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HEALTH WEALTH CAREER

FINANCIAL SECURITY: MEND THE GAP

PUBLIC PENSIONS PERSPECTIVE

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Pension systems around the world, whether they are social security systems or private sector arrangements, are now under more pressure than ever before. Declining birth rates and increasing longevity have impacted social, economic, and financial systems globally, placing financial pressure on current retirement income systems and putting the provision of financial security in retirement at risk. Yet this is not the only pressure point on our pension systems.

Others include:

- Increased government debt in some countries, which affects the ability to pay for benefits in pay-as-you-go systems
- The low-growth/low-interest economic environment, which reduces the long-term benefit of compound interest and increases pension liabilities
- Significant unemployment in some countries, particularly amongst the youth, which negatively affects future benefits and reduces contributions/income tax
- The increasing prevalence of defined contribution schemes and the related growing responsibility of individuals to understand the new arrangements

Each country's retirement system has evolved from its particular economic, social, cultural, political and historic circumstances. That means that no single system can be transplanted from one country and applied, without change, to another country. However, there are certain features and characteristics that, across the range of systems, are likely to lead to improved financial benefits for older individuals and households; an increased likelihood of future sustainability of the system; and a greater level of community confidence and trust. With these desirable outcomes in mind, the Melbourne Mercer Global Pension Index (MMGPI), now in its eighth year, uses the sub-indices of adequacy, sustainability and integrity to benchmark the retirement income systems of 27 countries, encompassing a diversity of pension policies and practices from around the world.

CALCULATING THE MELBOURNE MERCER GLOBAL PENSION INDEX

MELBOURNE MERCER GLOBAL PENSION INDEX

ADEQUACY

40%

- Benefits
- Savings
- Tax support
- Benefit design
- Growth assets

SUSTAINABILITY

35%

- Coverage
- Total assets
- Contributions
- Demography
- Government debt

INTEGRITY

25%

- Regulation
- Governance
- Protection
- Communication
- Costs

Subindex

Indicators including

ADEQUACY: DOES THE SYSTEM PROVIDE A SUFFICIENT AMOUNT OF BENEFIT TO INDIVIDUALS?

The adequacy of benefits is perhaps the most obvious way to compare different systems. After all, the primary objective of any pension system is to provide adequate retirement income. Thus this sub-index considers the base level of income provided as well as the net replacement rate for both poor and median-income earners, in addition to several design features and characteristics that enhance the efficacy of the overall retirement income system. The net household saving rate and home ownership rate are also included since non-pension savings represent an important source of financial security during retirement.

The countries with the highest value for the adequacy sub-index in 2016 are the Netherlands and Ireland, with South Africa and Mexico having the lowest values. Although several indicators influence these scores, the level of the minimum pension (expressed as a percentage of the average wage) and the net replacement rate for a median-income earner are the most important.

ADEQUACY SUB-INDEX RECOMMENDATIONS

At low-income levels, a minimum pension is provided that represents a reasonable percentage of average earnings in the community

At least 70% net (after tax) replacement rate at retirement for a full-time worker on a median income

At least 50% of accumulated retirement benefits to be taken as an income stream

SUSTAINABILITY: ARE THE PROVISIONS OF THE SYSTEM VIABLE OVER THE MEDIUM TO LONG TERM?

The long-term sustainability of the existing retirement income system is a concern in many countries, particularly in light of the aging population. The increasing old age dependency ratio (both now and in the future) may be difficult to change while others- such as the state pension age, the opportunity for phased retirement and the labor force participation rate among older workers- can be influenced, either directly or indirectly, by government policy.

An important feature of sustainability is the level of funding in advance, which is particularly important where the ratio of workers to retirees is declining. Hence, this sub-index considers contribution rates, the level of pension assets and the coverage of the private sector pension system. Finally, given the key role that the provision of a public pension plays in most countries, the level of government debt represents an important factor affecting a system's long-term sustainability.

The country with the highest value for the sustainability sub-index in 2016 is Denmark with the lowest values being for Italy and Austria. Although several indicators influence these scores, the level of coverage of private pension plans, the level of pension assets as a proportion of GDP and the projected demographic factors are the most important.

SUSTAINABILITY SUB-INDEX RECOMMENDATIONS

At least 70% of the working age population should be members of private pension plans

Current pension fund assets should be more than 100% of GDP to fund future pension liabilities

Labor force participation for those aged 55-64 should be at least 65%

INTEGRITY: ARE THE RIGHT CONTROLS IN PLACE TO ENSURE RESPONSIBLE ACTION BY ALL PARTIES?

A key area of focus when evaluating the integrity of the overall pension system is the strength of the private sector system. As most countries are relying on the private system to play an increasingly important role in the provision of retirement income, it is critical that the community has confidence in the ability of private sector pension providers to deliver retirement benefits over many years into the future. Therefore, this sub-index considers the role of regulation and governance, the protection provided to participants from a range of risks and the level of communication provided to members. In each case, we consider the requirements set out in the relevant legislation. In addition, we use the Worldwide Governance Indicators published by the World Bank to provide a broader perspective of governance within each country.

An important contributor to the long-term confidence of members is that they receive good value from their pension plan and that costs are kept to a reasonable level. Although an international comparison of the total costs of operating each country's system is difficult, this sub-index includes some proxy measures relating to industry structure and scale, which should provide a good indicator.

The country with the highest value for the integrity sub-index is Finland, with the lowest value being for Mexico. The better scores were achieved by countries with well-developed private pension industries.

INTEGRITY SUB-INDEX RECOMMENDATIONS

A strong prudential regulator supervising private pension plans

Regular member communications, including the provision of personal statements, projected retirement income and an annual report

Clear funding requirements for both defined benefit and defined contribution schemes

For further information, please contact your local Mercer office or visit our website at

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