Into Thin Air: Global Trends in Pension Reforms - Issues for New Zealand

Retirement Policy & Research Centre – University of Auckland

David O. Harris
Managing Director
TOR Financial Consulting Limited

Auckland, New Zealand

5 April 2018
Themes for the Presentation

• Broad Issues and Macroeconomic Insights
• Ageing & Cognition Issues
• Product Design Development
• Global Considerations
  • Australia
  • Ireland
  • The United Kingdom
  • Denmark and Sweden
• Self-care and Financial Wellness
• Insights for New Zealand
Broad Issues and Macroeconomic Insights

• Globally: ‘More people are worried about living too long than dying too soon’ – generational shift
• Ageing populations – baby boom nations USA, Canada, Australia and New Zealand
• Since 2007/Global Financial Crisis (GFC) has generated historically low interest rates
  • Some Anglo Saxon countries have seen investors remain in cash/missing equity uplift
• Regulatory co-operation and information sharing/reciprocation – OECD (IOSCO) & (IOPS)
• Greater levels of political, security and economic uncertainties
• Generational disparities – Baby Boomers and Millennials: Shirley Turkle MIT – Connected, but Alone?
• Financial Literacy Challenges - XXXX
• Artificial Intelligence and Big Data – understanding the customer
• Customers becoming ‘more demanding, less loyal and much more willing to complain’
• On-line real time engagement – 24 hour cycle
• More connected economies and cities – Brexit and Political Uncertainties – USA/Russia/EU/China
• Difficulty with home ownership – encouragement and engineering
• More complex generational transfers of assets across a spectrum of family members – legal issues: The Pinch
• Higher rates of divorce, later in life > Housing purchase impacts, insurance and retirement
• THE AGE OF UNCERTAINTY – GROWS
Ageing and Cognition

Lack of sleep, poor diet, no exercise and stress – prolonged poor lives

Cognition decline after 60 - 1% p.a.

Democratization of insurance and investment risk

10,000 US retirees every week

1 million new middle class in Asia

Old World and New World of Market Conduct for the elderly and the infirmed

Abandonment of traditional insurance businesses in mature markets - capital adequacy e.g., Australia and the UK

Responsive regulation for an ageing society

Financial Friendship

Financial Advice  Tell and Sell
Financial Guidance  Click and Stick
Financial Information
Product Developments

- Bespoke for specific customer needs
- Meeting and anticipating Long Term Care Needs - Mastertrusts
- Blending of accumulation and retirement solutions
- Smashing together of drawdown, insurance and annuity products
- Investment, Insurance and default fund solutions becoming more focused on by regulators
- Transparent fees and charges – insurance and retirement products blending
- Set and Forget Investments and Insurance – Financial Friendship
- Rise and rise of platform and tools based solutions
- Interwoven with mobile and iCloud technologies
- Shorter periods for the repricing of risk products
- Affinity groups or brands with product sales e.g. Airlines and Life Insurance
- Growth in equity release or reverse mortgages as a retirement/risk income supplement
Australian Snapshot

• Move to compulsion 1987 and 1992 – formation of industry funds and EBCs becoming product manufacturers

• Differing political treatment and considerations for superannuation – $2.6 trillion AUM

• Individual Discretionary Portfolio Services (IDPS) and Mastertrust Growth – promoted platforms

• 9.5% employer contributions increasing to 12% by 2025 (starting in 2021) + 3% voluntary contributions
  • Strong growth in Profit for Member – Industry Funds/Overtaking Retail Funds
  • Fee compression through the development MySuper – Default Fund
  • Insurance – Total Permanent Disability (TPD) plus additional opt in units. Also in salary continuance (unemployment)

• Eligible Rollover Funds for the Lost or Inactive Accounts (6 million in the system)

• TTE – Taxation Approach and SMSFs – containment/governance worries
## Types of Australian Funds Numbers & $ Assets

<table>
<thead>
<tr>
<th>Types of Funds</th>
<th>NO</th>
<th>$ assets b</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2006</td>
<td>2012</td>
</tr>
<tr>
<td>Corporate (2600 in 1990)</td>
<td>1000 (approx.)</td>
<td>119</td>
</tr>
<tr>
<td>Industry</td>
<td>56</td>
<td>44</td>
</tr>
<tr>
<td>Public</td>
<td>1000 (approx.)</td>
<td>38</td>
</tr>
<tr>
<td>Retail (Big 4 Banks)</td>
<td>131</td>
<td>128</td>
</tr>
<tr>
<td>Small (Trustee Companies)</td>
<td>6665</td>
<td>3242</td>
</tr>
<tr>
<td>Self Managed</td>
<td>250,000</td>
<td>500,000</td>
</tr>
</tbody>
</table>
Overview of the Market – Major Elements

- Big Four Banks - Dominated retail superannuation market but have sold out of insurance and in some cases asset management/superannuation
- KiwiSaver in NZ dominated by Australian banks – Royal Commission into Financial Services
- Insurance – AIG/Japanese insurers and Zurich
- Major shakeup and sell off – AMP only life insurer left in the market
  - Large losses in Group Insurance Book
- EBC product manufacturing – Mercer, AON and Russell Investments
- Continued growth in Self Managed Super – Accountant Driven
Retirement Income Considerations

• Cash Lump Sum for Small Superannuation Accounts – reduce debt, repairs and replace white goods
• Allocated Pensions/Drawdown Products – continued to be popular
• Strong growth in Traditional Annuities – 2008 Global Financial Crisis
• Comprehensive Income Products for Retirement (CIPRs) – Group Basis/Government Review
• Government commitment to sustainable/flexible retirement income savings – Deferred Annuities and Tax Changes
• Need for retention of members – Industry Funds developing retirement income solutions
Australian Investment Insights

• Diversified Growth Funds shaped by tax advantages of Australian Equities – franking credits
• Target Dated Funds – haven’t been embraced in the same way as in the US and to a lesser extent the UK
• Investment growth apart from the Global Financial Crisis – no economic recession
• Strong growth in Alternative Investments – Infrastructure: Airports/Toll Roads and King’s Cross Redevelopment – IFM
• Around 20% Australian superannuation assets invested abroad
• Choice of Fund and Investment – over 80% embraces the default option
• No price capping – greater levels of innovation against a backdrop of a low interest rates
Ireland – State of Play

• A Roadmap for Pensions Reform: 2018–2023
  • Favoured Auto Enrolment considerations – NZ Experiences
  • Political and Pension Policy considerations
  • Overarching roadmap – First Pillar, Defined Benefit and Workplace solutions
  • Four models being discussed – Role of the State – Hub/Administration, Investments, Governance and Workplace considerations
  • Coverage and contribution levels > tax incentives to Auto-Enrolment
  • Consultation process begins in June 2018 – New Zealand’s experience is under the microscope
  • State vs Private Sector – level playing field
  • Future of Defined Benefit Schemes and the Sustainability of the First Pillar
  • Recycle and reuse the existing financial services infrastructure
  • Higher rate tax relief – future considerations and purpose in an AE system
  • Government confined policy – UK and OECD input
  • Retirement incomes – annuities and ARFs
One of the sharpest increases in the OECD of employee and employer contributions

* 1% to 3% for employees April 6th 2018 > 3% to 5% April 6 2019

* 1% to 2% for employers – 2% to 3% – same period

Impact on opt out rates and the fiscal impact for the UK economy – Brexit

- Measure of success – ‘close your eyes and hope’
- Cost containment – charges
- Strong growth in mastertrust membership > compression of life insurance providers

Collective Defined Contribution (CDC)

- Royal Mail experiences with closure of defined benefit schemes
- Minimising democratisation of risk – less transparent/government legislative responses

Governance considerations for Trustees – IGC/Independence

Pension freedoms (liberty) – ongoing challenges of soft compulsion and move towards transfers – BSPS > ‘sausage and chips IFA meetings’ – Political and Pension policy colliding – slow regulatory response

NEST Loan – 1.8% contribution charge/0.3% ongoing management fee – continued loan growth – 2026 GBP 1.2 billion
Denmark, Sweden and The Netherlands

- Denmark – first pillar means tested pension and compulsory, second pillar occupational pension contributions and the third pillar – voluntary, tax incentivised pensions
- Dashboard development – complete, overarching solution
- Sweden – allowing part of the first pillar to be converted into NDC/PAYG – wide array of investment options. State constructed payment and collection hubs
- Occupational pension – 3% /3% employee and employer white and blue collar pension hubs – move to defined contribution solutions
- Self employed – tax incentivised third pillar – industry sponsored dashboards
- The Netherlands > sharp move away from DB solutions – CDC – Pure DC solutions
- Cross Border solutions for multinational corporations and the movement of their staff – reflecting pension benefits
- PAYG, DB pensions vs DC Anglo Saxon model: France and Germany/United States/Australia
The Growth in the concept of Self-care

- Self supporting and sustaining for medical, long-term and pension issues
- Tax incentives – targeting those who are frugal are rely less on the State
- Tax equity Basis/Government Review
- Social contract
- Growth in social media and cynicism in centralised government, in some cases
- Prolonged lack of engagement with welfare mechanisms and structures
- Financial and General Health Wellbeing
- Differentiation for Men vs Women – retirement and long term care > The Pinch
And specifically... Self-care

Financial Wellness ➔ Member engagement
Education
Guidance ➔ Execution/purchase of financial products
Enhanced contributions

HEALTH IS WEALTH
What I worry about

Indebtedness
Health of me and loved ones
Elderly care – Industry fund contribution
Education for my children
Retirement choices and decisions
Housing – affordability/bank or borrow
Give me a confidence boost or a Financial Friend
Generational and Gender differences
For New Zealand

• Lack of political will and appetite for necessary pension reforms
  • Using some of the PM’s political capital

• Regulatory alignment and fragmented policy development

• Harnessing complex retirement income and fiscal modelling – academic outreach

• Housing and Long Term Care pressures on pension policy

• Lifting contribution rates and actively minimising opt out rates

• Global pension policy trends – insights and lessons for NZ – things to admire and improve

• Pension reform is not a sprint but a marathon – needs a finish line

• Self-care and Financial Wellness – Millennials and engagement with the workplace
And for the Retirement Policy & Research Centre ...Continue!

“Success is Not Final, Failure is Not Fatal. It is the courage to continue that counts.”

Winston S. Churchill – Prime Minister, United Kingdom
Into Thin Air: Global Trends in Pension Reforms - Issues for New Zealand

Retirement Policy & Research Centre – University of Auckland

David O. Harris
Managing Director
TOR Financial Consulting Limited

Auckland, New Zealand

5 April 2018