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BRIDGING ASIA'S PENSION GAP

In 2009, the Asian Development Bank published a working paper titled, "Ageing Asia's Looming Pension Crisis". While countries have undertaken pension reforms since, the pace has been slow. Some of the biggest challenges include raising the retirement age and lowering the benefits. The need for asset managers to fill the gap with income-oriented solutions is becoming more critical than ever.

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Recent OECD data exposes a wide discrepancy in pension adequacy levels across Asia. For some countries, it is a question of balancing adequacy versus sustainability, while others do not even have well-running pension systems. With Asia ageing rapidly, there is an urgent need to establish adequate pension schemes. Falling fertility and mortality rates, declining extended family support, large rural populations, technological advancements and changing work habits are worsening this issue.

A BALANCING ACT

Every policy maker aspires to find the right balance between sustainability and adequacy. Sustainability refers to financial (i.e. sufficient assets to back the liabilities) and economic (i.e. long-term growth to finance the projected liabilities). Adequacy in turn must withstand longevity and inflation risks.

Asian pension schemes range from basic, minimum, social assistance (termed as Tier 1) to defined benefit (DBs) and defined contribution (DCs). Tier 1 provides the first layer of protection for retirees and elderly. DBs and DCs, which are mandatory earnings-related, pensions, fall into Tier 2. With a DC plan, the employee and employer contribute monthly to a retirement account while for DB the sponsors pay retirees a pension income, as a function of their salary, length of employment etc.

Both Tier 2 plans have pros and cons; DBs remove the burden of investment decisions for beneficiaries but risk becoming bankrupt if underfunded while DCs provide the flexibility in investing but require knowledge and expertise.

Instead of choosing one, there is a growing recognition globally to use a multi-pronged approach to address the pension gaps.

From Fig 1, we can observe the following: a) Japan's working population shoulders the highest burden of supporting the seniors; b) seniors in Korea, Japan and Singapore are expected to live longer in retirement, putting further pressure on the pension schemes, c) the gross replacement rates, showing pension benefit as a share of individual lifetime average earnings, vary greatly across Asia and are based on average income earners; d) the gender-based inequalities for replacement rates are due to women having earlier retirement ages in some countries and/or lower pre-retirement incomes than men.

Fig 2 depicts the results of the Mercer Global Pension index based on three sub-indices; the adequacy sub-index (@40% weighting) represents current benefits and system design features; the sustainability sub-index (@35% weighting) looks at future ability to provide these benefits and the integrity sub-index (@25% weighting) measures the overall governance of the system.

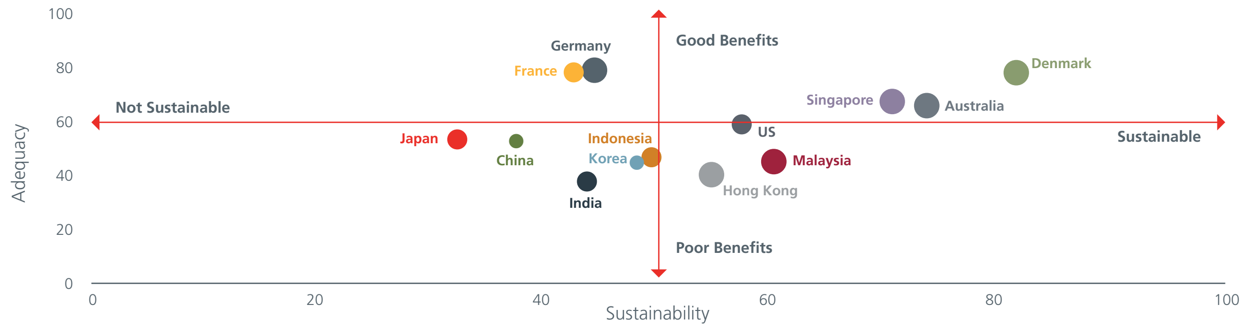
It appears that most Asian pension systems are not providing an adequate retirement income for retirees. There are also doubts on the sustainability of several. Like any other study, the results of

Fig. 1. Asia Pacific's key pension indicators at a glance[1]

Countries	Type of Pension		Population aged ≥ 65 as a % of working-age population	Life Expectancy Pension Age Gap (yrs)	Gross Pension Replacement Rates (%)		Coverage of mandatory pension schemes (%)	
	Tier 1	Tier 2			Men	Women	Population aged 15-64	Labour force
Australia	B	DC	23.7	17.5	32.2	29.4	69.7	90.7
China		DC	14.8	16.4	76.0	65.1	39.7	51.2
Hong Kong		DC	22.6	19.7	42.2	38.2	52.4	70.7
India		DB/DC	9.0	8.8	87.4	83.1	5.5	9.1
Indonesia	M	DC	7.9	11.4	62.1	57.8	13.1	17.8
Japan	B	DB/DC	45.0	22.1	34.6	34.6	75.0	95.4
Korea	SA	DB	19.2	22.6	39.3	39.3	54.2	79.9
Malaysia	SA	DC	9.1	15.5	69.4	64.1	33.5	46.0
Philippines	B, M	DB	7.6	9.2	71.9	71.9	19.0	27.3
Singapore		DC	17.9	20.9	53.1	47.3	49.6	61.2
Thailand	SA	DB	15.9	15.5	37.5	37.5	28.6	35.9
Vietnam	M, SA	DB	10.2	16.5	75.0	75.0	19.2	21.9
OECD	Combination		25.8	15.3	52.9	52.3	64.7	85.7

B: Basic, M: Minimum, SA: Social Assistance, DB: Defined Benefit, DC: Defined Contribution, OECD : Organisation for Economic Cooperation and Development.
DB and DC are typically public - the exceptions are Hong Kong and Australia where the DCs are private. Working age defined as 15 - 64.
Life Expectancy Pension Gap = Life Expectancy (at birth as at 2017) - Retirement Age Retirement Age used is based on data for men as most countries adopt same across gender with exception of Vietnam and China.
Coverage of mandatory pensions data is based on latest available data for respective countries

Fig. 2. Mercer Global Pension Index - Adequacy, Sustainability and Integrity of pension systems[2]



Note: Size of bubble indicates integrity; the bigger the size, the higher the integrity score.

the Mercer index can provide some insight on the current state of play but not necessarily an accurate comparison; each country has to deal with a distinct set of economic and social dynamics. It does however highlight the shortcomings of each system and provide an impetus for countries to improve. The good news is that many countries have shown improved scores over the years.

KEY CHALLENGES

Several measures can be undertaken to increase the retirement income adequacy in Asia. These include raising contributions and retirement age, providing incentives to improve participation, increasing the coverage of mandatory pension schemes, designing schemes that have fair redistribution elements and adopting an equitable gender-based pension payouts.

Of all the above measures, the biggest challenge is extending the pension coverage. According to OECD estimates, only 26% of Asia's working age population and 35% of the labour force are enrolled in a pension plan, compared to an average of 65% and 86% respectively for the 34 OECD countries.

Asia is home to large rural populations, making the informal sector a big player. Efforts to close the coverage gap for this group of people revolve around the eligibility and the type of pension scheme i.e. contributory or non-contributory. For non-contributory schemes to be successful, trust in the system is critical.

Gender-based inequality is another big issue. As per Fig 1, the replacement rates for women are typically lower. Moreover, women on average live longer than men which means the older elderly will be disproportionately female. It thus becomes essential to increase their benefits.

As policy issues take time, fixing Asia's pension adequacy gap via regulation will be a slow ongoing process. A faster approach perhaps could be to look at ways to improve the returns on pension assets.

ASIA'S GROWING MARKET SHARE

The world's 300 largest pension funds account for 44% of the total global pension market. Of this 300, Asia Pacific makes up the second largest share of 27.3%. North America boasts the largest at 42.3% while Europe has 26.5%. Even more notable is that 7 Asia Pacific pension funds are part of the top 20 of this list (Fig 3). Emerging markets have also become more visible in the rankings in recent years, with the Employees' Provident Fund (India) a new entrant into the top 20 in 2017.

Despite the growing pension assets, estimates done by the World Economic Forum[3] suggest that an individual's savings rates in most countries fall short of the recommended amount needed to support a reasonable level of income in retirement. Worse still, this savings "shortfall" is expected to widen due to increasing life expectancy.

Fig. 3. Top 20 of the world's 300 largest pension funds[4]

Fund	Country	Region	Assets (USD bil)
Government Pension Investment	Japan	Asia Pacific	1,444
Government Pension Fund	Norway	Europe	1,063
National Pension	South Korea	Asia Pacific	583
Federal Retirement Thrift	US	North America	531
ABP	Netherlands	Europe	495
National Social Society	China	Asia Pacific	457
California Public Employess	US	North America	337
Canada Pension	Canada*	North America	283
Central Provident Fund	Singapore	Asia Pacific	269
PFZW	Netherlands*	Europe	236
Californial State Teachers	US	North America	216
Local Government Officials	Japan	Asia Pacific	210
New York State Common	US	North America	201
Employees Provident Fund	Malaysia	Asia Pacific	200
New York City Retirement	US	North America	190
Florida State Board	US	North America	168
Ontario Teachers	Canada^	North America	151
Texas Teachers	US	North America	146
Employees' Provident	India	Asia Pacific	134
GEPF	South Africa^	Other	134
Total: Top 20			**7,448**

Data as at 31 Dec 2017 except otherwise stated. *as at 31 March 2018, ^as at 31 March 2017

INVESTMENT IMPLICATIONS

Against this backdrop of Asia's growing pension gap, investors are likely to look for more income-oriented solutions, as well as active allocation strategies that outperform and add value. But given that DC pension schemes, which tend to entrust the individual with the responsibility to manage their retirement savings, have been gaining popularity, investors without the financial expertise will rely on asset managers to fill the role.

Asian sovereign and public sector pension funds are also seeking to diversify investments as reflected by new mandates awarded to the asset managers; the focus is on sustainability-linked portfolios, global infrastructure and private market investments and with good reason too. Asian pension funds tend to be invested heavily in fixed income products while US and European pension funds prefer equities (Fig 4).

The large allocation of US pension funds to alternatives seems understandable given the returns of this asset class. As per Fig 5, several alternative asset classes have outperformed equities despite a strong bull market since the 2008 global financial crisis.

Higher returns from active asset management will enhance pension benefits and strengthen the financial sustainability. The opportunities for asset managers to expand their offerings are also expected to increase in the future; by 2027, Asia could become the top equity market region. Asia's market capitalisation, led by China/Hong Kong, could double to USD56trillion overtaking the US and Canada. Asia ex Japan's bond markets could also hit USD10trillion which is the size of the Japan bond market[7].

Given the nature of the risk-return of the various asset classes, a combination of innovative and diversified strategies (from the private and public markets) seems a good way to help narrow the pension gap. Going forward, asset managers will likely play a bigger role in helping greying societies to meet their pension obligations by offering such solutions.

Fig. 4: Asset allocation of the world's 300 largest pension funds[5]

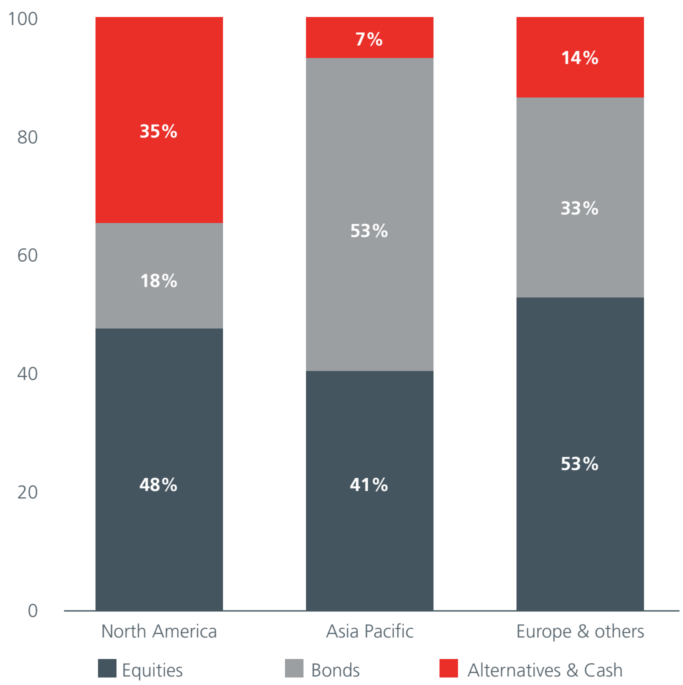
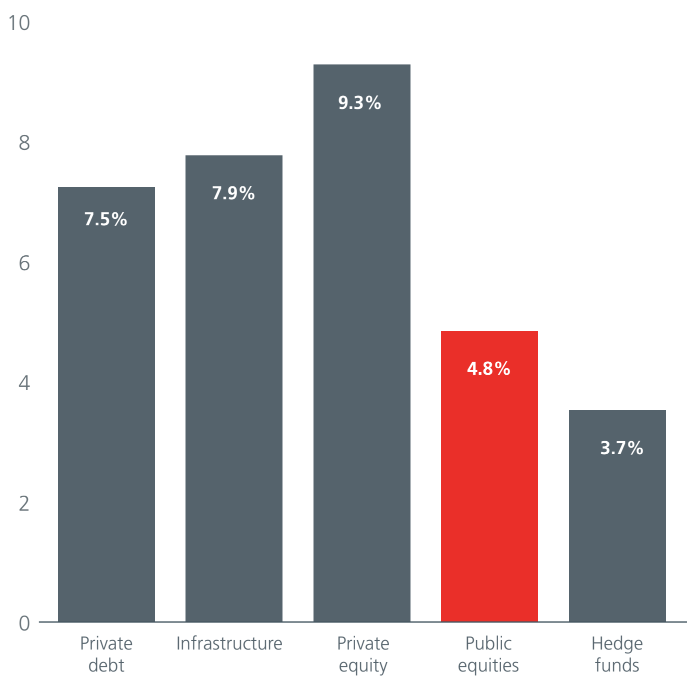


Fig. 5: Returns of asset classes[6]

10-year performance from 2008 to 2018 (annualised)



Sources: [1]OECD – Pensions at a glance Asia Pacific 2018, World Bank, International Labour Organisation [2]Melbourne Mercer Global Pension Index 2018 [3]We'll Live to 100 – How Can We Afford It? White Paper by World Economic Forum, May 2017 [4]https://www.willistowerswatson.com/en-US/Insights/2018/09/the-worlds-300-largest-pension-funds-year-ended-2017 [5]https://www.infrastructureinvestor.com/how-the-worlds-largest-pension-funds-allocate-their-assets/ [6]http://www3.weforum.org/docs/WEF_Investing_in_our_Future_report_2019.pdf, Mercer Analysis, Burgiss Private IQ (Mezzanine, respectively Buyout and VC/Cambridge Associated (all infrastructure) (Q1/17) MSCI ACWI/4 HFRI Composite [7]Morgan Stanley Institute for Sustainable Investing February 2015 report

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