum level must have immediate vesting and benefits should be accessible only under certain conditions.
8. Taxation support from government in an equitable way, providing incentives for voluntary savings and compensating individuals for the lack of access to their pension savings.
9. Governance of pension plans should be independent for the government and any employer control.
10. Appropriate regulation, including prudential regulation and some protection for pension scheme members.

Professor Kevin Davis specifically noted the need for clear objectives, such as a minimum level of funding would be necessary and simple default arrangements in both the accumulation and retirement phases. He stressed that people need to know what system they are paying into, the importance of flexibility to cater for individual circumstances. Furthermore, while the primary focus should be on income in retirement, 20 to 40 per cent of accrued benefits should also be available to be accessed in retirement for large health and aging related expenditures. Taxation support is also important and should be provided in an equitable and sustainable way, and that prudential regulation would be different for each economy.

Private sector responses

Australian experience

A senior representative from a major Australian pensions group, Australian Super, opined that the superannuation system was successful in Australia as a consequence of the universality of a mandatory system, which has had created scale and size. He noted that people should confidence in the integrity of the pension system and that this intangible quality is particularly important. It was also noted pensions should have a sound risk appetite in managing long-term savings in a volatile environment.

Cost effectiveness is an important consideration in an individual account-based pension system, with individual accounts being managed in a cost effective way and intermediaries not capturing all the benefits. Furthermore, in a defined contribution system, financial literacy and sound advice are necessary to facilitate the exercise of choice by individual fund members.

Regional issues

The Managing Director and Head of Pensions of Citigroup Asia Pacific, noted that at the regional level, US\$6 trillion in savings is held in a bank-centric system and that it was important to shift long-term resources into long-term assets. Major savings economies such as Chinese Taipei, Hong Kong China and Singapore are ageing societies and holistic retirement systems and an accompanying infrastructure framework is needed in those economies.

The challenge facing policymakers is to deliver outcomes in an underdeveloped market environment where pension funds and insurance companies have not yet engaged the market substantively by developing relevant financial products and services.

The Citigroup representative opined that mandatory provisions were needed to establish minimum protection for individuals, and that tax policies and incentives need to be reformed and streamlined to promote a shift away from bank-centric savings into retirement income schemes. The responsibility of both governments and the private sector to provide customer education and promote financial literacy, and the need for substantial policy reforms to develop effective distribution channels was also highlighted.

The Vice President of Retirement Income at Prudential Life Insurance of Korea observed that people seek to save enough for retirement and the challenge is how to ensure the accumulation of assets that produce retirement income streams that last a lifetime. From a consumer perspective, there seems to be little demand in Asia for retirement income schemes, with lump sum withdrawals and limited annuity products being the two primary options available to people for retirement income. This is believed to be generally reflective of a lack of unwillingness amongst consumers to relinquish control over their wealth and capital stocks.

The importance of better communications and sound financial advice to promote the use retirement income solutions cannot be understated. Furthermore, this dilemma may also mean that regional pension systems may need to incorporate defined benefit characteristics. The participant also noted that current environment is conducive to the provision of longevity solutions by insurance companies but, governments and the private sector would need to build confidence in retirement income systems.

Chronic illness and impacts on longevity retirement income

The Director of the Victoria Institute of Strategic Economic Studies outlined the impacts of chronic illness on longevity risk and pension systems as population age. The prevalence of chronic disease increases with age. Available data shows that for developing countries chronic disease impacts on around half of the population in the age group 50 – 64, but few of these countries have any form of disability system in place. It is estimated that the economic costs for seven regional economies facing those demographic challenges are quite high at around 1.5 to 3 per cent of GDP.

The private sector is beginning to respond to these challenges, including through early retirement, but government support is limited with no interventions for public health and chronic disease purposes. For this reason, effective collaboration and partnership between health funds, pension and retirement income funds is particularly important.

Unfunded pension entitlements also pose challenges as defined benefit (DB) schemes are phased out. DB schemes cause problems for US corporations which traditionally have taken on responsibilities for employee health costs – now rising a around 6% annually.

Characteristics of Longevity and retirement income products

Panel members noted that an adequate regional pension and retirement income system should exhibit the following characteristics and outcomes.

- In the regional context, developing an adequate pension and retirement income system which provides retirees with around 60-65 per cent of their pre-retirement income may not be feasible in the short- to long-term. However, over a longer period of 20-30 years a retirement income system with those characteristics and outcomes can be achieved.
- A pooled longevity product should provide a 25 per cent longevity benefit and have a retirement income stream based on 75 per cent of assets.
- Insurance companies should be allowed to invest in long-term assets or in derivatives; a new generation of longevity solutions would require dynamic risk management.
- In shifting long-term savings from banks' balance sheets to long-term insurance products, a holistic approach would be necessary – not one just looked at in terms of taxation incentives.
 - This would require a huge transformation in policies to support retirement products.
- In the Australian context, the recent Murray Inquiry explored the question of what the objectives of a superannuation system should be.
- The Australian system was found not to have a focus on dealing with the issue of longevity and income in retirement.
- Administrative costs in Australia were becoming increasingly scaleable and IT intensive, which should enable efficiency pay-offs; however, given preferences, advice to individuals could not be easily scaled.
- The phase out of DB to DC schemes involves many different agents and the process tends to take out some stabilisers, and shifts the risk and puts the onus on individuals.

- A consequence is the demand for higher wages to compensate for the shift; another is the collective benefit of the DB approach now requires that a government will need to consider a pooling of risk under DC schemes.
- Little has been done on gender and migration issues in Australia in relation to retirement income policies; a new mind set is needed to consider these matters and to reviewing policies which constrain the mobility of labour across sectors.

In summarizing the session, the moderator noted that this is a multidimensional issue covering retirement incomes, health and ageing. We should also think of generational issues and impacts on family structures. Clearly, more work is needed on education and research and on the design of products.

Scale is important, as is the role of government and the private sector on matters relating to technology, payments mechanisms and payment networks. Also more thought is needed on catering for the unemployed and self-employed and the fact that in many societies there is a growing population outside any retirement system.

Next Steps – Agenda for 2016

The Australian APEC Study Centre proposes that, in collaboration with the APFF sub-stream on Retirement Income and Longevity Solutions, further public policy analysis be undertaken in 2016 on developing regional pension systems and retirement income and longevity solutions. The aim of this work will be to develop a deeper understanding of the policy, regulatory and financial market and institutional capacity issues impeding the development of regional pension systems. This work will be reported to ABAC through APFF, with a specific workplan and agenda for 2016 to be reported at the first meeting of ABAC in San Francisco in January 2016.

LSI workstream’s proposed policy analysis on regional pension systems

AASC interest areas

- Public policy goals of pension system
- Research/analysis on pension system design features
- Policies and regulations needed to divert bank savings to pension system

Aim

- The aim of analytical work is to develop a better understanding of the key public policy considerations and options in developing an effective pension system in the Asia-Pacific

Approach

- As coordinator of the *APFF Linkages and Structural Issues* workstream, the Centre will collaborate closely with the *APFF Retirement Income and*

Longevity Solutions sub-stream to complement its work and report outputs and recommendations to the APFF.

2016 work agenda

- A review of APEC economies with codified pension system purpose/goals
 - Which economies have defined the goals of their pension system? Are those goals broadly similar or are there substantial differences?
- A comparative study/review of pension system features in APEC economies
 - Demographic trends and savings needs
 - How much savings do economies need to have in their pension systems, given demographic trends?
 - Which economies have large (private) bank savings, but underfunded/underdeveloped pension systems?
 - Policies and regulations that impede and/or incentivise diversion of bank savings to market-based retirement income/health & longevity products
 - Mapping key features of APEC economy pension systems:
 - Scope/size of public pension system
 - DB v DC
 - Mandatory contributions
 - Preservation/access rules
 - Retirement income product choice
 - Longevity solutions
 - Publicly-funded safety nets
 - Low-income/informal economy coverage/micropensions