AsianInvestor

Exploring Global Pension Trends and Asia's Challenges

Only two things in life are certain — but retirement funding isn't one of them. Death and taxes aside, adequate retirement funding is on the growing list of uncertainties that workers, employers and governments face today

Countries such as Greece, where workers relied almost solely on a government-sponsored retirement program before it faltered, may be the most-prominent example of inadequate retirement schemes. Individuals in many nations face similar predicaments on a lesser scale. Ultimately, we need to ensure that workers — whether in the Asia-Pacific region or elsewhere — have enough money to last through their golden years. But what are the best approaches for particular countries and circumstances, considering the global diversity of public and private programs that form the backbone of most workers' retirement savings?

Some countries, such as Denmark, the Netherlands and Australia, already have robust retirement systems comprised of both public and private programs to deliver good benefits to employees. But a number of Asia-Pacific nations (See side bar 1 for the list of countries) face major weaknesses affecting their retirement systems' efficiency and sustainability that must be addressed.[2]

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ASIA'S LANDSCAPE, CHALLENGES

In Asia, the pension landscape is heterogeneous, with many of the larger retirement pools founded on defined benefit (DB) pay-as-you-go pension systems originating more than 40 years ago. Now, the challenges of an ageing population, resulting from low fertility rates and longer life expectancy, are straining pension systems and government budgets as inter-generational inequalities arise between contributors and retirees.

Governments are responding to the recognition that retirement income from these plans is inadequate and unsustainable. Many of these countries are working to maximise returns in their pension portfolios. Some are reforming their pension parameters by considering higher contribution rates, lower benefit levels or raising the retirement age. Other countries are creating and encouraging more contributions to voluntary DC schemes to augment government-run DB schemes. And some governments are implementing mandatory DC schemes, such as Taiwan's Labour Pension Fund which replaced the Labour Retirement Fund for individuals joining the workforce or changing employers from 2005 onwards. In Korea, all corporates will need to enrol their employees into private pensions by 2022 giving them the option

Sidebar 1: Melbourne Mercer Global Pension Index

There are three overarching concepts, all part of the Melbourne Mercer Global Pension Index,[1] to consider when assessing local government pension systems. First is **adequacy**, which encompasses topics such as the current sufficiency of the existing structural underpinnings of the taxing system, the benefit program's design features and participants' savings. A second area of focus is on **sustainability**, which covers future concerns such as the program's coverage, the effects of government debt and demographics. This addresses the issue of longevity risk, or whether the funds accumulated for retirement will last through a worker's entire retirement years. The final key factor revolves around **integrity**, which considers overall governance and operations and affects the level of confidence that workers have in a country's retirement system. The weighted average of these three sub-indices for 20 countries comprises the overall index, which is widely used to assess the effectiveness and quality of a country's retirement system.

Each of the 20 countries assessed in the index is scored on more than 40 indicators, with a final index value ranging from 42 to 80.2 in the most-recent ranking. Denmark (grade A; index value exceeds 80), Netherlands and Australia (grade B+; index value of 75-80) rank first through third, respectively. At the bottom of the list are China, Japan, South Korea, India and Indonesia (grade D; index values of 35-50), suggesting that there is much room for improving retirement systems in these five Asia-Pacific nations.

1 Australian Centre for Financial Studies, Mercer – Melbourne Mercer Global Pension Index, October 2013.
2 Northern Trust Defined Contribution Solutions, "The Path Forward Survey: DC Participants Want More," May 2015.

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of DB or DC. Regardless of the approach, Asian countries must maintain the integrity of these systems so that benefit promises remain credible.

GLOBAL TRENDS

Despite the diversity of pensions in Asia-Pacific, global trends provide some pointers as to how pensions in this part of the world could evolve.

Investment diversification

More pensions globally are increasing their exposure to alternatives as they seek to maximise both returns and asset growth while better matching returns with liabilities. In Asia, many pensions have also decreased their fixed-income holdings in favour of equities and altered their investment strategy by shifting from domestic to offshore allocations.

The growing complexity in pension portfolios has sparked greater demand for transparency, more granular reporting and analytics and for access to specialist expertise from asset servicing providers like Northern Trust. This also heightens demand for tools to measure and monitor liquidity and counterparty risk in pension portfolios and conduct exposure analysis across the diverse asset class. An example of this is the need from some pensions to have reports enabling them to "peek through" to the underlying company holdings for exposure reporting on their private equity investments.

Maintaining a strong governance framework

Regulatory changes globally, including ones requiring disclosure reporting and risk modelling, are fuelling a focus on governance that is driving pension fiduciaries to establish best practices in governance structure and oversight. The new Dutch Financial Assessment Framework reporting requirements and the Australian Prudential Regulation Authority reporting enhancements are examples of such regulations. This greater internal and external regulatory scrutiny also has heightened expectations around the timeliness, accessibility and usability of data provided by asset servicing providers. More often, it is not just about data but rather about what information the data can translate into.

Where pension assets are split across multiple custodians and multiple managers, or where a portion is managed in-house or externally, there is a growing need to aggregate this data to produce a consolidated view. This enables visibility across the entire pension portfolio in relation to performance, risk and concentration levels as well as adherence to investment restrictions.

Evaluating the liability side of the equation

Across much of Asia, despite the concern about the sustainability of publicly managed pension schemes, the focus on growing pension assets has overshadowed the focus on liabilities. But in the United States and Europe, demand is growing for detailed information on how assets are performing against long-term liabilities. As a result, for asset servicing providers, reporting on assets alone is no longer sufficient. Being able to provide risk analysis that also takes into account a pension's liabilities is increasingly important.

The shift to DC schemes

While DB plans remain the dominant retirement funding vehicle across Asia-Pacific, the growth of DC assets is accelerating, particularly in countries where DC schemes are mandatory, such as Hong Kong, Taiwan, Singapore, Malaysia and Australia.

Moving from DB to DC also means transferring the investment decision from the government or plan sponsor to the individual. They are helping plan participants by adopting DB-like strategies within existing DC schemes so participants don't feel so overwhelmed. This might include adding auto-enrollment and auto-escalation features and offering "do-it-for-me" investments like target date maturity funds, for participants who don't want to make investing decisions.

Regulators can facilitate this transition by enforcing transparency and fee fairness so participants aren't penalised by unseen fees and investment attributes they didn't know about or understand.

Australia has already moved in this direction by passing legislation through Parliament in 2013 that has enabled the implementation of lower cost products and enhanced transparency in the superannuation industry. Asset servicing providers like Northern Trust are assisting superannuation funds meet these new reporting requirements. Similarly Hong Kong is also looking to launch a standard default investment strategy by the end of 2016 to achieve similar objectives.

Moving forward

There are numerous other challenges that plan sponsors and governments in the Asia-Pacific region will confront as they work to shore up retirement safety nets. For many, however, a key point is simply acknowledging that, like death and taxes, these shortcomings exist and making a commitment to address them. ■

Contact

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