INSIGHTS FROM THE 2013 Global Retirement Savings Conference

THE ROLE OF INVESTMENT FUNDS

HONG KONG
26–27 JUNE 2013

ICI Global

INSIGHTS FROM THE 2013

Global Retirement Savings Conference

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Letter from Dan Waters
ICI Global, Managing Director

As systems for building retirement resources come under increasing pressure, countries of every size and economic situation are facing long-term savings challenges. To meet these challenges, it is critical that pension industry experts, policymakers, and fund industry representatives come together to learn from one another and to share solutions that put the needs of savers first.

That is why ICI Global hosted the *Global Retirement Savings Conference: The Role of Investment Funds* on 26–27 June 2013 in Hong Kong.

We approached the conference with three goals:

1. Foster an international dialogue about the long-term savings issues facing jurisdictions worldwide
2. Examine the rise and evolution of defined contribution (DC) systems in response to those issues
3. Discuss how investment funds are uniquely positioned to serve investors in such systems

More than 100 people representing 13 countries attended the event, which featured speakers, panellists, and participants from around the world, including fund industry representatives, world-renowned industry experts, representatives of top-tier media outlets, and key government officials and regulators.

The ideas and insights that emerged from these different panels and discussions are documented in this report, but three overarching themes resounded throughout the event.

First, attendees firmly believed that an international dialogue about the long-term savings issues facing countries worldwide was timely and needed. As participants discussed the issues facing different regions, the conference's second theme emerged: many countries are looking towards DC systems to help address retirement savings challenges. DC systems have become a popular alternative or supplement to government-provided retirement schemes—perhaps because they are flexible and can be adapted to fit the different needs of different nations. This adaptability led to our third theme from the conference: current DC systems vary from country to country because each country has its own unique history, institutions, characteristics, and needs.

Thus, it is important to keep in mind that the ways in which governments, companies, and individuals respond to long-term savings challenges do not necessarily represent universal truths. It is equally important to understand that this report is not offering prescriptions for global policy; instead, it is simply offering insights into how different countries are responding to retirement savings challenges.

I hope you enjoy reading this report. ICI Global is committed to advancing the dialogue about how to improve retirement security worldwide, and I encourage you to share this report with others. Addressing global savings issues is a daunting challenge, but my hope is that the information in this report will help us take the next steps towards meeting that challenge.

‘Let the Old People Live Good Lives’

GLOBAL TRENDS IN RETIREMENT

Paul Schott Stevens
Investment Company Institute, President and CEO

The history of retirement, evolution of the defined contribution (DC) system in countries around the world, and the role that funds can play in meeting the long-term savings needs of investors worldwide took centre stage in opening remarks made by Paul Schott Stevens.

‘From the United States to Sweden to China, governments, businesses, and individuals are struggling to improve the programmes needed to provide retirement security to growing populations of the elderly’, said Stevens. Yet, as he explained, people didn’t always think of ‘retirement’ as they do today.

What follows are edited excerpts of Stevens’s remarks.

History of Retirement

‘Retirement’ is a relatively recent concept. Before the Industrial Revolution, people did not anticipate an extended period of leisure after their working years. Life expectancies were short, and a worker’s ‘retirement plan’ consisted of his land, tools, skills, relationships with his family and community, and whatever he could put by to save for later.

The exception to this pattern tended to be militaries, which have a long history of pensions. The armies of ancient Rome were the first to offer pensions, when Emperor Augustus created such a plan for legionnaires. Armies under the Chinese emperor also had retirement plans long before other sectors.

Other than in the military, however, pensions as we know them today were not common before the Industrial Revolution. Families usually took care of the elderly, and the community also was expected to help out as needed. Long before the introduction of banks or investment funds, communal granaries and savings societies helped villagers meet emergencies and fund one another’s new enterprises. As Confucius wrote, ‘Let the old people live good lives, let those in working age contribute to the society, and let children be well-educated’.

The Industrial Revolution changed the nature of work and thus the nature of retirement. In the nineteenth century, private and public pension systems emerged to help support older workers

who could no longer keep up with the pace of work in factories or offices. The vast majority of these systems were defined benefit (DB) schemes, and many government retirement systems were created on a pay-as-you-go (PAYGO) basis—meaning that benefits for current retirees were supported by taxes collected from current workers. Created during a period of rapid population growth, such systems initially had a large number of workers supporting a smaller number of retirees, and due to their success were gradually adopted by countries around the world.

DB and DC Plans

Many countries are rethinking DB plans and implementing DC models. In recent decades, DB models have come under intense pressure, spurring many countries to reform their retirement systems. Changing demographics have rendered PAYGO government-provided retirement systems increasingly unsustainable, while DB plans have proven more expensive, and their costs more volatile, than employers anticipated. These demographic issues and funding problems have been apparent for decades, but the twin bear markets of the twenty-first century exacerbated and highlighted them. In the face of these trends and financial stresses over the years, a number of countries have been reviewing their populations' retirement resources and have sought to reform their long-term savings systems. Many of those nations have adopted a DC approach.

The DC model has several features that help address the demographic, fiscal, and workplace issues that have undermined DB pensions. For example, for governments or employers, one primary improvement is that the cost of funding a DC plan is transparent and predictable. For workers, DC plans provide ownership of their retirement resources, and the corollary benefit of portability. DC account assets can grow throughout a career as a worker moves from job to job—whether the account is in a centralized system, left in previous employers' plans, or rolled over into new retirement accounts. This portability fosters a flexible labour market. DC plans also have the ability to generate significant income in retirement.

DC systems take different forms, are in different stages, and perform different roles in countries around the world. Despite their common advantages, DC systems take different forms in different countries—and many countries are at different stages with their own DC systems. This is because every country has its own unique history, institutional framework, and economic situation, all of which influence how a country designs its DC system and what role that system plays. DC plans have been used to replace or supplement employer-sponsored occupational schemes, or to replace or supplement national government-provided systems.

Themes

There are five common themes among DC systems globally. In preparation for the 2013 Global Retirement Savings Conference, ICI Global reviewed the retirement systems in nine jurisdictions, studying how their use of the DC model evolved. The systems that ICI Global researched were in Australia, Chile, Hong Kong, Japan, New Zealand, Singapore, Sweden, the United Kingdom, and the United States. Though the DC plans in

'As Confucius wrote, "Let the old people live good lives, let those in working age contribute to the society, and let children be well-educated".'

each country are very different, ICI Global nonetheless found five common themes among them.

1. The use of automatic features is growing—for example, to enroll participants, increase their contribution rates, or direct them into default investments.
2. DC plans provide transparent disclosure and education to help individuals make the financial decisions necessary to direct their plans.
3. DC systems offer a range of investments to savers.
4. There is a movement towards diversification of the default investment option.
5. There is a rising sensitivity to fees.

Investment Funds

Investment funds can play a vital role in DC plans and in building the future of retirement. DC plans are growing and evolving as they take a larger role in providing retirement security in jurisdiction after jurisdiction. Funds can play an important role in improving retirement security worldwide as part of DC plans, because they are designed to serve retirement savers well. Not only are investment funds professionally managed, well-regulated, transparent, diversified, and cost-effective, but fund companies also have a long history of interacting with investors and can provide valuable insights into how to reach, educate, and serve retirement savers.

Because of this long history and deep expertise, the fund industry—with its global scope and perspective—can inform policymakers as they consider reforms to their pension systems. And the fund industry can and must continue to do many other things, including:

- Educating individuals about the power and importance of retirement savings vehicles, such as DC systems
- Supporting innovations in DC system design that will improve participants' experiences in these plans, as well as their retirement savings outcomes
- Providing DC plan participants with tools that help them make informed investment choices and manage their resources effectively through their working and retired years
- Embracing and explaining public policies that provide structures and incentives to help investors achieve retirement security

Finally, and perhaps most importantly, the fund industry must continue to advance the dialogue among all the key parties—professionals in the fund industry, policymakers, employers, and workers—to improve retirement security through DC systems around the world.

Resources

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ABOUT ICI GLOBAL

ICI Global is the global affiliate of the Investment Company Institute (ICI). ICI Global's members are regulated funds publicly offered to investors in leading jurisdictions worldwide. ICI Global seeks to advance the common interests and promote public understanding of global investment funds, their mangers, and investors. Members of ICI Global manage total assets in excess of US $1.3 trillion. ICI Global is headquartered in London, and has an office in Hong Kong.

ABOUT THE INVESTMENT COMPANY INSTITUTE

ICI is the world's largest association of registered investment companies, representing regulated funds offered in the United States and globally. ICI's US members include mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. US members of ICI manage total assets of $15.2 trillion and serve more than 90 million shareholders.

ICI has a deep interest in the retirement system and retirement policy. In the United States, ICI's mutual fund members manage roughly half of the US $11.1 trillion in assets in defined contribution (DC) plans and individual retirement accounts (IRAs). The Institute has a large and active research programme on retirement trends, economics, and policy issues, and is the primary source for statistical data and research on retirement plans and the role of mutual funds in helping investors save for retirement.

To Learn More

Contact Anna Driggs, Associate Counsel—Pension Regulation, at anna.driggs@iciglobal.org with questions about this report or about global long-term savings and retirement.

Watch Qiumei Yang, ICI Global Executive Vice President and Head of Asia-Pacific, discuss ICI Global's work and priorities at www.iciglobal.org/video/asia_expansion.

To learn more about ICI's retirement research, visit www.ici.org/retirement.

Restructuring Retirement Systems for Resiliency in an Aging World

Olivia S. Mitchell
Professor, Insurance and Risk Management
Professor, Business Economics and Public Policy
Professor, International Foundation of Employee Benefit Plans
The Wharton School, University of Pennsylvania

'We're going to have to go back to a world where we consume less and save more, because we're going to live so much longer.'

Economic and demographic stresses have resulted in changes in the design of retirement systems around the world. The longer-term trend of aging populations, which cause pay-as-you-go (PAYGO) systems to suffer from rising numbers of retirees collecting benefits in proportion to workers paying in, has spurred the 50-year trend towards funded pensions. Funded pensions can take the form of defined benefit (DB) or defined contribution (DC) plans, and there also has been growth of individual account-based designs. The financial crisis took its toll on funded pensions and also put additional stress on PAYGO systems. There are many details to consider around funded plan design, and it is important to have a range of investment options; to be aware of fees; to have transparency; and to improve the financial literacy of individuals so that they can navigate financial decisions, including planning for retirement.

What follows are edited excerpts of Mitchell's remarks.

Pressures on Retirement Systems Worldwide

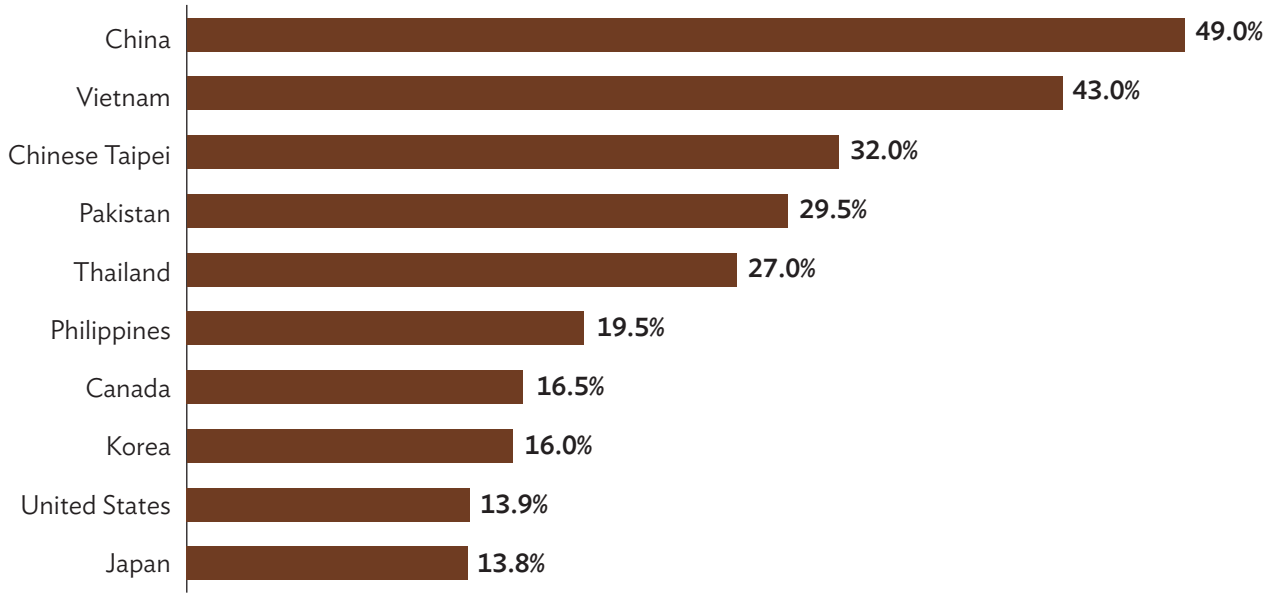
Retirement systems around the globe are being restructured to manage the rising burdens of aging populations and increased longevity. In addition, the impact of the 2008–2009 financial crisis on retirement assets focused everyone's attention on the role of the international financial system and its impact on retirement well-being. These developments have presented choices and challenges for policymakers, employers, and individuals.

Demographic pressures on retirement systems result from the rising numbers of retirees per worker and increasing longevity. Population aging in some countries has meant that the number of older people living during retirement

FIGURE 1

Required Contribution Rates to Pay Public Pension Promises

Estimated percentage of labour earnings



Source: OECD Pensions in Asia/Pacific

has risen faster than the growth of the workforce. Also, retirement duration has gotten longer, with the average number of retirement years now about 19½ years for men and 24 years for women. These trends, and the challenge of financing such long periods of leisure, are likely to require that people will need to work substantially longer in the future.

The more generous are old age social security systems, the more young people will have to be taxed; taxing the young in turn increases labour disincentives. In the United States and many European countries, there is little active policy discussion over exactly what affordable social insurance benefits might be and how adjustments will need to be made to pay for these benefits. Yet the Netherlands and Sweden have both demonstrated political will and creativity in implementing benefit changes and automatic adjustment factors that make it possible to respond to underfunding issues without dramatically cutting retiree payments. Public pensions in much of Asia also appear unsustainable and will require very large contributions to cover future promises (see Figure 1).

There is a delicate trade-off that varies by country regarding the relative size of its pension assets and the generosity of its social safety net. In an environment such as the United States, where there is a fairly generous social insurance programme, private pension contribution rates tend to be lower than in countries that lack a social safety net. Singapore, for example, which has never favored the social insurance model, has mandated much higher savings rates—up to 36 percent of salary (which includes healthcare and retirement costs).

'We must think much more about the potential liability of living a long time in retirement.'

'Demographers and actuaries now predict that babies born today will likely live to 100, and some to 200. This dramatically changes the way we need to think about education, work, saving, investment, and retirement.'

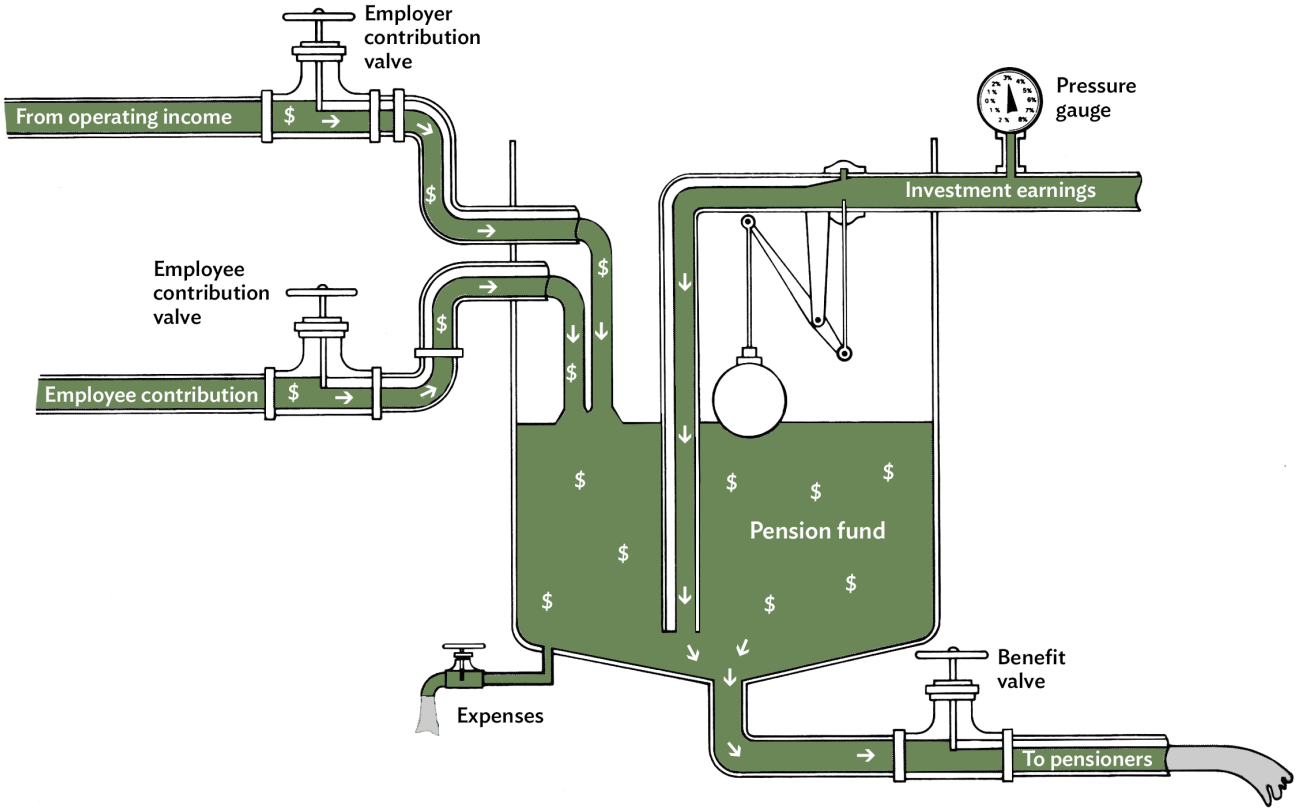
Trend Towards Funded Pensions

The 50-year trend towards funded pensions around the world still bears much promise. With funded pensions, the assets set aside for retirement protect the promises made. This helps protect against political risk (meaning one party or another cannot easily change the promises). In addition, funded pensions help provide diversification because individuals are not forced to rely on a single firm to provide future benefits.

Funded pensions also have costs and face challenges. The assets must be managed, which results in administrative and investment costs. In addition, to protect the assets, regulatory and supervisory requirements are key to prudently managing a funded retirement system. Another question is which assets will be held in these funded plans and what roles the government will play in guiding or selecting the funds' investments. There have been some worrisome cases of late, where assets of funded pensions have been expropriated or restricted to politically favored investments.

Funded systems are more complicated than PAYGO systems, where incoming contributions or taxes essentially go out to pay the retired group immediately. As Figure 2 shows, a funded pension has two inflow 'pipes,' one representing employee contributions, and the other depicting employer contributions. The inflow due to investment income builds assets in the pension fund. The bottom larger pipe represents the benefits paid out, while the small spigot on the bottom left represents the fees and charges associated with managing the money, the size of which varies across countries.

FIGURE 2
Pension Funding



Source: Adapted and reprinted with permission from "ABCs of Pension Funding" by Charles L. Trowbridge. Harvard Business Review, *March 1966.*
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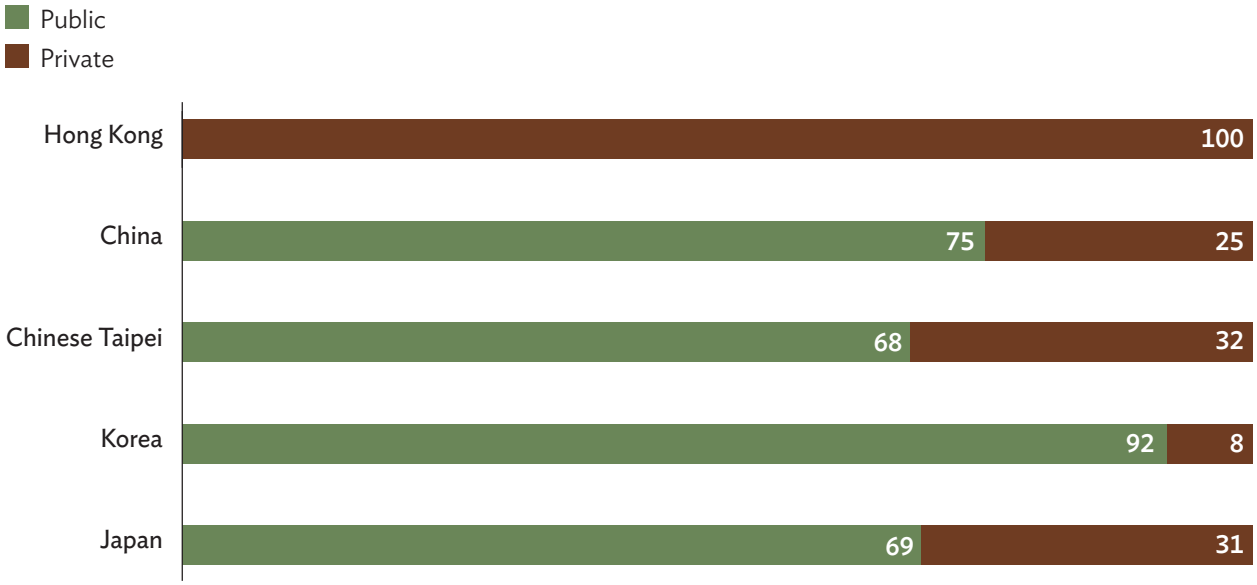
FIGURE 3

East Asia's Pension Assets by Management Responsibility

Percentage of pension assets, 2011



Source: Blanc-Brude, Cocquemas, and Georgieva (2013)

The financial crisis of 2008–2009 hit equities and increased DB plan liabilities, while the economic downturn stressed corporate and government budgets. After the global financial crisis hit, retirement assets that were concentrated in equities lost value. The decline in interest rates led to an explosion in liabilities in DB plans: US actuaries estimate that for every 2 percentage point decline in interest rates, DB plan liabilities have risen by 25 percent. The third factor constraining the retirement system was that the sponsors—employers or governments—became tightly stretched financially. All of these forces led to a global problem of underfunded retirement systems.

With funded pensions, home-country bias and government investing can be a concern. One of the issues facing many pension systems is that they are either government-run or heavily influenced by governments. As a result, they are often home-country biased in terms of their investments, meaning that they're not properly diversified around the world. Policymakers also tend to funnel pension assets into infrastructure projects and other government-favored investments. But when a pension's assets are essentially 'loaned' to the government mandatorily, then capital markets will not broaden and deepen as needed for financial stability.

Growth of Individual Accounts

Within the funded retirement plan arena, efforts to counter some of these concerns have led to the growth of individual accounts. Yet it is important to recognise that the introduction of individual accounts requires households to have sufficient financial literacy: that is, they need to know how to save enough, how to invest with financial forethought, and how to manage their money during the retirement period. As shown in Figure 3, countries are at different stages of individual or privately managed pension assets (brown bars) versus publicly managed assets (green bars). Because of the strong government role still in place in many countries, governance matters, even in these individual accounts.

'This has been a big challenge in many of the Asian countries—to make sure that both the amounts saved and the returns earned are high enough to support a healthy old age.'

'There is clearly a role for financial education at multiple points in the lifecycle.'

In individual accounts, it is important to have a range of investment options and products, and to be aware of fees. Examination of some Asian pension systems reveals that people tend to hold their assets in their funded systems in insurance-related products. In selecting the lineup of investment options or products to offer individuals, it's important to weigh:

- the products' benefits and costs;
- alternatives to the products;
- participants' levels of financial understanding; and
- whether there are guarantees and what these cost.

In addition, in an environment where returns on assets are not as high as they were a decade ago, it's useful to keep an eye on expense ratios, front- and back-end loads, and switching costs.

Financial Literacy

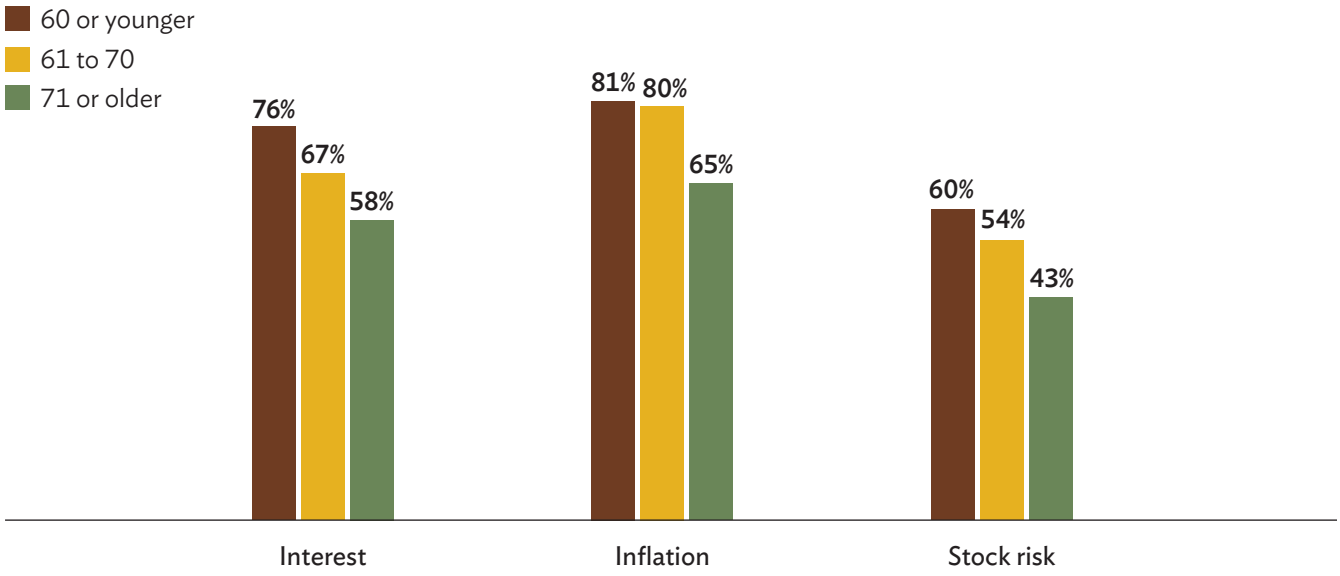
Individuals are increasingly responsible for managing their retirement savings, as well as their decisions around mortgages, credit cards, and household expenses. This makes it critically important to enhance financial literacy. Research* shows that people who are more financially literate do a better job saving, investing, and managing their payouts in retirement. Improving financial literacy is particularly a concern when dealing with older population groups, which tend to be less financially literate, as shown by Figure 4. The responsibility to increase financial literacy lies with many parties. The ideal approach is to start education early, at home, in the family. The government also can promote financial literacy through the schools. Employers should offer comprehensive programmes on retirement benefits. And the financial services industry can promote financial literacy by providing material explaining the basics of saving and investing.

*See Olivia S. Mitchell and Annamaria Lusardi, eds. 2011. *Financial Literacy: Implications for Retirement Security and the Financial Marketplace.* Oxford: Oxford University Press for the Pension Research Council at The Wharton School, University of Pennsylvania. Available at www.pensionresearchcouncil.org/publications/0-19-969681-9.php.

FIGURE 4

Financial Literacy Falls with Age

Percentage of respondents answering questions correctly by age, 2011



Note: The three financial literacy questions covered the compounding of interest, the impact of inflation on spending power, and whether a single stock provided a safer return than a portfolio of multiple stocks.
Source: Mitchell's tabulations from the Health and Retirement Study

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Organisation for Economic Co-operation and Development. *Pensions in Asia/Pacific.* Available at www.oecd.org/els/soc/41941763.pdf.

PANEL 1:
The State of Pension Provision Around the Globe

PANELLISTS

Stephen P. Utkus, Moderator
Principal
Vanguard Center for Retirement Research

Ángel Melguizo
Lead Specialist, Labour Markets and Social Security Unit
Inter-American Development Bank

Brigitte Miksa
Head of International Pensions
Allianz Asset Management AG

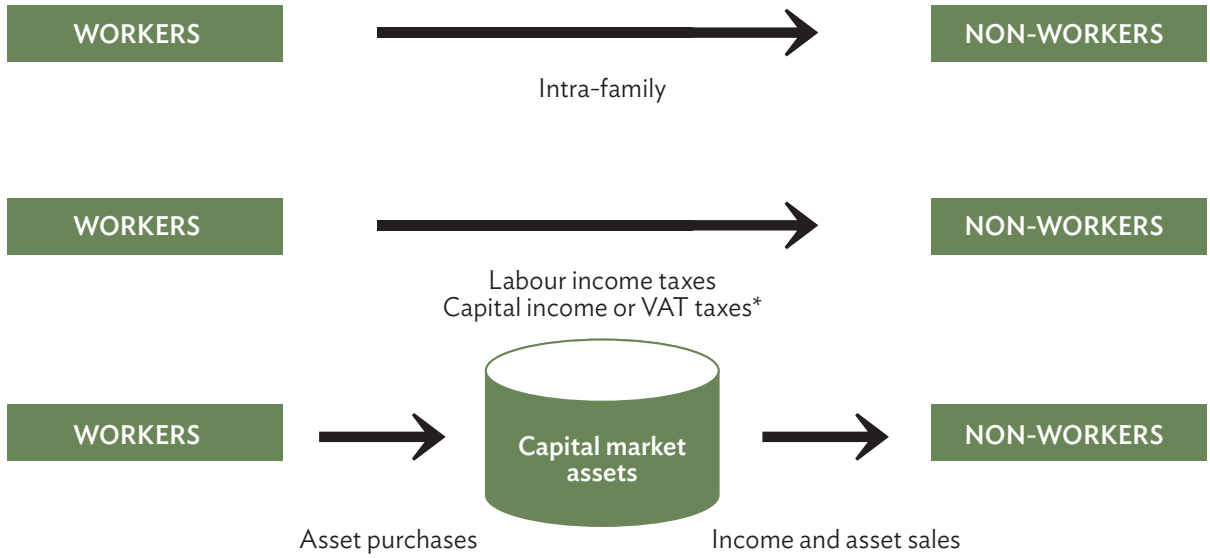
Yoon Ng
Associate Director
Cerulli Associates

During 'The State of Pension Provision Around the Globe', panellists representing different regions discussed the challenges facing pension systems worldwide, including sustainability, coverage, and country-specific dynamics. In addition, panellists talked about reforms to pension systems; the role of defined benefit (DB) programmes; and the growth of—and variations in—defined contribution (DC) systems around the world.

What follows are edited excerpts of the panellists' remarks.

FIGURE 1

Macroeconomic Transfers View of Retirement



**May also represent transfers from non-workers to non-workers.*
Source: The Vanguard Group

Retirement from a Macroeconomic Perspective

The fundamental economic question is, how do economies transfer goods and services produced by workers to retirees? Those looking for the answer must first disregard any financing mechanism and think about the real transfers that have to occur to finance old-age retirement security. If there were only workers in the world, they would produce various goods and services and then spend their earnings on consuming them. When non-workers are introduced, the question becomes, how do they get goods and services, because non-workers are not producing services and products or generating income to consume them.

As Figure 1 shows, there have been three mechanisms for these transfers:

1. through family members;
2. through taxation of current workers to provide funds for current retirees (e.g., through social insurance programmes and tax systems); and
3. through the capital markets, including funded retirement accumulations, whether in DB or DC plans.

'Whether it's families, whether it's tax transfers, whether it's private-market capital market transfers, it's important to recognise that the key to all retirement system transfer programmes—the essential key for economic security in old age—is worker productivity.'

Stephen P. Utkus

'Communication becomes a very key part of the discussion—both to increase literacy and to emphasise the importance of pensions.'

Brigitte Miksa

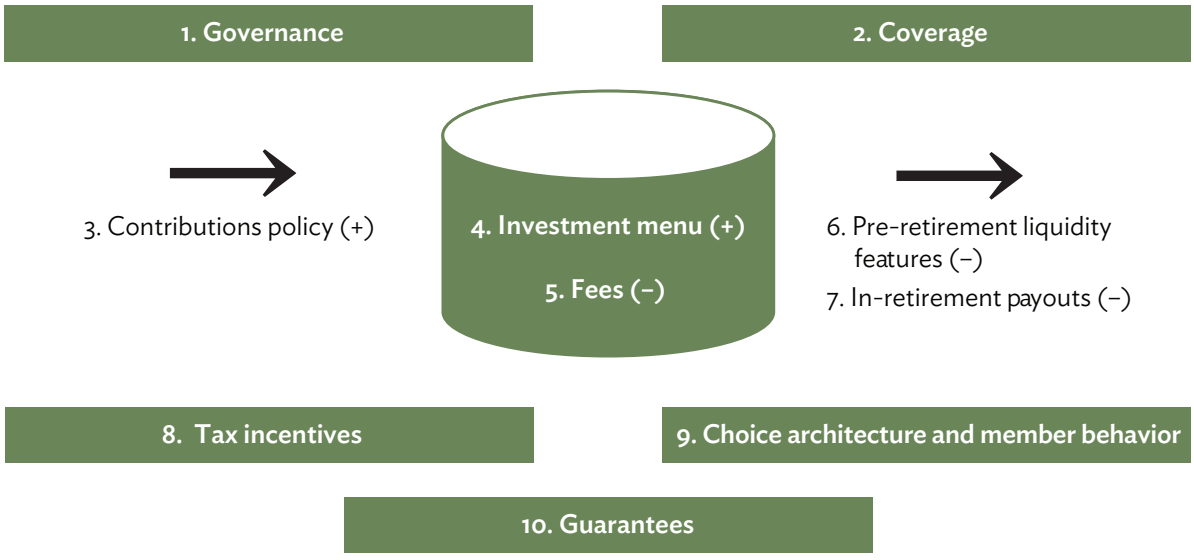
Systems that have capital markets at their centre have several additional benefits. Countries with funded pension system components are more likely to produce a larger pool of national savings, lowering the cost of capital. And they are more likely to have a broader investment base, which makes workers more productive. Worker productivity is the key to financing retirement security in these funded systems, whether they are DB or DC plans.

A 10-point framework has emerged as a way to think about the themes that are influencing DC systems. First, as Figure 2 shows, the question of governance and the legal authority associated with each entity in the programme, whether it's the employer, the employee, the service providers, or the government, must be determined. Second, the scope of the programme—its coverage—needs to be decided. Which workers will be covered? Will coverage be mandatory or voluntary? Third, the contributions policy will determine the amounts of contributions, and who is making them—the employee, the employer, or both. Fourth, the investment menu, and fifth, the associated fees will affect the assets accumulated in the plans. Plans may allow pre-retirement withdrawals or loans (the sixth feature),and then the design of retiree distributions and how to make those last throughout retirement must be spelled out (the seventh feature).

One of the fundamental questions in designing DC plan systems has to do with incentives. These can be economic incentives through the tax code (the eighth feature), or behaviorally motivated incentives based on framing and defaults (choice architecture, the ninth feature). Finally, a tenth theme, the question of guarantees, is pervasive in DC systems. Guarantees can be quite simple (for example, guaranteed investment options) or quite complex (for example, guaranteeing certain payout structures).

FIGURE 2

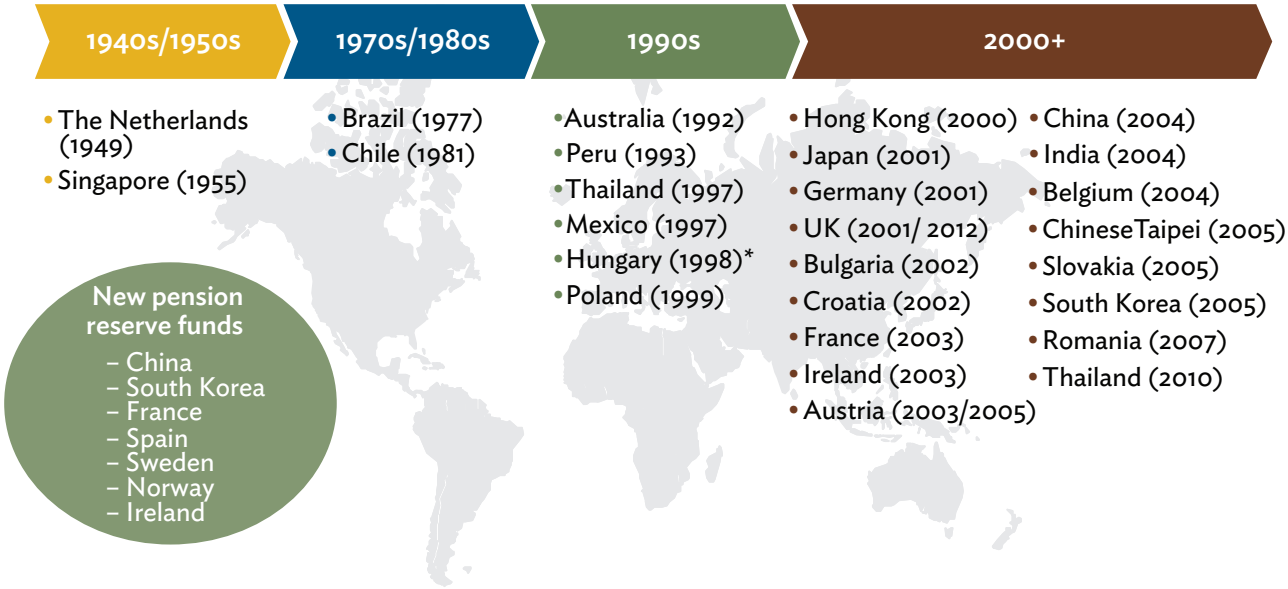
A 10-Point Design Framework for Funded DC Systems



Source: The Vanguard Group

FIGURE 3

Pension Reforms Around the World



**Factual nationalisation of DC pensions in 2010—pension contributions are turned into taxes and the bulk of the country's HUF2.7trn (€9.6bn) in second pillar pension assets will be returned to the state treasury.*
Source: Allianz Asset Management AG 2013, Project M

Trend Towards Individually Funded Pensions

Policymakers around the globe are examining the mix of individual and mandatory components in their retirement systems. Several decades of reform had led to a shift towards individually funded pension plans (see Figure 3); however, in the wake of the financial crisis, many systems have been rebalancing towards a stronger governmental role. Governments are not necessarily returning to pay-as-you-go (PAYGO) pensions, which face demographic pressures, but policymakers are discussing how to introduce semi-mandatory individual savings schemes with auto-enrolment mechanisms.

Reforms have been driven in large part by a desire to create sustainable pension systems, particularly social security–type pensions. Assessing the need for improvements in sustainability system wide requires consideration of:

» the dynamics of population aging,

» the pension reforms in place and the extent of the ongoing shift to funded pensions, and

» the legacy fiscal burden of the social security systems in place.

Using these dimensions to assess sustainability, countries can be ranked according to the likelihood that further reform will be needed. But sustainability is only part of the story; the issue of adequacy also is significant.

'The next stage is actually more policy reform and not necessarily more state intervention.'

Ángel Melguizo

In the shift to funded pension systems, it is important to determine if the funding rules will result in adequate retirement income. Many naively believed that capital markets would do more to help solve the problem, but asset returns in many countries have been below expected values. Increasingly, policymakers are examining funding requirements, but many retirees will have to continue working in retirement.

Sustainability is not the same as adequacy, and additional reforms are needed in many jurisdictions to attain adequacy. For example, as Figure 4 shows, Hong Kong's system is sustainable, but it ranks very low with respect to retirement income adequacy. On the other hand, Japan has a higher ranking for retirement income replacement, but has pressure for reform because of sustainability issues. Norway, Denmark, the Netherlands, and Sweden have the highest retirement income adequacy rankings and are maintaining sustainable systems, while Thailand, India, and China need to improve both sustainability and adequacy.

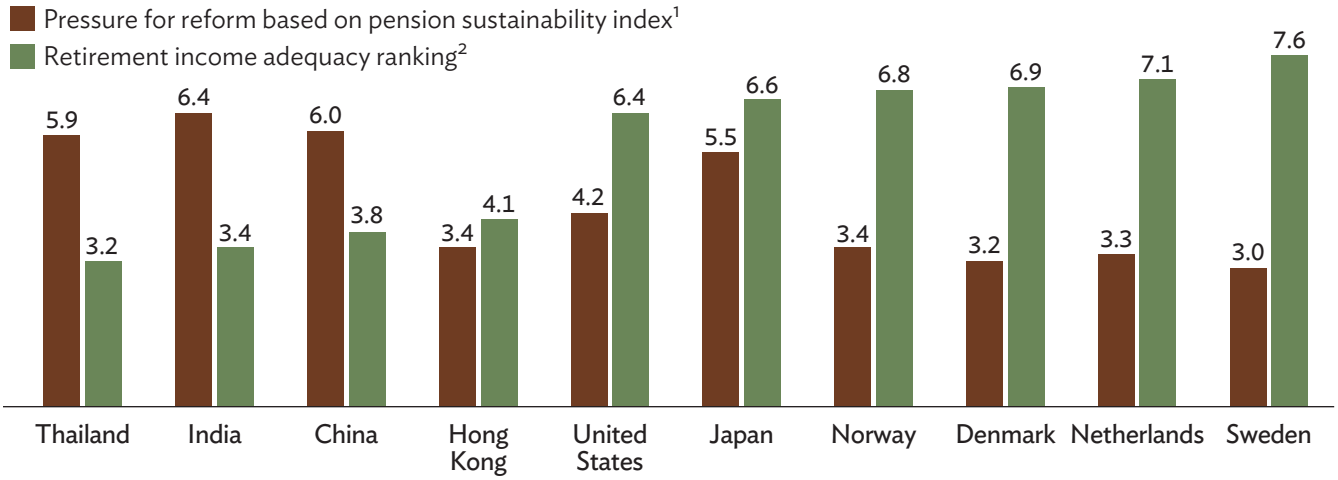
Insights into Activities in Latin America

Latin America suffers from a low percentage of retirees receiving pension income, which is a problem inherited from the past, and low pension coverage among current workers, which reveals a problem for the future. Across the region, an average of only 30 percent of older individuals receive pension income, while only 40 percent of current workers are contributing to any type of pension scheme. As Figure 5 shows, contribution rates range from less than 20 percent of workers contributing in Peru, Paraguay, Bolivia, Honduras, and Nicaragua, to about 70 percent of workers contributing in Uruguay and Costa Rica. A high level of informal employment in many Latin American countries is a big reason for this low pension coverage.

FIGURE 4

Adequacy and Sustainability Don't Always Go Together

October 2011



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

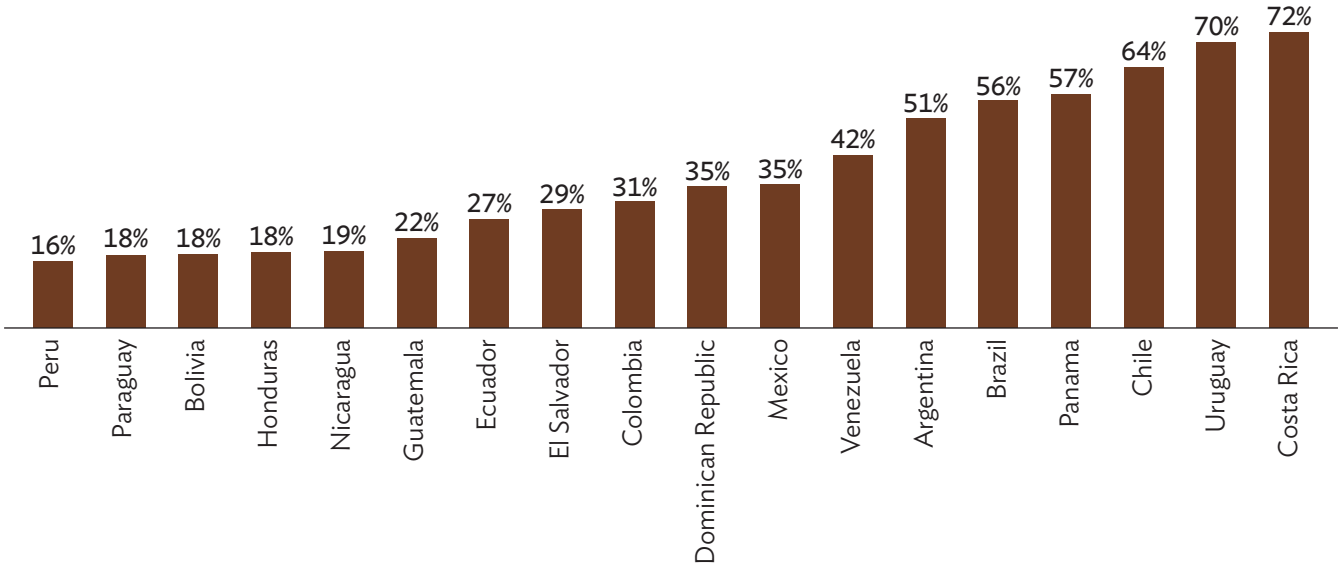
[2]*Scale from 1–10: 1=least adequate, 10=most adequate*

Source: Allianz Asset Management AG 2013, Project M

FIGURE 5

Most Latin American Workers Are Not Active Contributors to Pension Schemes

Pension contribution activity; percentage of workers (aged 15–64), 2010



Note: Includes workers who are still affiliated with a pension scheme although they may not be contributing.
Source: Inter-American Development Bank, Better Pensions, Better Jobs *(forthcoming)*

One Latin American trend, expanding old-age assistance programmes based on need rather than on contributions that the recipient made while working, has raised concerns. It is not clear whether this type of reform—which will require those working in the formal sector to contribute—will close the coverage gap, because many workers do not participate in the formal sector. There are questions about whether the countries can pay for these plans now, as well as questions about changing demographics and future costs, which may increase costs and reduce incentives for workers participating in the formal sector. The possibility that policymakers will change the plans also poses a political risk.

Low levels of pension coverage and contributions are a result of how the labour markets function in these countries. Pension coverage tends to be targeted at employees at large firms, while employees at smaller firms are less likely to have coverage. How to reach the informal workforce—the self-employed and workers without formal contracts—is an additional problem. Most pension schemes are targeted at the formal sector, which means that those in informal work arrangements, who often make up a majority of the workforce, are left out. For example, as shown in Figure 6, only about one-third of middle-class non-agricultural workers in Colombia, Mexico, and Peru work under a written contract. The two-thirds that have informal work arrangements need incentives to save for retirement.

'A lot of the governments are still toying with different initiatives.'

Yoon Ng

Matching contributions are an important plan innovation that is particularly well suited to address pension saving among the emerging middle class in Latin America. A key challenge in reaching middle-class workers is their tendency to work in the informal sector—that is without a formal contract and required social benefits (e.g., pension and health benefits). To allow those workers the opportunity to save for retirement, policymakers have begun to focus on the use of matching contributions—transfers from the government based on voluntary worker contributions into individual pension accounts. Matching contributions, which could be associated with informal-sector employment, would provide a financial incentive to help more middle-class workers save for retirement. It is important to create savings schemes that allow individuals to continue contributing and saving for the future whether they participate in formal or informal work arrangements, since many individuals move in and out of formal work arrangements throughout their careers.

Role of Private-Sector Asset Managers in the DC Market

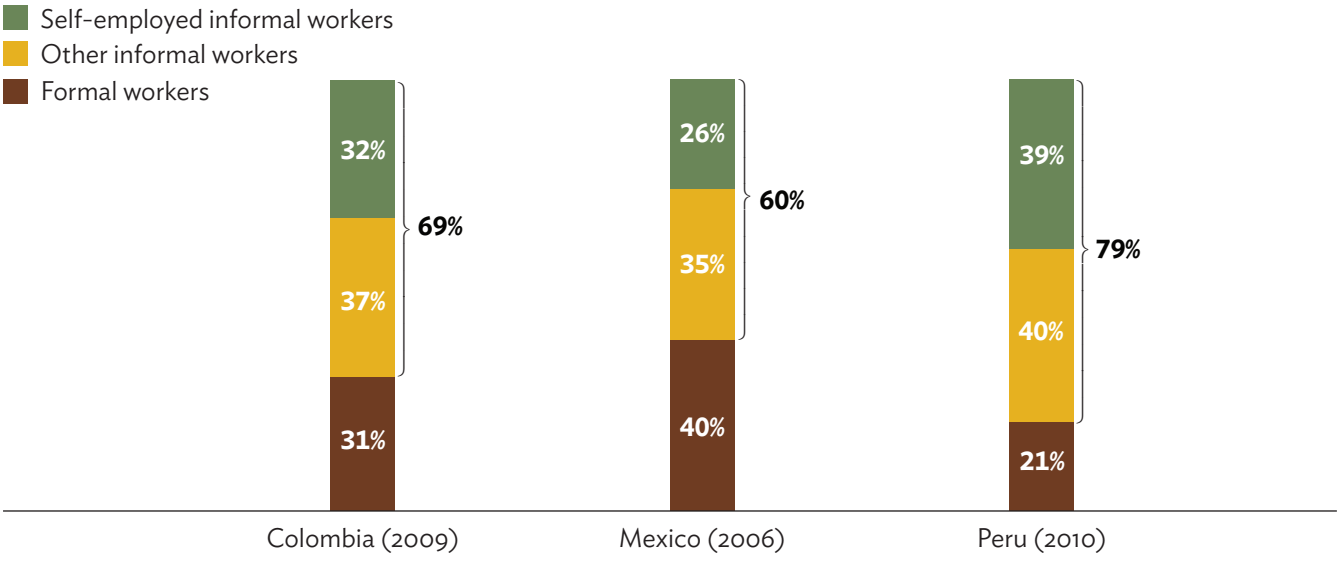
Though DC plans have become a significant share of pension assets in the United States, their penetration is much lower in other countries. In Europe, asset managers indicate that DB pension plans are their most important client segment. Worldwide, the DC pension transition has been slower and more concentrated than most people realise. As shown in Figure 7, Latin America represents the greatest growth opportunity, with DC plan assets projected to rise 21 percent on average per year over the next five years, compared with a 7 percent projected average annual growth rate for the United States and Europe, and a 10 percent average annual growth rate for Asia.

Asset managers wishing to service the DC plan markets in different countries face various challenges. Each country has a unique institutional framework and there is a wide array of DC plan designs and terminologies, including pure DC, collective DC, hybrid DC, DC Plus, and DC with guarantees. Even in

FIGURE 6

Informal Labour Arrangements Can Be Widespread in Latin America

Percentage of middle-class non-agricultural workers (aged 14–64)

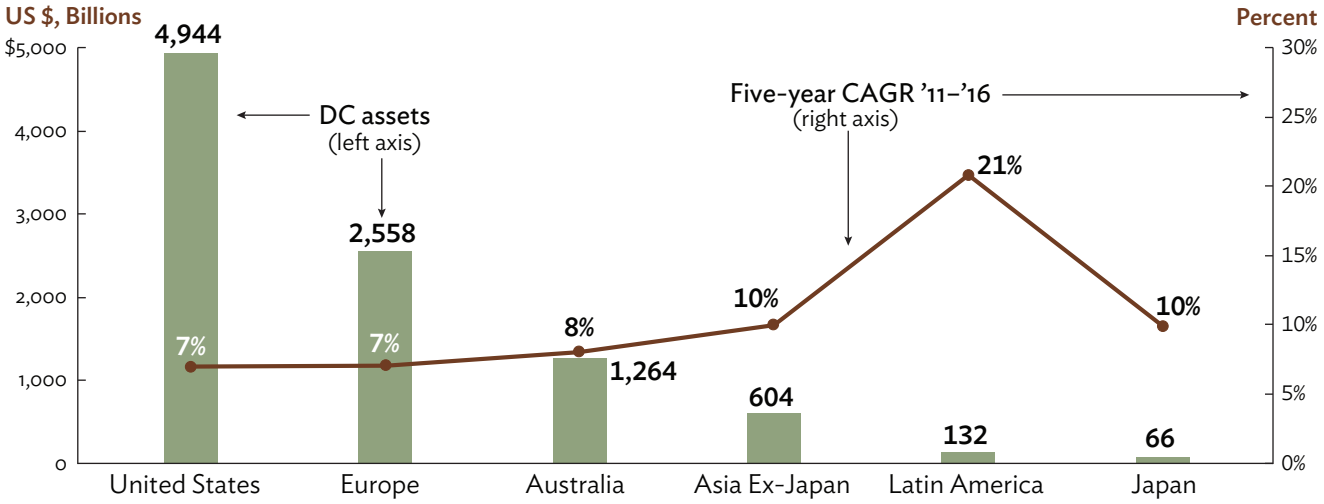


Note: Components may not add to the total because of rounding.
Source: Carranza, Melguizo, and Tuesta, 'Matching Contributions in Colombia, Mexico, and Peru: Experiences and Prospects', in Matching Contributions for Pensions *(The World Bank, 2013)*

FIGURE 7

Global Defined Contribution Assets and Projected Growth

Assets at year-end 2011; five-year compound annual growth rate (CAGR), projected 2011–2016



Source: Cerulli Global Defined Contribution Pensions 2012

the United States and Australia—the two most commonly talked-about DC examples because of their size, maturity, and sophistication—DC plans play different roles in the country's overall retirement planning and have significant differences. For example, in the United States, contributions to 401(k) plans are voluntary, while contributions to the superannuation system in Australia are mandated.

Entry of asset managers into the DC systems can be difficult in some jurisdictions. Governments may manage or limit the list of financial services providers that can be offered in the plans, or regulatory burdens may be high. Local recordkeepers have a home-court advantage and often offer affiliated funds. In some cases it is necessary to partner with a certain type of firm within the country—for example, an insurance company—to get a foothold into the DC business there.

Resources

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PANEL 2:

Characteristics, Opportunities, and Challenges of Defined Contribution Retirement Systems

PANELLISTS

Peter Brady, Moderator
Senior Economist
Investment Company Institute

Ross Jones
Deputy Chairman
Australian Prudential Regulation Authority

Bo Könberg
Chairman of the Board
Swedish Pensions Agency

Akiko Nomura
Senior Analyst
Nomura Institute of Capital Markets Research

Will Sandbrook
Director of Strategy, Research and Analysis
National Employment Savings Trust

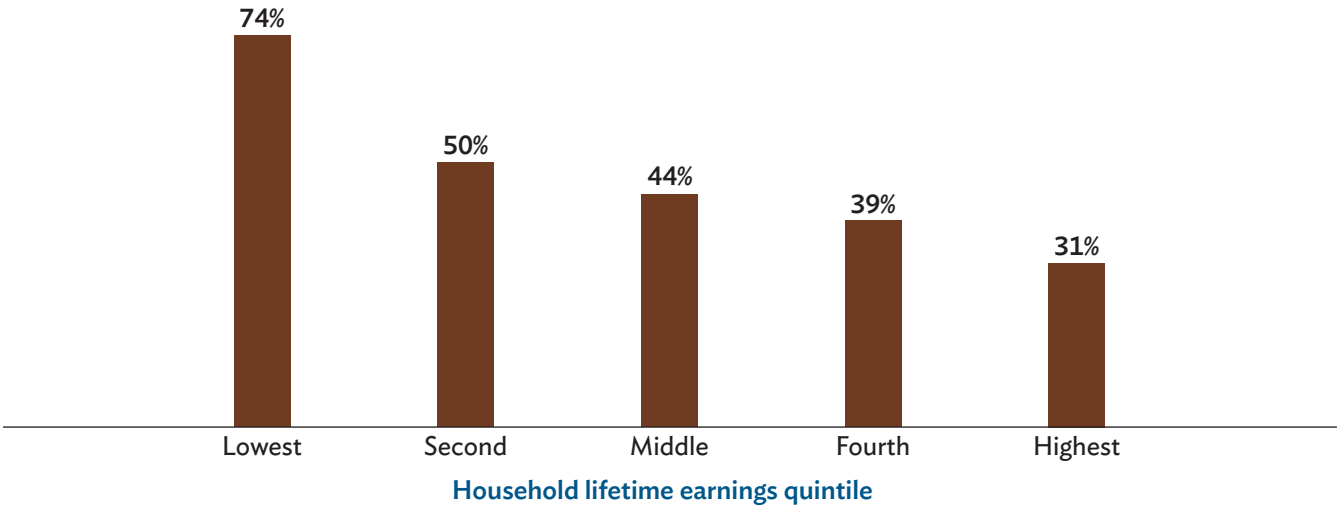
Although the role they play differs from country to country, defined contribution (DC) pension plans are now an important component of retirement systems around the globe. This session focused on the experiences of Australia, Japan, Sweden, the United Kingdom, and the United States. In all five countries, DC pensions have supplanted older defined benefit (DB) pension plans. In some countries, DC plans represent the primary contributory pension and are compulsory; in others, they supplement the primary pension and are voluntarily provided by employers. In compulsory systems, regulators increasingly are focused on fees and the design of investment options. This is in contrast with the experience in voluntary systems, where regulation has focused mainly on disclosure.

What follows are edited excerpts of the panellists' remarks.

FIGURE 1

US Social Security Benefit Formula Is Highly Progressive

Estimates of the median ratio of first-year benefits to average indexed earnings for individuals retiring at full retirement age by household lifetime earnings, 1940s birth cohort, percent*



**Full retirement age for the 1940s birth cohort ranged from age 65 years and 6 months to age 66 years. Beneficiary weighted average full retirement age is approximately age 65 years and 10 months. Relative to claiming at age 65, claiming at full retirement age would increase benefits by 5.9 percent for the 1940s cohort.*

Sources: Congressional Budget Office (see Congressional Budget Office 2012); Investment Company Institute, The Success of the US Retirement System

DC Plans' Role

In addition to universal benefits for the aged, which typically are funded using general revenue and for which eligibility is means-tested, each country has work-based contributory pensions.

In the United States, the mandatory work-based contributory pension is Social Security, a pay-as-you-go (PAYGO) DB pension. Payroll taxes of 12.4 percent are collected from current workers and are used to pay benefits to current retirees. Benefits are based on a worker's average monthly earnings, with benefits proportionally higher for workers with lower lifetime earnings (see Figure 1). Provided that payroll taxes and accumulated surpluses are sufficient to fund annual benefit payments, benefits can only be cut legislatively. DC plans are a part of the nation's voluntary employer-provided funded pension system, which provides resources to supplement Social Security benefits in retirement. Although most government workers continue to be covered by DB pensions, DC pensions are now the predominant type of employer-sponsored plan offered by private-sector employers.

'To understand private-sector pension provision in the United States, one must appreciate the role of Social Security. You get nearly a 75 percent replacement rate from Social Security for the bottom 20 percent of workers. It's really a pension plan for the lower-earning part of the workforce, and it provides substantial benefits for other employees.'

Peter Brady

'One of the most important aims, maybe the most important aim, of [Sweden's] pension working group in the beginning of the 1990s was to have a system that was sustainable during all the time we have the Baby Boomers with us.'

Bo Könberg

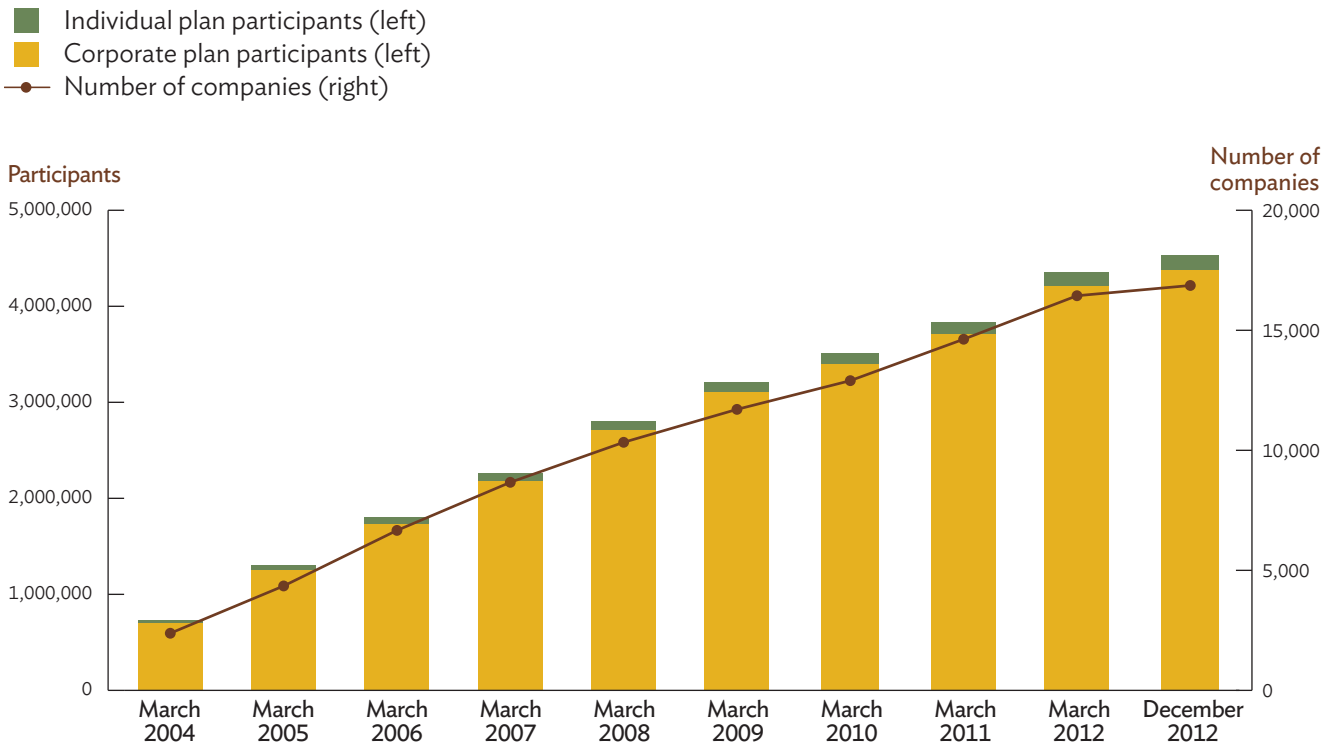
Japan's mandatory contributory pension is a PAYGO DB pension that is funded with payroll taxes of slightly less than 17 percent of total pay (scheduled to increase to 18.3 percent in 2017). Benefits pay a fixed percentage of a worker's average monthly earnings for each month worked (up to 40 years). In addition, employers can provide pension benefits voluntarily. Employer plans are predominantly DB, although DC plans have been growing rapidly since their introduction in 2001 (see Figure 2).

Sweden's mandatory contributory pension is primarily a PAYGO pension. However, reforms in the 1990s replaced the existing DB pension with a DC pension. The National Pension consists of a non-financial DC pension (NDC) and a financial DC pension (FDC). Payroll taxes of 16 percent are collected from current workers and are used, in combination with previously accumulated surpluses, to pay NDC benefits to current retirees (see Figure 3). Benefits are proportional to a worker's average earnings. However, benefits are adjusted automatically for both life expectancy and economic growth, enabling the system to remain solvent without increasing payroll taxes. The FDC portion of the National Pension is a funded pension. Contributions of 2.5 percent of earnings are contributed to FDC individual accounts, with investments chosen by workers. For 90 percent of workers, another 4.5 percent of earnings are contributed to occupational pensions, which also have changed from DB plans to DC plans.

FIGURE 2

Role of Defined Contribution Plans in the Japanese Retirement System

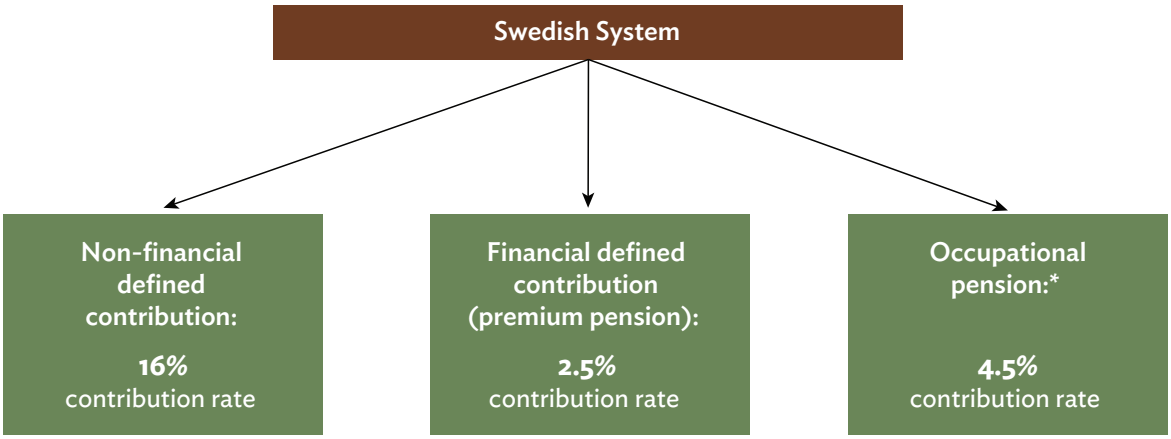
March 2004–December 2012



Sources: Japan Ministry of Health, Labour, and Welfare; Nomura Institute of Capital Markets Research

FIGURE 3

The Swedish System Is a Defined Contribution System



**Ninety percent of employees have an occupational pension.*
Source: Swedish Pensions Agency

In the United Kingdom, 2012 reforms have increased the prominence of DC plans. The compulsory PAYGO government pension was changed to a flat benefit, increasing benefits for workers with lower lifetime earnings and reducing benefits for workers with higher lifetime earnings. Formerly voluntary employer-provided pensions were made mandatory, with compulsory employer contributions on behalf of participating employees. Over time, contributions for participants will increase to 8 percent, with 5 percent coming from employees and 3 percent from employers. The vast majority of enrolments are expected to be into DC individual accounts. In these arrangements, employers choose the financial services provider and employees choose among the investment choices offered.

In Australia, the mandatory contributory pension—the Superannuation Guarantee—is a funded system, requiring 9 percent as of June 2013 (scheduled to increase incrementally to reach 12 percent in 2019) of salary paid on behalf of each worker. Although employers can choose to use these contributions to fund a DB pension, about 90 percent of the contributions go into DC plans. DC plan contributions are invested in superannuation funds

'Members can choose whichever fund they like. However, if they make no choice, then the employer will choose for them, and effectively it will be a default.'

Ross Jones

'[One feature of DC plans] is having your assets in an individual account that has nothing to do with the health of your employer, even in the extreme case of bankruptcy. This has proved to be an important DC feature in the Japanese context.'

Akiko Nomura

provided by a licensed trustee. Each fund offers multiple investment options. Employers nominate one superannuation fund for their employees, with one of the investment options designated as the default investment. Employees can choose to invest in the fund nominated by their employer, or in any other approved fund. In addition to mandated contributions, workers also can make voluntary contributions to superannuation funds.

Shift from DB Plans

In all five countries, DC plans have largely supplanted an older system of DB plans. In the United States, private-sector employers have moved from primarily offering funded DB plans to primarily offering funded DC plans. In Sweden, the National Pension has become a PAYGO DC plan, with a smaller, supplemental funded DC plan. In addition, employer-provided pensions have largely moved to DC plans. In Australia, which previously did not have a mandated contributory pension, the mandatory Superannuation Guarantee replaced a system of voluntary employer-provided pensions that were largely DB plans (see Figure 4). In Japan, changing workforce demographics and slow economic growth have made employer-provided DB plans increasingly unsustainable. The United Kingdom has experienced a drop in the share of employees covered by DB plans in the voluntary employer-provided pension system, with no commensurate increase in DC plan coverage (see Figure 5). The country's mandated pension provision was adopted to reverse this reduction in pension coverage, with the expectation that new coverage would come from DC plans.

FIGURE 4

The Three Pillars of the Australian Retirement Income Policy

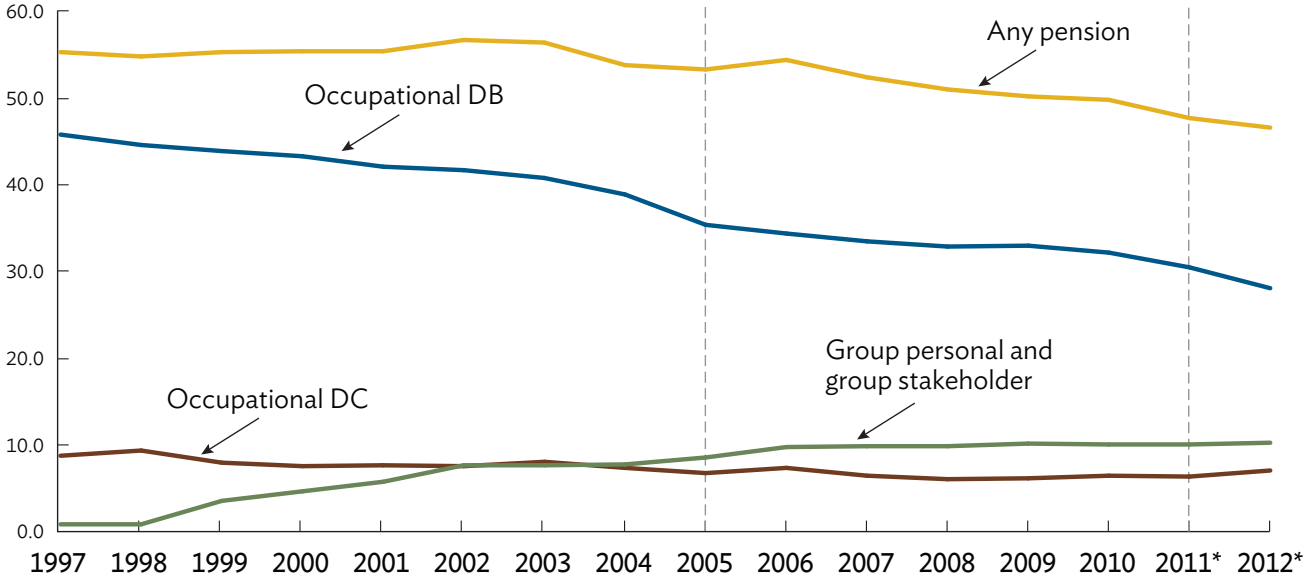
	Age pension	Superannuation Guarantee	Voluntary additional superannuation and other savings
Funded by	Government funded	Compulsory employer contributions	Additional contributions encouraged by tax concessions and government co-contributions
Level of benefit	Flat means-tested benefit; maximum benefit is 27% of national average earnings if single, 42% for a couple	9% of salary payable to fund chosen by employee (or default fund); planned increase to 12% in 2019	Depends on contribution election
Coverage	Universal	Employees	Voluntary

Source: Australian Prudential Regulation Authority

FIGURE 5

Trends over Time in United Kingdom Pillar Two Pensions

Percentage of workers, 1997–2012



Note: Results for 2005 onwards are based on a new questionnaire and may not be comparable with earlier results.
**ASHE estimates for 2011 onwards are based on the 2010 Standard Occupational Classification (SOC).*
Source: Annual Survey of Hours and Earnings *(ASHE), Office for National Statistics, United Kingdom*

Affect of Mandates on the Market

Countries that have DC plans as part of a mandatory system realise that the mandate changes the nature of the market.

The fact that employers provide retirement plans voluntarily in the United States is likely the primary reason why American pension regulators historically have focused on disclosure in an attempt to ensure that market participants have access to all relevant information. Rather than directly regulating fees or financial product design, regulators typically have relied on competition between financial services firms to reduce costs. And in the US pension system, employers play a pivotal role. Employers decide if they offer a plan; they choose the design of the plan and the investment options; and they select pension plan service providers. Because the plan is an important part of the overall compensation package used to attract and retain employees, the employer has every incentive to offer a well-designed, low-cost plan. Employers also have market power, in that they have the option not to offer a plan if they feel the costs outweigh the benefits.

'I think we expect to see almost complete reversal of the decline in participation. I think we'll get coverage rates back up to where they were, probably actually higher than they have ever been in pillar two.'

Will Sandbrook

'NEST, as a pension fund, came about in recognition of the fact that if we were going to make all employers enroll all their workers in a pension fund, there had to be at least one fund there for them to use, and that it couldn't say no to any employer. And it is really very much designed for those sectors of the market that haven't had good access.'

Will Sandbrook

When employers face a mandate to offer a plan, employers and employees lack market power, so regulators in mandatory systems have focused on protecting them from high fees. For example, the United Kingdom's National Employment Savings Trust (NEST) system was specifically set up to ensure that employees of all types had access to a plan. In Sweden, the pension agency is the central clearinghouse for all investment options—a design chosen in part to minimize the cost of investments. Employers typically have had the primary role of choosing investment options and investment defaults in Australia. This changed when 2012 legislation collectively known as 'Stronger Super' was passed. The legislation was motivated by the impression that fees were too high and that fund choice on its own did not produce a competitive market that reduced costs. The legislation requires regulators to set standards and issue regulations for data and payments (with the goal of reducing back-office expenses), mandates new disclosures on investment options, and limits the types of fees that can be charged. In addition, the legislation creates 'MySuper' products—investments that, regardless of provider, meet criteria set forth in the legislation and associated regulations on diversification, services, and fees—and requires that funds use one of these products as the default investment option.

Financial Literacy

Financial literacy and the engagement of individual investors are important for the success of self-directed accounts. If individuals are given the freedom to choose investments, it is important that they are capable of making the proper choices in managing their accounts.

In the United States, employers have played an important role in educating employees about their savings and investment options. Employers also choose among a number of investment options to create a menu of investment choices that they feel is appropriate for their employees, and choose the default investment option for participants who do not make a choice. In addition, plan sponsors and investment providers have asked regulators to remove any unnecessary barriers preventing financial services firms from providing more financial education to plan participants.

In Japan, DC providers are required by law to provide financial education.

In Australia, the concern that participants may not be actively engaged in the compulsory system contributed to its adoption of the Stronger Super legislation. This legislation implied that the choice of default investment was too important to leave completely to employers.

Resources

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'When there is a mandate, it's not really a market. If you mandate that everyone needs to buy blue t-shirts, then the price of blue t-shirts has to be regulated in some manner.'

Peter Brady

Changes Necessary for the Second Pillar of Hong Kong's Retirement Savings Structure

The Honourable Anna Wu Hung-yuk
Chairman, Hong Kong Mandatory Provident Fund Schemes Authority

As the twenty-first century approached, Hong Kong established a key component of its approach to retirement saving: a mandatory, privately managed, and fully funded contribution system known as the Mandatory Provident Fund (MPF). The system launched in December 2000 with nearly 200,000 employers participating. As of June 2013, the MPF system accounted for 70 percent of Hong Kong's 3.7 million workers.

Chairman Wu acknowledged the system's accomplishments while explaining that it must evolve if it is to play an important role in providing retirement security for the working population of Hong Kong. She examined three issues in particular: the adequacy of retirement protection, fees and investment returns, and administrative complexity.

What follows are edited excerpts of Chairman Wu's remarks.

Issue One: The Adequacy of Retirement Protection in Hong Kong

The adequacy issue has at least three aspects: coverage, interaction with other retirement protection measures, and leakage.

COVERAGE

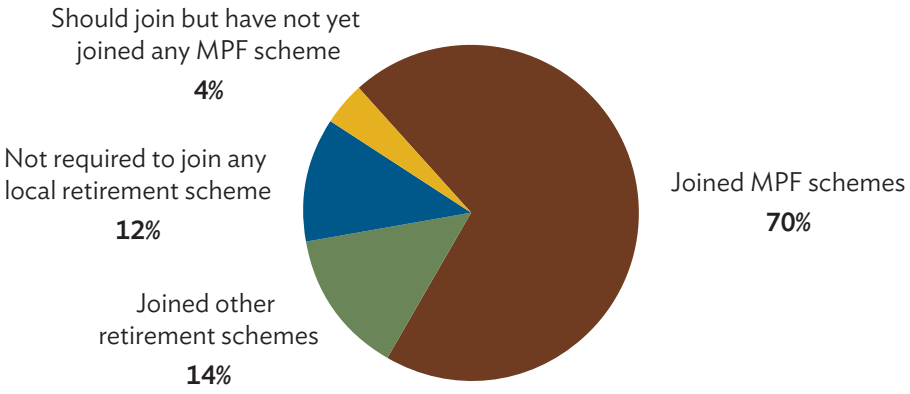
A measure of success of the Mandatory Provident Fund (MPF) system is that coverage has nearly tripled. Before the system was launched, only about 30 percent of employed persons had any form of pension coverage. Now, 84 percent of employed persons have some form of formal coverage (see Figure 1).

Nevertheless, the Mandatory Provident Fund Schemes Authority (MPFA) recognises that the contribution rate is low. Contribution rates are set at 5 percent for members and another 5 percent from employers, with the total monthly contribution cap set at HK$2,500 (about US$320). This contribution rate should be viewed against the backdrop of a citizenry unfamiliar with the concept of retirement and social security. At the time of the MPF's creation, the primary social safety net was family support, and there was employer resistance over higher personnel cost concerns.

FIGURE 1

Hong Kong Employed Population by Type of Retirement Schemes

As of June 2013



Source: Mandatory Provident Fund Schemes Authority

INTERACTION WITH OTHER RETIREMENT PROTECTION MEASURES

The MPF system was established as the second pillar of retirement protection under the World Bank's three-pillar retirement protection approach published in 1994. Hong Kong has a comprehensive social security assistance scheme as its first pillar of retirement protection, while its third pillar comprises voluntary personal savings and insurance. The three pillars are supposed to work together to provide sufficient retirement protection for any individual in the community. By design, the employment-based MPF—with contribution amounts set as a percentage of an individual's income—cannot, and was never intended to, cover those who are not employed. Some retirement protection is nevertheless available from the other pillars.

LEAKAGE

The third aspect involved in the issue of MPF adequacy is leakage. Generally speaking, pre-retirement withdrawal of MPF benefits is allowed only under very limited circumstances, such as when the member is totally incapacitated, or the member does not intend to work anymore and their benefit amounts are very small.

The Hong Kong system has what might be construed by some as a troublesome feature—referred to as an offsetting arrangement—that may give rise to serious benefit leakage from the system. In specified situations, such as when a worker is laid off or made redundant, Hong Kong employment law requires the employer to make certain payments (known as severance payments or long-service payments) to the employee. The offsetting arrangement allows benefits derived from employer's contributions

to be withdrawn by the employer from the employee's MPF account to make up for these required severance payments. The current chief executive of the Hong Kong Special Administrative Region does recognise this leakage issue, but also recognises that abolishing the offsetting arrangement would increase the operational cost for employers. Some argue that the increase for small- and medium-sized businesses could be so significant that their operations would no longer be financially viable.

Issue Two: Fees and Investment Returns

'Our ultimate goal is, of course, to give full control back to the employees over all of their benefits. We hope to make the system more employee-driven and more responsive to employee needs.'

Another area of vigorous debate involves the fees and investment returns of the MPF. Initially, disclosure of fees and charges was quite rudimentary, but in 2004 the MPFA implemented a comprehensive disclosure regime. For comparative purposes, the MPFA has developed a very simple but comprehensive fee indicator called the fund expense ratio (FER). Scheme administration, investment management fees, and charges and expenses are included in the FER.

FEE CHALLENGES

Over the past five years, the FER has declined from 2.1 percent to 1.72 percent of assets. Although the fees have been falling, the general sentiment about these fees is that they are still too high, particularly when compared with overseas pension systems. However, there is no simple comparison of fee levels among pension systems in the world, because both the systems and the fee structures and charging mechanisms are different. The MPFA's focus is to bring fees down.

STEPS FOR IMPROVEMENT

Last year, the MPFA commissioned a study to identify improvements that could lead to additional cost savings. Currently, the MPFA is following up on the recommendations, such as encouraging members to merge multiple accounts into one. The MPFA also is requiring trustees to automate scheme administration further, to provide at least one low-fee fund under each MPF scheme, and to consider eliminating less-efficient schemes and funds.

Since last year, employees have been provided with more control over MPF investments through the employee choice arrangement (ECA). When the MPF system was launched, it gave the right to choose MPF schemes for employees to employers. ECA enables employees to transfer the MPF benefits derived from their mandatory contributions in the employer-chosen scheme to an employee-chosen scheme, at least once per calendar year.

The MPFA's ultimate goal is to give employees full control of all of their benefits. The MPFA hopes to make the system more employee-driven and more responsive to employee needs. However, this will take some time, particularly with the offsetting arrangements still in place.

Employers want control over the investment of their contributions to accounts, because each dollar that the MPF system earns affects the amount of benefits available for offsetting. At a minimum, employers need to know where the money is. Some additional infrastructure for benefit tracing is required.

The Hong Kong government has invited the MPFA to map out the implementation of full portability by early 2016. The MPFA is now conducting a study of the costs involved in setting up systems to facilitate the implementation of full portability.

INVESTMENT RISK AND FINANCIAL LITERACY

An issue that continues to cause a lot of concern is the level of investment risk in the system. The equity content of the MPF system is extremely high, which means that volatility also is extremely high. In addition, MPF participants may not have the financial literacy to fully understand the choices they are making and the potential consequences. To facilitate employee choice, to achieve greater efficiency, and to reduce volatility, the MPFA is now investigating whether and how a standardized low-cost default investment arrangement could be structured for all the MPF schemes.

Issue Three: Administrative Complexity

The administration of the MPF involves many steps and processes that are detailed in a statute. Simplifying and streamlining administration would benefit members and operators, and help reduce cost. The MPFA has been working on legislative amendments to simplify the system.

The MPFA is working towards a recommendation to use electronic means for enrolment, contributions, and transfers among the schemes. Because the MPF system covers a wide spectrum of employees and employers, it is quite challenging to move members and employers away from paper-based transactions to paperless ones. Some employees may not be computer literate—there is computer illiteracy in much of the senior generations in Hong Kong—and some smaller employers in Hong Kong do not use computers at all for their business transactions. The MPFA would need to consider an appropriate paperless means to fit this uneven landscape.

Conclusion: Remaining Static Is Not an Option

Overall, this ambitious social programme has achieved its objectives of providing greater retirement protection for the Hong Kong working population. This was the result of three decades of hard work to secure a retirement protection scheme for the working public in Hong Kong.

This is the right juncture to reflect on the objectives of the retirement system and to consider making longer-term changes for the next phase of the system development. If a difference is to be made in the life of the working population in Hong Kong, remaining static is simply not an option.

'If we are to make a difference to the retirement life of the working population in Hong Kong, remaining static is simply not an option.'

Resources

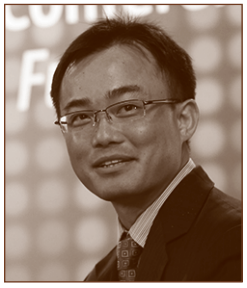
Hong Kong Mandatory Provident Fund Schemes Authority. Available at www.mpfa.org.hk.

PANEL 3:
The Role of Investment Funds in Retirement Savings

PANELLISTS

Philip Lin, Moderator
Vice President and Director of North Asia Region
T. Rowe Price International

Michael Falcon
Managing Director and Head of Retirement
J.P. Morgan Asset Management



Andy Lin
Chief Executive Officer
China Universal Asset Management Co., Ltd.

Pauline Vamos
Chief Executive Officer
Association of Superannuation Funds of Australia

Across the globe, investment funds such as mutual funds are playing a significant and expanding role in helping retirement savers prepare for the future. This role springs from the key advantages that investment funds broadly offer investors: diversification, transparency, professional management, cost efficiencies, and a wide range of investor protections that are embedded into a robust regulatory framework.

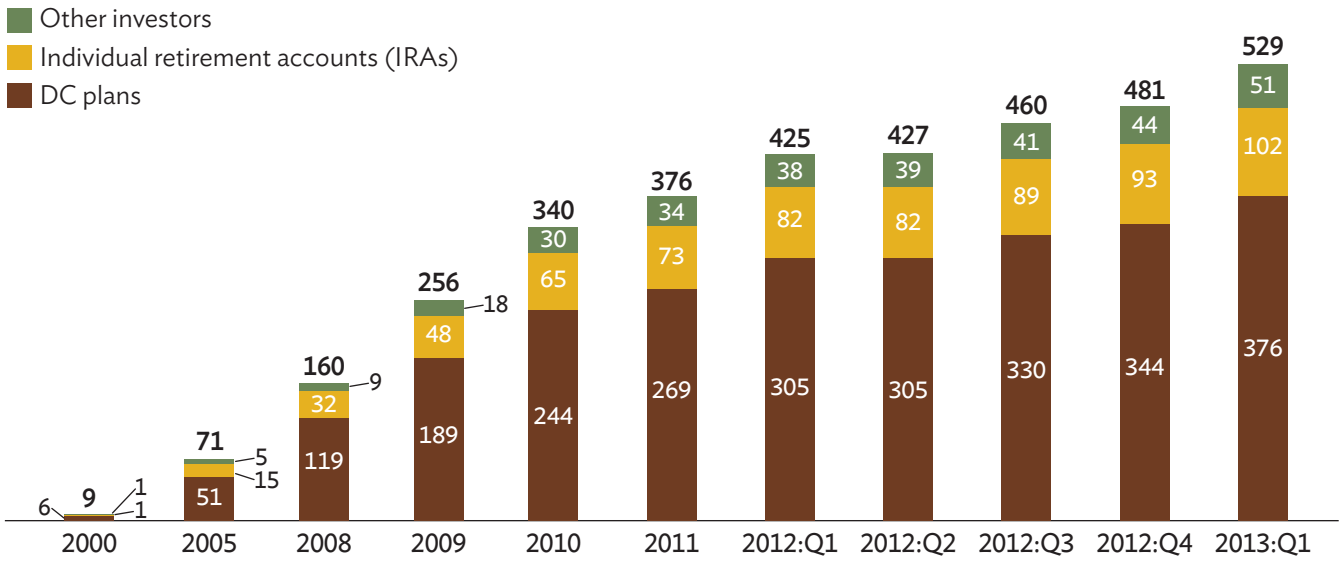
Naturally, the role of investment funds in retirement saving will not be identical in every country, given varying approaches to retirement policies. The needs arising in a public, compulsory defined contribution (DC) system like that of Australia or Hong Kong, for example, may differ considerably from those in a private, voluntary arrangement, such as the US 401(k) system.

What follows are edited excerpts of the panellists' remarks.

FIGURE 1

Target Date Mutual Fund Assets

Billions of US dollars, end-of-period, selected periods



Note: Components may not add to the total because of rounding.
Source: Investment Company Institute

Innovating to Meet Investor Needs

Innovation is a key aspect of funds' service to investors. Australia's superannuation system is an example. Under the country's superannuation law, as of July 2013, Australian employers will pay 9.25 percent of a participant's salary into a 'super' fund held by that participant to accumulate retirement assets. Also in July 2013, Australian funds will begin to offer MySuper, a new, simple, and cost-effective superannuation product that will replace existing default products. Funds choosing to offer MySuper must offer a product with a single investment strategy and a standard set of fees available to all prospective members.

Investors benefit from innovative investment options, such as target date funds. Target date funds are made up of a mix of asset classes, professionally designed and managed, and rebalanced to become more conservative as the investor ages. Choices like target date funds—which feature a disciplined approach that helps investors take a long-term view and avoid the emotion-driven trap of buying high and selling low—are increasingly popular, becoming one of the fastest-growing asset classes in the US fund industry. Target date funds have grown to become a $529 billion mutual fund investment category in the United States, with DC plans holding a majority of that total (see Figure 1). By 2020, forecasts indicate, target date funds will account for 40 percent of assets in US DC plans, up from roughly 10 percent today. Key factors in this growth include low fees, ease of use by plans and participants, and the establishment of target date funds as a default investment option for retirement plans offering auto-enrolment features.

'Funds play a crucial role in more multiproduct investment solutions.'

Michael Falcon

'A target date fund is age appropriate and rebalances the asset allocation along with the approaching retirement age.'

Philip Lin

'We are starting to see a real focus on cost, and that means a much more intelligent way of investing.'

Pauline Vamos

Providing Choice and Flexibility

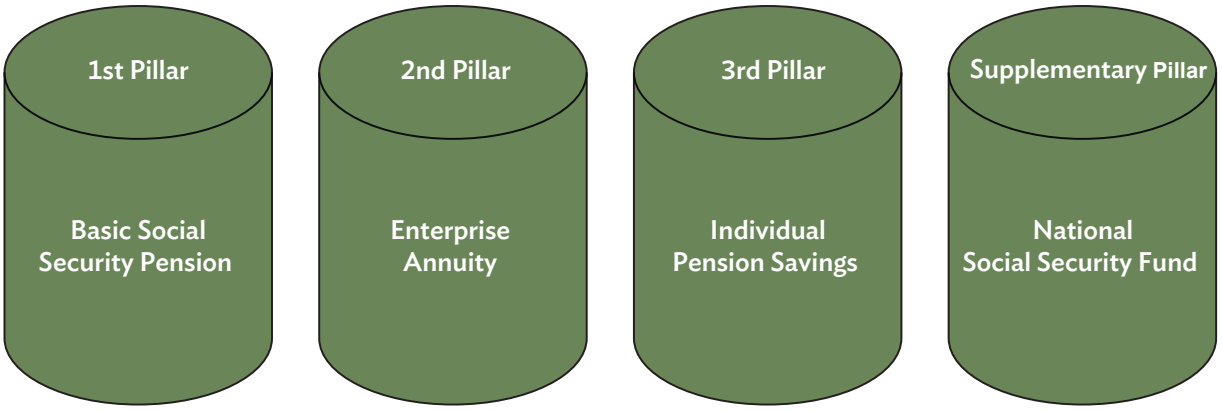
Funds can provide choice and flexibility for investors. Though products such as target date funds provide a convenient and sensible default option for many retirement savers, others may want investment solutions that are more tailored to their needs. For example, Australian superannuation investors can choose from a variety of portfolio types—balanced growth, high growth, and so on—as well as portfolios concentrated in a single asset class, such as cash or equities. This enables financial planners to build a portfolio to suit individual clients. Funds also help satisfy investor appetite in other contexts, such as socially responsible investing. Younger Australian shareholders in particular want transparency so they can be sure that their assets are invested in companies that maintain sound labour or environmental practices, for example, and funds are responding to this desire.

Rising to New Challenges

Funds will be a key tool for policymakers as they contend with massive demographic shifts and other challenges in the coming decades. The experience of China, where the aging population is facing a pension liability problem, illustrates these challenges. China's pension system remains in its infancy relative to those of many other countries. In 1997, the country began a shift from a one-pillar, state-provided pension approach to a multipillar approach that includes a pay-as-you-go (PAYGO) social security system, a DC system known as an enterprise annuity, and individual pension savings (see Figure 2). The urgency of these and other retirement savings challenges has pushed pension reform to the top of the agenda for the new Chinese government. Though it's hard to say what role funds will play in the resolution of the country's retirement savings problems, they certainly will be considered as part of the solution.

FIGURE 2

Key Pillars of the Chinese Pension System



Source: China Universal Asset Management

Resources

Association of Superannuation Funds of Australia (ASFA). Available at www.superannuation.asn.au.

J.P. Morgan Asset Management. 2012. *Observations and Thoughts: From the 2012 J.P. Morgan Retirement Symposium*. Available at www.jpmretirementsymposium.com/pdf/observations_thoughts.pdf.

Target Retirement Date Funds Resource Center. Investment Company Institute. Available at www.ici.org/trdf.

'China is a country that is aging very quickly, and that has a tremendous problem of pension debt.'

Andy Lin

PANEL 4:

Governance of Retirement Systems and Investment Fund Regulatory Oversight

PANELLISTS

Susan Gordon, Moderator
Partner
Deacons

Michel Canta
Deputy Superintendent of Private Administrators of Pension Funds and Insurance
Superintendency of Banking and Insurance, Peru

George Ding
Chief Executive Officer
HuaAn Funds, HuaAn Asset Management, Ltd.

Darren McShane
Executive Director, Regulatory and Policy
Mandatory Provident Fund Schemes Authority, Hong Kong

Fund companies must be aware of the regulatory environment, oversight issues, and potential roadblocks relating to the use of investment funds in the countries where they seek to market their products. They also need to appreciate that the regulatory constraints imposed on their products largely stem from the political and social economic pressures that regulators face when structuring or making changes to national pension systems.

Globally, funds can play a role in the retirement savings evolution by creating products responsive to social and economic pressures, in addition to other concerns driving changes in the various systems. They also must continue to help individuals saving for retirement by educating them on the power and importance of retirement savings, as well as the methods for achieving and maintaining adequate retirement savings.

What follows are edited excerpts of the panellists' remarks.

Investment Choice Considerations

Too many investment choices can raise concerns. In designing defined contribution (DC) systems, system sponsors must select the array of investment options available to participants. Though members in DC systems generally bear most of the investment risk for their investment choices, too much choice can actually foster 'bad habits' and create more risk for investors. For example, the regulatory authority is concerned that the 469 funds available through Hong Kong's Mandatory Provident Fund (MPF) system are too many for a fairly small system like Hong Kong's, confusing members and causing them to chase results as they hunt to find the best fund in the system.

The large number of funds offered through the Hong Kong MPF system creates a skewed attitude towards risk, because most of the new funds added to the system are higher-risk mixed-asset or equity funds. Consequently, members have an average asset allocation of more than 60 percent in equities, which is not an appropriate weighting for many of them. Members have told administrators, 'This is too hard for me, so I'll have a bit of everything'. Fewer choices might lead to a more balanced approach to investing.

These issues are beginning to drive the thinking of the regulatory community in Hong Kong, where regulators are focusing on default arrangements that reduce the complexity and range of choice while lowering fees. The Mandatory Provident Fund Schemes Authority (MPFA) is looking at whether—and how—a standardised, low-cost default investment arrangement could be structured for all schemes. Regulators believe that low fees would encourage members to use the default arrangement, reducing risk and the potential for negative outcomes over the long term.

Too few choices can limit growth. While the regulators of Hong Kong's MPF system are looking at narrowing the range of investment choices, other more historically prescriptive systems are looking at expanding—to a small degree—the number of funds available.

Latin American pension systems have received considerable criticism for high fees and weak competition. Some governments in the region have taken steps to lower fees, including eliminating certain fixed fees or fees on contributions that fund managers can collect, in an effort to better align the interests of the managers with the goals of the system.

Pension funds in Latin America have slowly begun to broaden the investments offered, a new approach for a region where investments had been relatively limited. Some countries also have expanded the range of investment options available to workers to better match their risk tolerance and lifecycle stage. In Peru, for example, new funds offered include lifecycle funds, as well as funds that include alternative assets, options, derivatives, and new financial investments focused on infrastructure, product development, and concessions.

Context drives investor behavior—and fund offerings. The investment management industry must respond to socioeconomic conditions in regions and

'The most obvious of those bad habits involves chasing short-term performance information from the past to try to pick the best funds.'

Darren McShane

'Investment product sponsors make products that are simple for people, and help them understand the benefit of having a pension.'

Michel Canta

individual countries by providing products that are relevant to investors' needs and regulatory requirements. For example, the lack of a broad-based social security system in China has led the Chinese people to focus on saving, and the fund industry has an opportunity to respond by offering a range of low-cost investments that fit conditions facing investors and regulators.

Pension Reform and Coverage

Socioeconomic changes in Latin America, particularly in Peru, Chile, and Mexico, have led to reforms intended to respond to the challenges faced by the systems there. Maturing pension systems face ongoing policy challenges related to coverage, contribution rates, costs, and competition. Major restructuring in the Chilean system and significant reforms in Mexico and Peru have included efforts to expand system coverage, reduce fees, increase competition, broaden investments, examine the impact of gender on benefits, and focus on the importance of financial education.

Coverage is a primary concern in Latin America. For example, coverage of the economic labour force is only 14 percent in Peru and 28 percent in Mexico (see Figure 1). Regulators in the region generally are disappointed that rates of coverage have not improved—in fact, they have declined since the move to a DC structure, given its reliance on coverage through formal employment in a region where employment in the informal sector remains pervasive and persistent. Improving coverage rates remains one of the primary challenges for policy reform in the region.

In the context of coverage, regulators in Latin America are examining how pension reform affects men and women differently. Because women tend to earn less than men, and spend more time outside the formal labour force in caregiving activities, their coverage rates and pension benefits have been lower. Mexican and Chilean reform efforts have sought to remedy this gender differential by introducing a basic social pension and solidarity pension contribution pillar.

FIGURE 1

Pension Fund Assets Relative to Gross Domestic Product

March 2013

Country	Pension fund assets/GDP[1] *(Percent)*	Pension fund assets *(Millions of US dollars)*	Fees[2] *(Percent)*	Coverage *(Contributors/Economic labour force; percent)*[3]
Peru	19.1%	$38,744	0.63%	14%
Chile	61.1%	$168,906	0.61%	63%
Mexico	20.4%	$237,404	0.62%	28%

[1] *GDP data are as of December 2012.*

[2] *Fee data are reported by the International Organisation of Pension Supervisors.*

[3] *Coverage data are as of December 2012.*

Sources: Comisión Nacional del Sistema de Ahorro para el Retiro; Denise Gomez Hernandez and Fiona Stewart. 2008. Comparison of Costs and Fees in Countries with Private Defined Contribution Pension Systems.

Regulators in the region also recognise the importance of financial education as a critical component of pension reform. Many individuals lack the basic knowledge necessary to make good investment decisions and need to be provided educational materials to guide them through decisions in the system.

Until recently in China, most pension participation has focused on the public sector, covering mostly civil servants and urban residents. Observers are optimistic, however, that the Chinese saving culture can be expanded into one that focuses on retirement investment rather than just bank saving, though Chinese policymakers are debating the best way to achieve this. Even under the communist system, there are opportunities for a compromise between a top-down, mandated model at the national level and the ability to offer millions of prospective retirees an approach based on the DC plan model.

Resources

Hernandez, Denise Gomez, and Fiona Stewart. 2008. *Comparison of Costs and Fees in Countries with Private Defined Contribution Pension Systems*. Working Paper, no. 6 (June) Paris, France: International Organisation of Pension Supervisors. Available at www.oecd.org/site/iops/41269747.pdf.

Hong Kong Mandatory Provident Fund Schemes Authority. Available at www.mpfa.org.hk.

'If you look at the bank savings ratio in China, it's at 50 percent. And if you ask why that is, I think it is very simply that the traditional three-prong approach in terms of the retirement savings is just not there. I mean, two legs are missing.'

George Ding

Conference Programme

DAY 1 | WEDNESDAY, 26 JUNE

DINNER EVENT

Welcoming Remarks

Dan Waters
Managing Director
ICI Global

Dinner Speaker

Paul Schott Stevens
President and CEO
Investment Company Institute

Dinner sponsored by:

DAY 2 | THURSDAY, 27 JUNE

NETWORKING BREAKFAST

Welcoming Remarks

Dan Waters
Managing Director
ICI Global

KEYNOTE SPEECH

Restructuring Retirement Systems for Resiliency in an Aging World

Olivia S. Mitchell
International Foundation of Employee Benefit Plans Professor
Professor of Insurance / Risk Management, Business Economics / Public Policy
Director of the Pension Research Council, The Wharton School, University of Pennsylvania

PANEL 1

The State of Pension Provision Around the Globe

Panellists discuss the state of pension provision, changes and reforms to pension systems, and the growth of defined contribution systems.

Stephen P. Utkus, Moderator
Principal
Vanguard Center for Retirement Research

Ángel Melguizo
Lead Specialist
Labour Markets and Social Security Unit
Inter-American Development Bank

Brigitte Miksa
Head of International Pensions
Allianz Asset Management AG

Yoon Ng
Associate Director
Cerulli Associates

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PANEL 2

Characteristics, Opportunities, and Challenges of Defined Contribution Retirement Systems

Panellists from selected countries identify the key features of their defined contribution systems and the opportunities and challenges faced in implementing such systems.

Peter Brady, Moderator
Senior Economist
Investment Company Institute

Ross Jones
Deputy Chairman
Australian Prudential Regulation Authority

Bo Könberg
Chairman of the Board
Swedish Pensions Agency

Akiko Nomura
Senior Analyst
Nomura Institute of Capital Markets Research

Will Sandbrook
Director of Strategy, Research and Analysis
National Employment Savings Trust

LUNCHEON AND SPEAKER

The Honourable Anna Wu Hung-yuk
Chairman
Hong Kong Mandatory Provident Fund Schemes Authority

Lunch sponsored by:

PANEL 3

The Role of Investment Funds in Retirement Savings

Panellists discuss how investment funds are uniquely positioned to serve investors in defined contribution systems.

Philip Lin, Moderator
Vice President and Director of North Asia Region
T. Rowe Price International

Michael Falcon
Managing Director and Head of Retirement
J.P. Morgan Asset Management

Andy Lin
Chief Executive Officer
China Universal Asset Management Co., Ltd.

Pauline Vamos
Chief Executive Officer
Association of Superannuation Funds of Australia

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PANEL 4

Governance of Retirement Systems and Investment Fund Regulatory Oversight

Panellists discuss the regulatory environment, oversight issues, and potential roadblocks relating to the use of investment funds in retirement systems in selected countries.

Susan Gordon, Moderator
Partner
Deacons

Michel Canta
Deputy Superintendent of Private Administrators of Pension Funds and Insurance Superintendency of Banking and Insurance, Peru

George Ding
Chief Executive Officer
HuaAn Funds, HuaAn Asset Management, Ltd.

Darren McShane
Executive Director, Regulatory and Policy
Mandatory Provident Fund Schemes Authority, Hong Kong

NETWORKING RECEPTION

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IN THE NEWS:
The 2013 Global Retirement Savings Conference

A variety of media covered ICI Global's 2013 Global Retirement Savings Conference, including several mainland China publications, two Hong Kong radio networks, *Investment & Pensions Europe,* and *Ignites Asia*. Below is a sample of the coverage.

- 'Global Experts Weigh Up Asia's Pension Challenge', *Investment & Pensions Asia,* 28 June 2013
- 'Hong Kong's MPF Authority Eyeing Default Option, Alternatives to Lump-Sum Payouts', *Pensions & Investments,* 1 July 2013
- 'Investment Funds Key to Retirement: ICI Global', *Ignites Asia*, 2 July 2013
- 'HK MPF Members Pick Up Bad Habits Post-Choice Regime', *Ignites Asia,* 2 July 2013
- '"No Chance" of MPF Self-Directed Accounts Any Time Soon', *Asian Investor,* 3 July 2013
- 'A Call to Action: Slow Growth Not Good Enough for China's Needs', *Asia Asset Manager,* August 2013
- 'Global Funds Have More Work to Do as Part of This Retirement Savings Evolution', *Investment & Pensions Europe*, 2 September 2013
- 'Happenings', *Benefits and Compensation International,* September 2013

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