Pursuing a pension panacea

The issues of increasing longevity and a rapidly ageing population continue to bog Asia and its governments alike. But while consumers' awareness of retirement planning and security is improving, progress on pension reforms remains slow. What gives?

By **Dawn Sit**

The topic of pensions in Asia is a tough and wide one to broach. Just as the ageing process, economic development and institutional set-up differ amongst Asian nations, so too are pension systems in the region varied, said Mr Richard Wolf, an economist with the Allianz Asset Management's International Pensions team. "The wide diversity of Asia's pension systems stretches from Bismarckian-style institutions (eg Japan, South Korea), to adopted colonial rule legacy regimes (eg Malaysia, Singapore, Hong Kong), and to quasi-Beveridgean approaches to old-age provision (eg China)."


Mr Richard Wolf

Nonetheless, he noted that two main challenges underpinned pension reforms: financial sustainability and retirement income adequacy.

Financial sustainability

"In terms of financial sustainability, the diverse pension situations in Asian countries show widely varying needs for reforms," he said. Comprehensive pension systems in most of Asia still require further development, and increasing the coverage of the public pension system is still a challenge.

Citing an Allianz study in which it introduced the Pension Sustainability Index (PSI) to capture an indication of a country's need for reforms to maintain long-term financial sustainability, he said Asian pension systems that rely on a strong funded pillar, score the best ranking. (See chart "2014 Pension Sustainability Index for selected countries in Asia".)

Elaborating on India as an example, he said despite its relatively favourable demographics, the country is still under pressure to reform its pension system, as only 12% of the population is covered by a formal pension arrangement. "The extremely low degree of coverage remains the primary challenge for India's pension policy."

Retirement income inadequacy in Asia

Turning to compare retirement income adequacy, Mr Wolf noted that most Asian countries "fail to provide a pension income that allows for sustainability of living standards during retirement" and that the financial protection of the elderly is "especially weak in emerging Asian countries".

It is also worthy to note that whilst Malaysia, Hong Kong and Singapore were considered "financially sustainable" on the PSI, they remain low-ranked in terms of pension adequacy, according to Allianz's Retirement Income Adequacy (RIA) indicator that assesses – on a broad approach – whether countries have the potential to provide an income that is sufficient to sustain living standards during retirement.

"People in these systems have to rely on their own accumulated assets and it depends on the set-up of the schemes whether they are able to deliver a fair amount of income," he said. In Malaysia, for example, people are able to access their retirement savings at the age of 55. Despite the option of accessing the EPF's pension pot via a withdrawal plan, many still opt for a lump sum and spend down their pension wealth within the first years of retirement.

"In absence of an intra-societal risk pooling and redistribution, it requires private arrangement in the form of life insurance or other mechanisms to provide for the retiree's longevity risk," added Mr Wolf.

Asia needs to "get richer before it gets old"

Mr Rex Auyeung, Chairman – Asia, Principal Financial Group shared similar sentiments. Highlighting Asian Development Bank (ADB) statistics, he said Asia is on track to becoming the oldest region in the world, with an elderly population (over 65 years of age) projected to reach 1 billion by 2050.

Mr Rex Auyeung

"According to UN figures, about 30.5% of the total population was over 60 in Japan in 2010, whilst for China it was just 12.3%. But China will have to face the challenge of getting rich fast enough before it gets old," he added.

Broad consensus on need for reform now

Dr Richard Jackson, President of the Global Aging Institute noted that it "often takes years for public awareness about a policy challenge to reach the point where there is broad consensus about the need for reform". In the Institute's latest survey – "From Challenge to Opportunity" – conducted in collaboration with Prudential Corporation Asia, findings indicated that "most, if not all" of the 10 East Asian markets surveyed have "reached this point" of consensus on the need for reform.

Dr Richard Jackson

In particular, he said the survey revealed three points that policymakers should take note of. Firstly, citizens almost everywhere in East Asia are highly concerned about their retirement security; second, this concern is leading workers to take concrete steps to improve their retirement prospects; thirdly, and perhaps the crux, is that the survey revealed a "remarkable willingness" on the part of citizens throughout the region to support constructive retirement reforms, "even when doing so might involve personal sacrifice".

Willingness to make sacrifices

In every market except Indonesia, Vietnam and the Philippines, Dr Jackson said a majority of the respondents believe that the government "should raise taxes to provide a basic pensions to those elderly who are in financial need". With the exception of China, Taiwan, Vietnam and the Philippines, a majority of respondents also held the view that governments should raise the retirement age.

"And in every market, without exception, a majority of respondents not only believe that the government should encourage workers to save more for their own retirement by offering them tax breaks, but that it should also require workers to save more for their own retirement." The implications of Asia's ageing population and longer life expectancy will only continue to grow, and so governments – and the industry – must address pension issues now, all three experts said, starting with expanding state pension coverage.

Tackle urgent issues starting with expanding coverage

Whilst in all high-income markets surveyed, today's workers are much better covered by state pension systems than today's retirees during the latter's working years, the outlook in many of the region's middle-income markets is less reassuring, said Dr Jackson, with less than half of Indonesian and Vietnamese workers expecting to receive a state pension benefit when they retire.

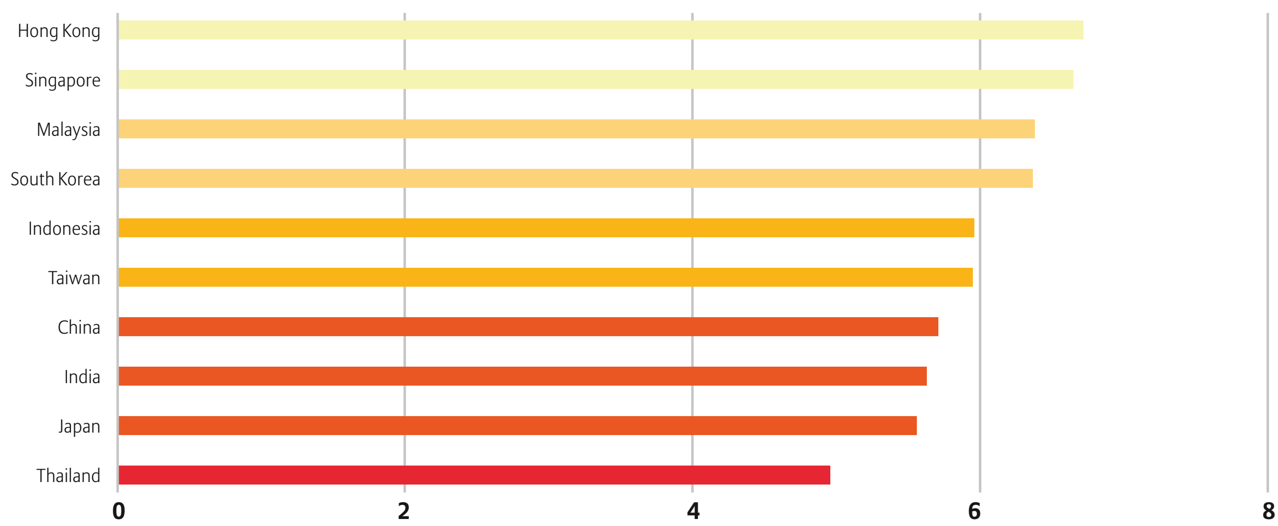
He acknowledged that achieving universal coverage "may not be a realistic goal for countries with large informal sectors". However, China's experience had demonstrated that "with concerted government efforts, such as the creation of a new 'Flexible Employment Pension', enormous progress is possible".

A need to overcome taboo of raising contribution rates

Next, there is a need to increase contribution rates, an issue generally taboo to policymakers for fear of adverse political consequences. "Virtually every expert who has examined this issue agrees that contribution rates in most of East Asia's state pension systems are far too low to achieve the goals of adequacy and sustainability," Dr Jackson said.

"Governments should bear in mind that not raising contribution rates will have adverse economic consequences,

2014 Pension Sustainability Index for selected countries in Asia



* Scale from 1 – 10: 10 minor need for reforms, 1 high need for reforms

Source: Allianz Asset Management, International Pensions namely greater old-age poverty and a more expensive old-age safety net. They should take heart in the fact that a majority of the survey respondents would support requiring workers to contribute more to the state pension system in every market except Vietnam."

Incentives can boost voluntary contributions

Mr Auyeung said that some Asian countries lacked a proper tax structure to incentivise employers and employees to contribute voluntarily for retirement savings – the Hong Kong government for example, does not offer such any tax deductions on voluntary contributions.

He added: "Unlike in the US, retirement systems in Asia are predominantly government-sponsored programmes. And common characteristics of such programmes are the low investment returns and limited investment options. Private mandatory and voluntary Defined Contribution (DC) schemes have yet to gain the level of popularity as seen in the US." However, citing Malaysia's example, he said that the government's launch of the Private Retirement Scheme (PRS) was a step in the right direction.

Move away from lump-sum payments

Thirdly, Asia should move away from lump-sum payments. It is a general view of pension experts that lump-sum payments may increase the risk that retirees will squander and/or outlive their retirement savings, said Dr Jackson. To be adequate, any state pension system should require mandatory annuitisation, at least above a minimal threshold.

Whilst the traditional assumption is that lump-sum payments are what workers would prefer to receive, the Global Aging Institute-Prudential survey suggested otherwise. "When today's workers were asked how, if given the choice, they would prefer to receive their pension benefits, those who said they would prefer to receive them all in monthly payments exceeded the share who said they would prefer to receive them in a single lump-sum payment in every country by margins that ranged between 2:1 and 11:1," he added.

All hands on deck required for robust pension system

Amidst all these issues, the insurance industry has a crucial role to play. Mr Auyeung noted that the pension landscape in Asia "is getting tougher" and that "there are a number of critical moments facing us ahead. But all parties – regulators, market players and investors – play a significant role in developing the framework and mechanism of a robust pension system.

He added that in this "era of personal responsibility", public pension systems will come under immense pressure and the shift towards DC pension plans will become more prominent. "This being said, as retirement planning gains traction in Asia, the popularity of life-cycle funds and products that balance risk and returns over one's lifespan should increase."

Three trends for insurers to note

Dr Jackson agreed and said findings from the survey suggested the likelihood of "enormous changes" in the pensions market, and more generally the retirement savings market over the next 10 to 15 years.

He highlighted three trends in particular that the industry needs to pay attention to. The first is the receding role of the extended family in providing financial support to retirees, together with a growing awareness that state pensions are likely to be inadequate, will drive a rising demand for supplemental retirement savings products, including personal pensions, life insurance, and annuities.

Second, as younger cohorts with higher levels of educational attainment climb the age ladder, a growing share of the workforce will be eager for financial advice about retirement planning and products.

"Finally, the younger and more educated customers are likely to pay much more attention to investment performance, and may be increasingly intolerant of government or industry policies that prevent them from earning a market rate of return on their retirement savings", he said.