International Comparisons – Are There Lessons to be Learned in Plan Design?

Dan DeKeizer
Vice President & Sr. Actuary
Global Employee Benefits – Center of Expertise

Agenda

• Common Causes

• Diverse Responses

• Application to the U.S. System
  ➢ Trends affecting the U.S.
  ➢ Lessons to Learn from Plan Design
Common Causes

- Sustainability threats to Public/Corporate Savings
  - Demography
  - Economic Growth Trends
  - Inflation

- Adequacy Threats to Private/Individual Savings
  - Savings Level
  - Annuitzation Rates
  - Cost Threats – Inflation/Healthcare
Demographics / Aging (Country Examples)

The Growing percentage of people living beyond the age of 65 in selected countries between 2000 and 2050

1 World Population prospects, UN Population Division, March 2009
2 OECD Observer, March 2007
3 Social Trends 39, UK Office of National Statistics, 2009

Public Finance Strain

% Change in Real GDP\(^1\)

<table>
<thead>
<tr>
<th>Country</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>-0.6</td>
</tr>
<tr>
<td>Italy</td>
<td>-0.4</td>
</tr>
<tr>
<td>U.K.</td>
<td>0.4</td>
</tr>
<tr>
<td>U.S.</td>
<td>1.6</td>
</tr>
<tr>
<td>Brazil</td>
<td>2.8</td>
</tr>
<tr>
<td>Korea</td>
<td>3.6</td>
</tr>
<tr>
<td>China</td>
<td>8.1</td>
</tr>
</tbody>
</table>

1 Bloomberg, 2012
Adequacy of Individual Savings

- U.S. – near retiree median 401(K) plan in 2011 held $149,400
  - Households 60-62, with a 401(k) plan from work
  - Included plans from previous employers
  - Would generate an annuity of only $9,073 – about 10% of their employment income level

1 The Wall Street Journal – Retiring Boomers Find 401(K) Plans Fall Short, Feb 2011

Diverse Responses

- Increasing Contributions
- Increasing Retirement Ages
- Encouraging Annuitization of Benefits
- Shift towards DC Plans
- Renationalization?
Application to the U.S. System

U.S. Not Immune to Global Trends

- Demographics – aging population
  - 2010 – 18.2% of population 60 + years old
  - 2050 – 27.4% of population 60+ years old

- Public Finance Strain
  - 2010 - First Social Security Deficit since 1983

- Inadequate savings for retirement compounded by:
  - Living longer
  - Saving too little
  - Underestimating health care costs

1. Axco Report, 2011
2. Status of the Social Security and Medicare Programs, A Summary of the 2011 Annual Reports
Lessons to Learn from Plan Design

**WORK LONGER**
- SS retirement age 71
- SS early retirement factors
- “Partial” retirement
- 70 ½ waiver for workers

**SAVE MORE**
- SS contribution rate
- 401(K) auto enroll
- Tax preference (limits, %)?

**SPEND LESS**
- Redefine retirement lifestyle
- Healthcare/LTC reform?
- Move
- Cutting SS benefits

**EFFICIENT USE OF ASSETS**
- Annuitization
- Motivate home downsizing
- Privatization of SS?

Appendix
### Australia

- **Retirement System Structure**
  - Universal old age pension (PAYG)
  - Mandatory Superannuation scheme (mainly DC plans)
  - Additional voluntary contributions to Superannuation scheme

- **Adequacy concerns of the Superannuation scheme**

- **Increasing mandatory minimum contribution from 9% to 12%**


### France

- **Retirement System Structure**
  - Compulsory general Social Security system (PAYG)
  - Compulsory supplementary system (PAYG)
  - Voluntary corporate plans

- **Social Security budget deficit (EUR 29.8 B in 2011)**

- **Will boost retirement age from 60 to 62 by 2018**

Increasing Contributions and Retirement Ages

Germany

- Retirement System Structure
  - Compulsory general Social Security system (PAYG)
  - Occupational pensions
  - Individual retirement investments

- Increasing contribution rates – current SS rate of 19.9% to be increased incrementally to 22% by 2030

- Increasing retirement age for standard pension to be increased from 65 to 67 by 2029

- Including other changes, the above measures should adequately finance the SS program through 2030


Promoting Annuitization of Benefits

Chile

- Retirement System Structure
  - Solidarity Pillar
  - Mandatory Contributory Pillar (AFP)
  - Voluntary Pillar

- Pension reform created in 1981 created mandatory second pillar (AFP), making Chile a pioneer in the 3 pillar model

- One component of AFP – promotes annuitization of benefits by placing restrictions on taking lump sum withdrawals
  - ~60% of retirees take an annuity
  - ~40% of retirees take a phased withdrawal

1. Annuities and other Retirement Products – Designing the Payout Phase – Rocha, Vílase, Rudolph; The World Bank, Copyright 2011
Promoting Annuitization of Benefits

United Kingdom

- Retirement System Structure
  - Basic State Pensions
  - Additional State Pensions, including State Second Pension (S2P)
  - Occupational Plans
  - Voluntary Plans (individual or group)

- 2011 – legislation introduced related to annuitization of retirement funds, moving from compulsory annuitization for all to minimum income approach


Promoting Annuitization of Benefits

Australia

- No restriction on payout type from superannuation funds

- Culture of “Lump-Sum Mentality”

- Percentage of benefits paid out as lump sums slowly declining
  - 1990s – Lump sums accounted for 80% of all benefit payments
  - 2009 – Lump sum portion of payments declined to 56.4%

Shift towards DC Plans – U.K. vs. The Netherlands (2001-2011)\(^1\)

<table>
<thead>
<tr>
<th></th>
<th>UK 2001</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>DB</td>
<td>92%</td>
<td>61%</td>
</tr>
<tr>
<td>DC</td>
<td>8%</td>
<td>39%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Neth. 2001</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>DB</td>
<td>98%</td>
<td>93%</td>
</tr>
<tr>
<td>DC</td>
<td>2%</td>
<td>7%</td>
</tr>
</tbody>
</table>

\(^1\) Data sourced from Watson Wyatt Worldwide - Global Pensions Assets Study 2007, and Towers Watson Global Pension Assets Study 2012, based on selected countries

**Netherlands**

- **Retirement System Structure**
  - General Old Age Pensions Act (AOW)
  - Occupational Pension Plans
  - Personal Annuities offered by insurance providers

- **DB to DC shift occurring more slowly than the global trend**
  - Pushback from unions
  - The Hybrid Plan option
Shift towards DC Plans - Embracing

United Kingdom

• Occupational plans shifting to DC
  ➢ Freezing DB Plans
  ➢ Growth of Contract Based DC Plans (GPP or GSIPP)

• Auto-Enrollment and the National Employment Savings Trust (NEST)
  ➢ Default option for employers with no pension arrangement
  ➢ DC savings mechanism for employees with lower earnings to have access to a retirement plan
  ➢ Implementation beginning in 2012

Renationalization

Poland

• Retirement System Structure
  ➢ Social Security (ZUS)
  ➢ Mandatory Occupational Pension Plans (PTE)
  ➢ Voluntary Individual and Corporate Plans

• Success of the mandatory occupational plans

• In 2011 Rising government deficits spurred governing party to redirect portion of funds from PTE back to Social Security¹

Renationalization

Hungary

- Retirement System Structure
  - Social Security
  - Voluntary Individual and Corporate Plans

- 1997/1998 - Initial Reform
  - First country in CEE region to implement major pension reform
  - Included mandatory DC pillar

- 2010 – Government decides to renationalize accumulated funds in second pillar