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Tackling the Common, Complex Problems of Pension Systems

Tackling the Common, Complex Problems of Pension Systems
By Paul Schott Stevens
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The pressure on pension systems shows no sign of relenting. Even before the financial crisis, both governmental and employer-based retirement plans were struggling to cope with longer life expectancies, funding challenges and fiscal pressures. An extended period of slow economic growth and low interest rates since the crisis have only exacerbated the challenges, for all types of schemes – pay as you go, defined benefit and defined contribution.

Coping with those challenges demands the best thinking and cooperation from all sectors. That is why ICI Global – the worldwide voice of regulated investment funds – recently brought together regulators, academics and fund industry retirement experts in Geneva for its second Global Retirement Savings Conference. More than 20 experts from 12 countries on five continents shared knowledge and insights about pension reforms around the world.

In particular, they addressed the challenges of investor attitudes and financial education, the role of a wide variety of default products in helping workers reach their retirement goals and the means to deliver sustainable incomes when workers become retirees, and drawdown of assets replaces accumulation.

What did we learn? I took away three overarching themes. First, pension systems are complex – and must be considered in all of their complexity. As one speaker put it, pensions are “so special, so important, so individual, so complex”. In every country, retirement provision has been shaped by social relationships, labour-force structures and economic and cultural factors. Most systems are composed of interlocking, overlapping programmes designed to deal with different sectors of the population and different social needs. Any assessment of a system’s adequacy in providing retirement security must take into account all of those elements. As a result, pension reform requires widespread social commitment and strong political leadership – unfortunately, all too often in short supply.

Second, the movement toward defined contribution options continues apace – with no evidence that it will stop. Country after country is experimenting with DC models, whether voluntary or mandatory, to supplement or replace older systems. As Pablo Antolin-Nicolas, head of the private pensions unit at the Organisation for Economic Cooperation and

Development (OECD) explained in his keynote address, the experience of these countries highlights key principles – the need for coherent and efficient design to deliver adequacy in resources – for others to follow.

Regulated funds can play a vital role in these emerging DC systems. Funds provide diversified access to a wide range of markets in a transparent product with comprehensive investor protections. Investment through funds also benefits economies, fostering the development of financial markets and providing a flexible source of capital to businesses and governments. And in many retirement systems, funds have led the way to innovations, including target-date funds, that have simplified and strengthened investing.

The third theme is that DC systems, new and old, face a common set of concerns. They need to maximise participation – particularly in voluntary schemes – and increase contribution levels to ensure workers are saving at the optimal level. And they need innovative measures to harness market forces – especially in mandatory schemes – to create strong incentives to reduce costs.

In each case, one key to addressing these concerns is simplicity in design of pension schemes. Tim Jones, chief executive of the UK's National Employment Savings Trust Corporation (NEST), challenged industry participants to make pension systems clearer, less intimidating and more appealing to average citizens. Retirement savings plans should provide a reliable, clearly understandable product without requiring a deep understanding of finance – just as carmakers sell an automobile without bombarding drivers on the details of engine design.

A fourth conclusion: dialogue on these issues is vitally important. As Solange Berstein, former head of the Pension Supervisory Authority in Chile, told our conference: "We still have a lot to do – but, in retirement policy, we always still have a lot to do."

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