

Panel 1: Building Retirement Resources: How Do Governments and Regulators View Their Role and What Should Their Role Be?

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Structure of the Presentation

- **Multi-pillar Pension Systems: Definitions**
- **Pension Reform Trends in the Past Decades**
- **Main Outcomes of Private Pension Systems**
 - Focus on the Mandatory Private Systems
- **Pension Reform Reversals in Recent Years**
 - Types of Reversals, Main Causes, Challenges
- **Policy Agenda for the Future**
 - Strengthening Existing Mandatory Private Pillars
 - Developing/Expanding Voluntary Private Pillars

Multi-Pillar Pension Systems

(World Bank Definitions)

- **Zero Pillar:** Basic, Universal, or Minimum Benefits, Tax-financed
- **First Pillar:** Mandatory, Contributory, PAYG, Publicly managed
- **Second Pillar:** Mandatory, Contributory, FF, Privately managed
 - Some quasi-mandatory systems are classified as second pillars
 - Personal or Occupational, DB or DC, but mostly DC
- **Third Pillar:** Voluntary, Contributory, FF, Privately managed
 - Personal or Occupational, DB or DC
- **Fourth Pillar:** General savings, housing, other income

Notes: PAYG = Pay-As-You-Go; FF= Fully-Funded; DB= Defined Benefit; DC = Defined Contribution

Main Reform Trends in the Past Decades

- **Introduction/strengthening of zero/basic pillars**
 - Especially in emerging countries, addressing low coverage of first/second pillars and poverty at old age
- **Many parametric/design reforms in first pillars**
 - Reflecting chronic imbalances of PAYG systems
- **Introduction of second pillars in almost 30 countries**
 - Mostly in Latin America and Central and Eastern Europe
- **Efforts to develop/expand third pillars**
 - To complement the declining benefits in mandatory systems

Multi-Pillar Pension Systems Across Regions

(Number of Countries)

	Pillar 0	Pillar 1	Pillar 2	Pillar 3
High Income OECD (24 countries)	21	17	7	All
Latin America and Caribbean (32 countries)	19	29	11	Some
Central Europe and Central Asia (31 countries)	17	29	14	Some
East Asia and Pacific (24 countries)	12	19	1	Few
South Asia (8 countries)	4	4	1	Few
Middle East and North Africa (20 countries)	2	17	0	Few
Sub-Saharan Africa (47 countries)	9	35	2	Few

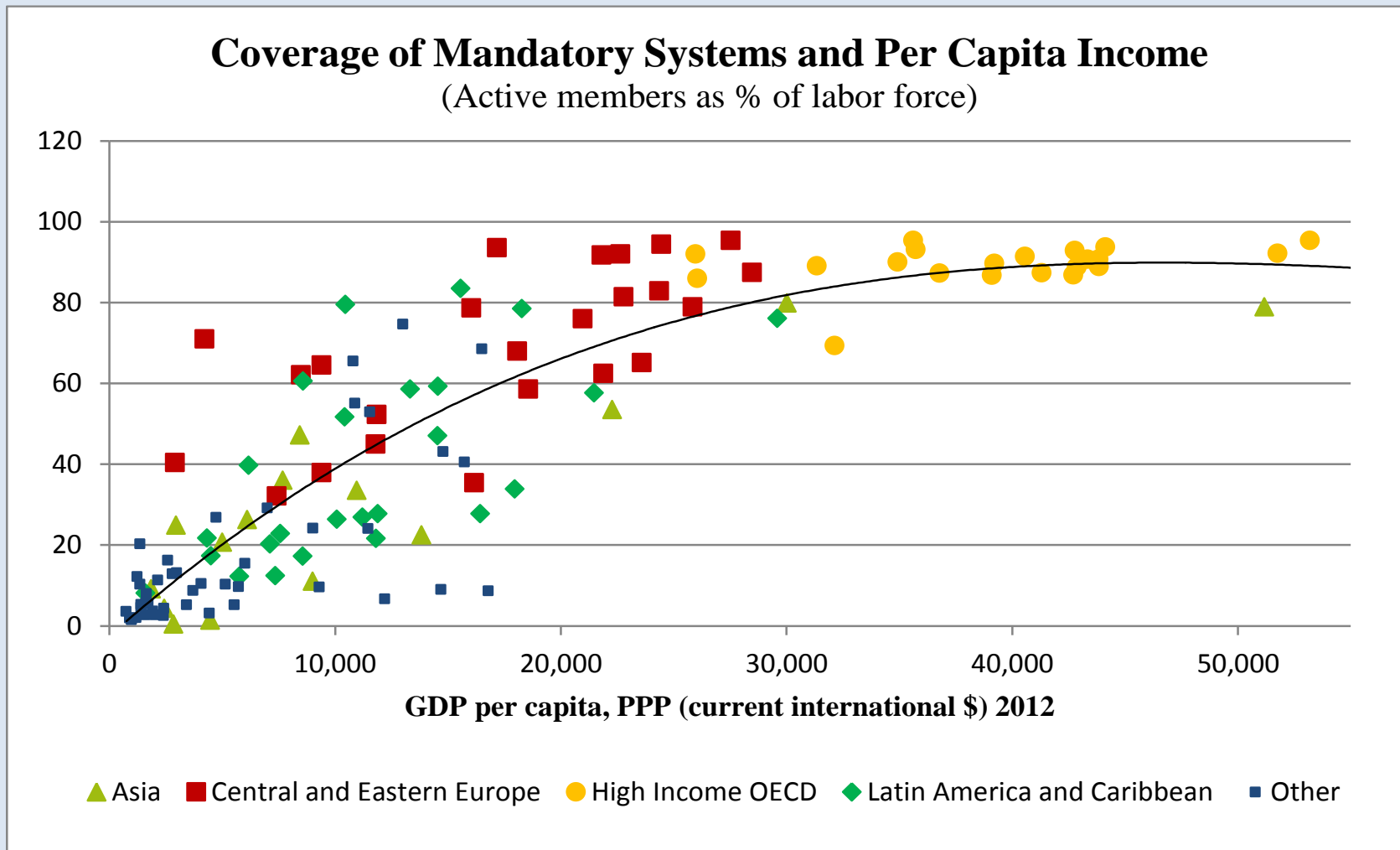
Sources: World Bank, OECD, National sources

Outcomes of New Second Pillars: Mixed

- **Coverage remains a challenge in emerging countries**
 - Challenge remains even in mandatory systems
- **Pension assets have grown faster in mandatory systems**
 - Good outcome, but growth remains constrained by many inefficiencies
- **Costs/fees have declined but are still high in many countries**
 - Individual-based systems affected by price inelasticity, consumer inertia
- **Portfolios have remained conservative, due to many causes**
 - Large fiscal deficits in the reform implementation period
 - Short-term bias of the industry and regulators
 - Lack of pro-active capital market reforms
- **Mixed return performance**
 - Reflecting mostly the conservative portfolios
 - Global financial crisis also affected returns, especially in Central Europe

Coverage of Mandatory Pillars (1 and 2):

Driven by fundamental factors such as level of development, informality
Central European coverage has been higher for historical reasons

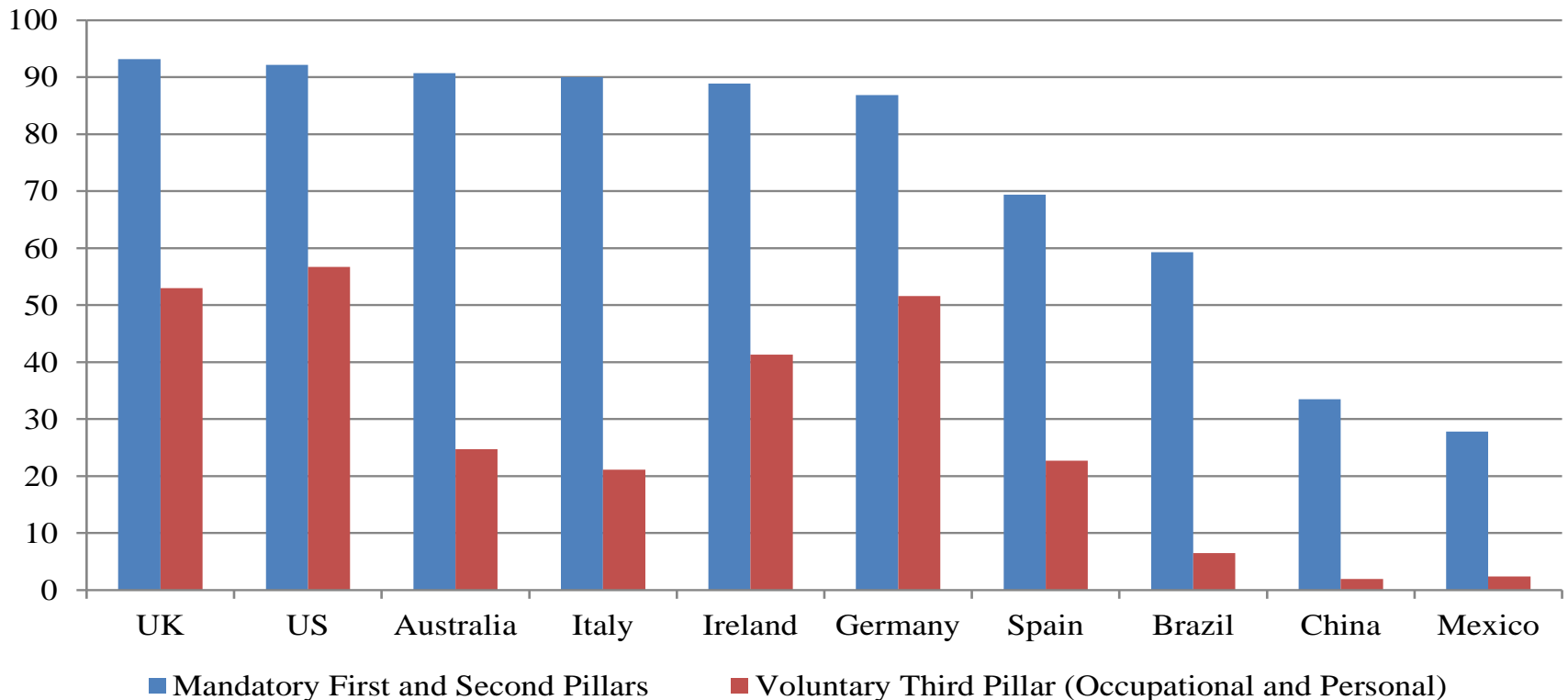


Coverage of Voluntary Third Pillars: Low to Moderate

Expanding voluntary/complementary coverage is an even greater challenge, especially in emerging countries

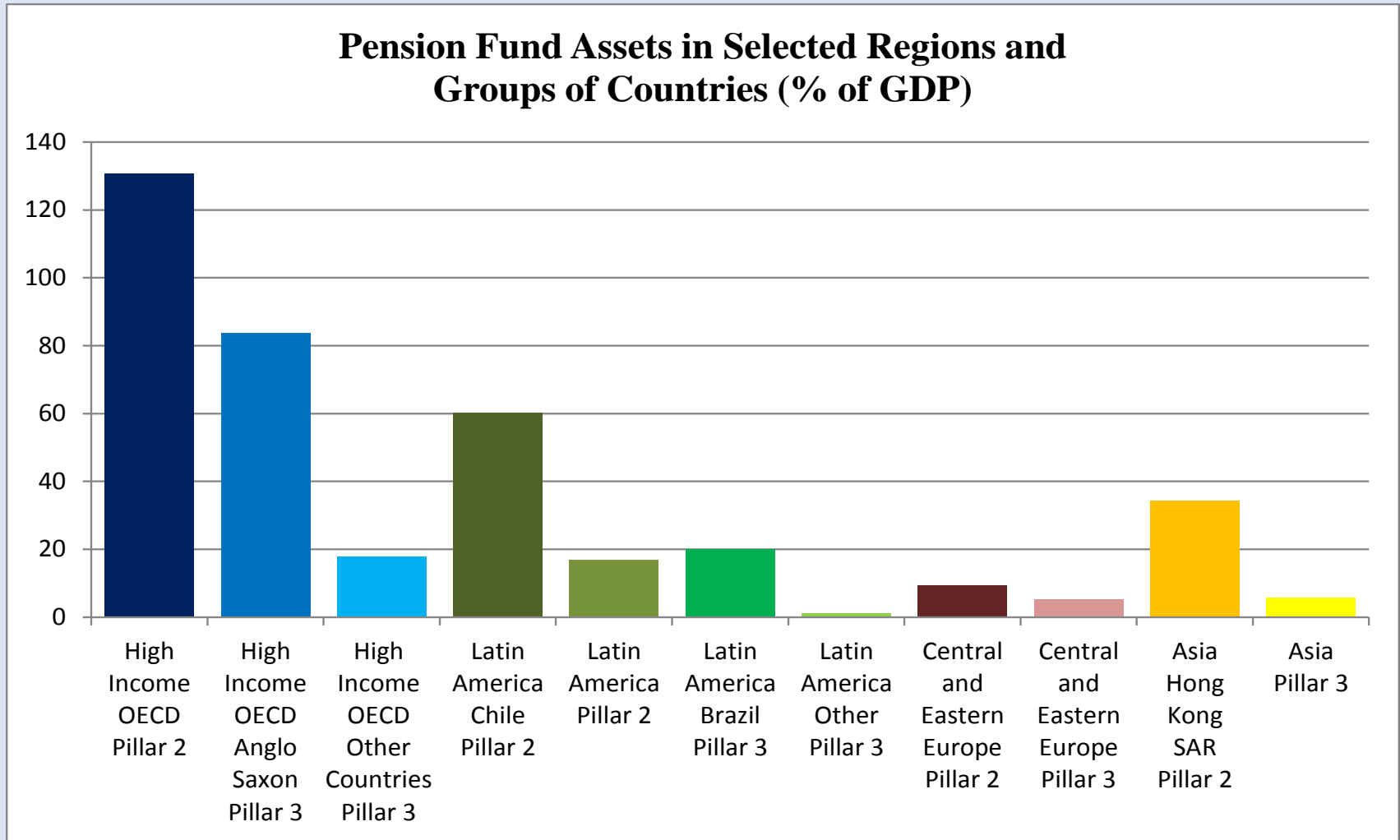
Coverage of Mandatory and Voluntary Systems

(Active contributors, as % of the labor force; Selected countries)



Mandatory pension systems accumulate more assets

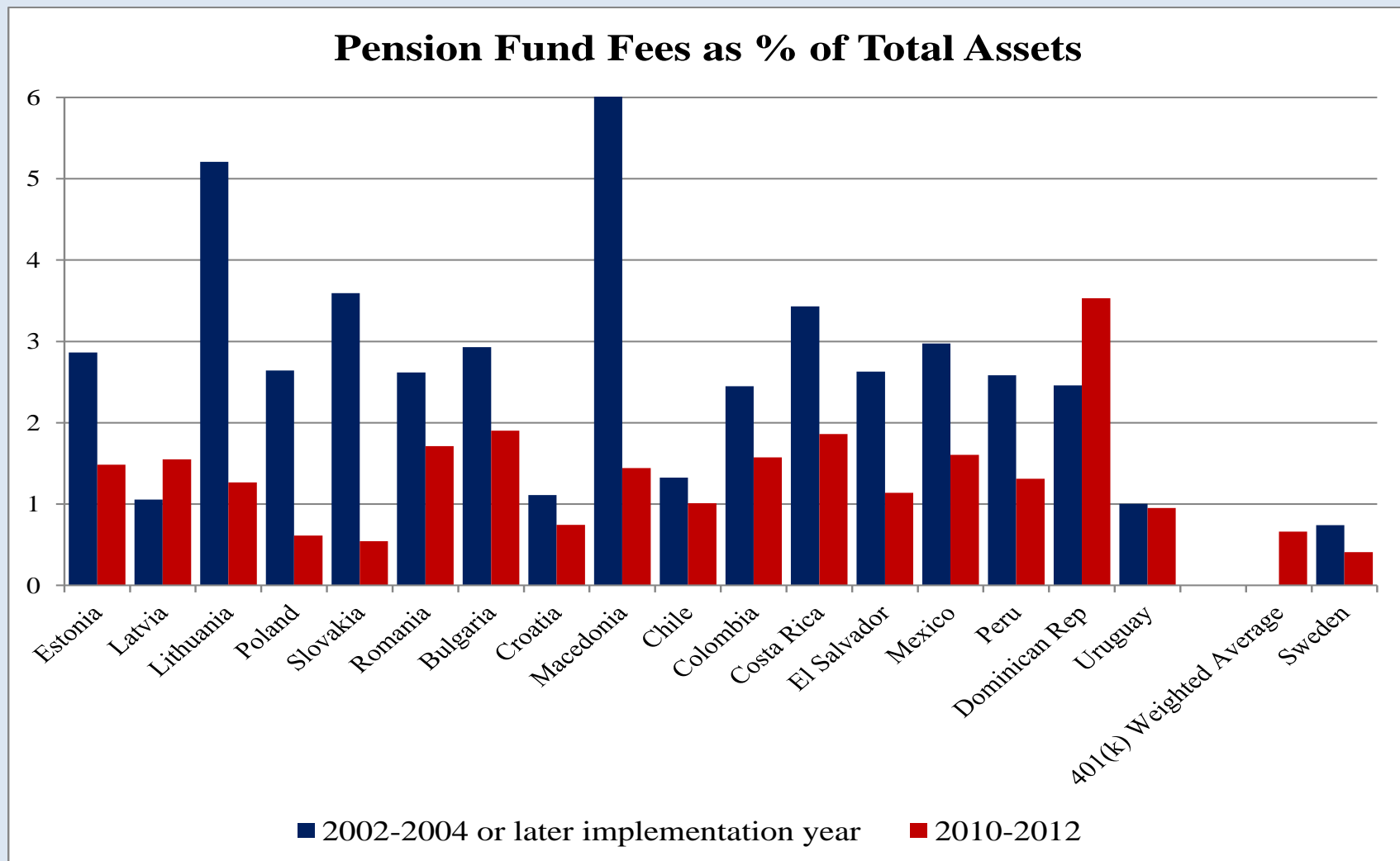
But asset growth is still constrained by low coverage, low contributions, and poor outcomes (fees, returns) in many emerging countries



Sources: OECD global pensions database, World Bank staff from National Sources

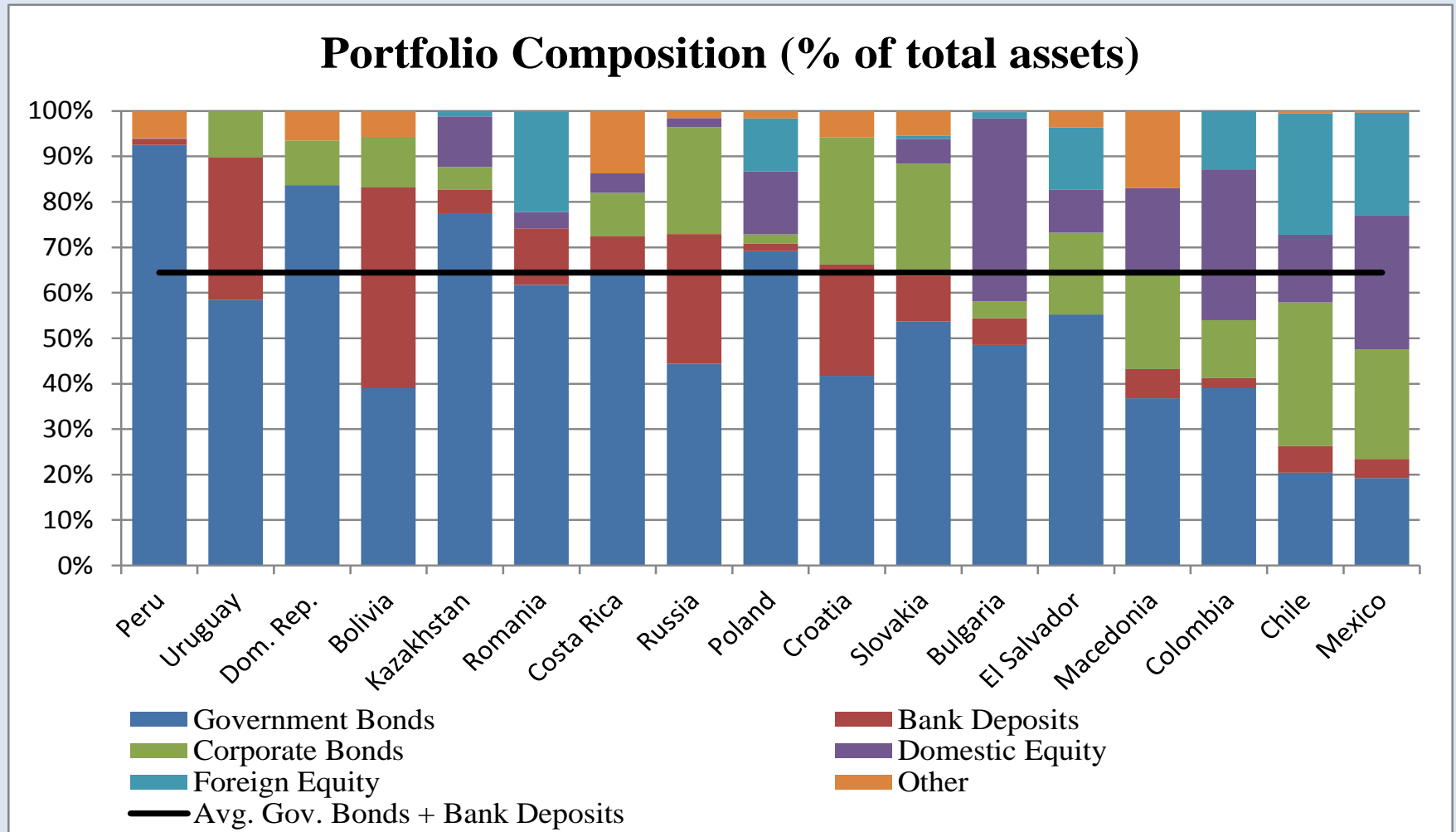
Fees have declined but remain high in many cases

Due to price-inelasticity and consumer inertia in individual-based systems
Many countries imposed caps and other policy measures to handle high fees



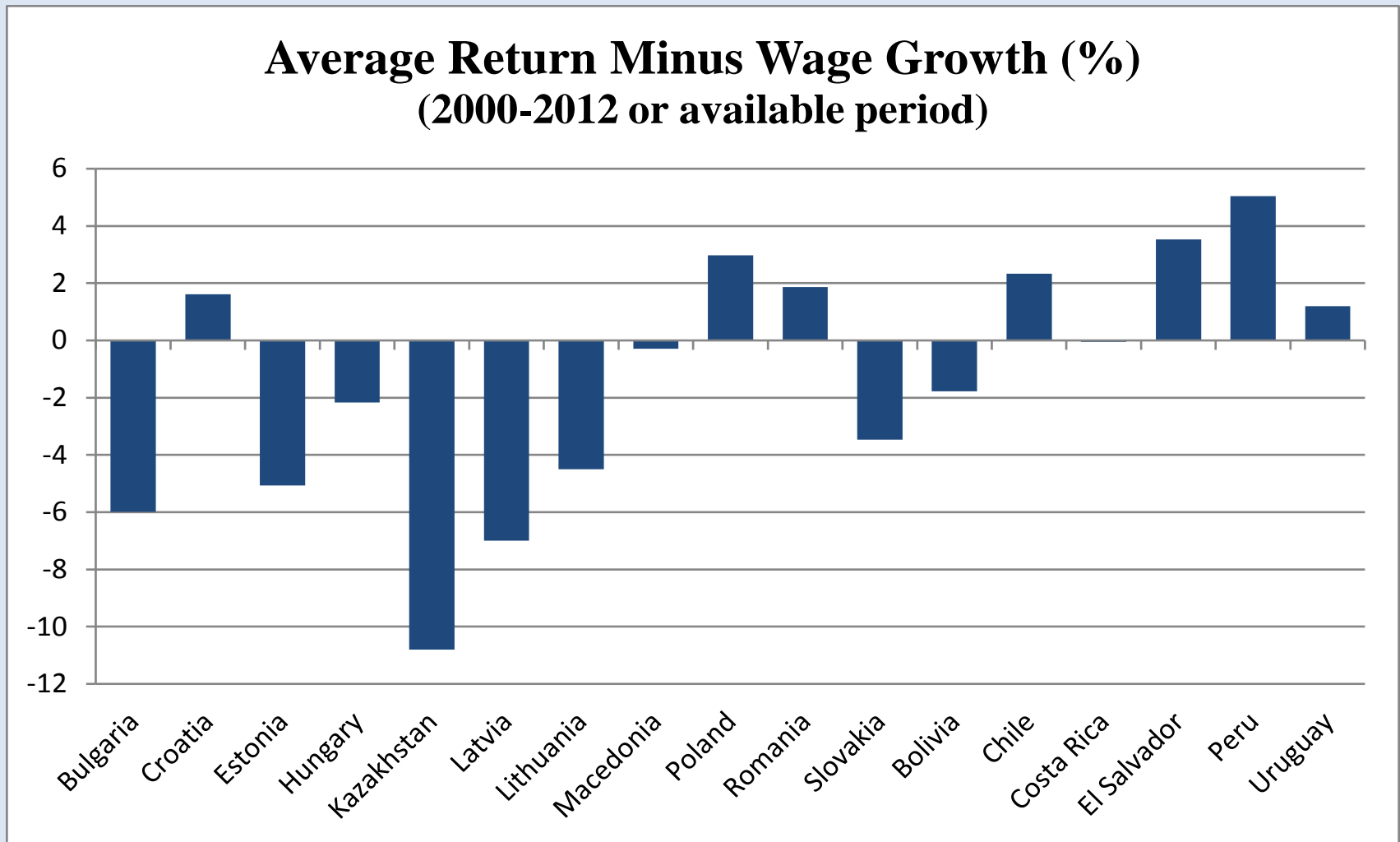
Portfolios remain disappointing in many cases

Share of government bonds (with short durations) and bank deposits is 70% of assets or higher in many countries



Returns below wage growth in many cases

Need to ensure positive differential in the long-term



Source: World Bank from National Sources

Status of Second Pillar Reforms in Central Europe and Latin America (May 2014)

Status	Full Reversal	Substantial Reversal	Moderate Reversal	No Reversal
Main Policy Measures	<ul style="list-style-type: none"> • Full transfer of assets to the first pillar, and • Termination of second pillar 	<ul style="list-style-type: none"> • Partial transfer of assets to the first pillar, and/or • Substantial and permanent reduction of contributions, and/or • Change from mandatory status to opt-in status 	<ul style="list-style-type: none"> • Moderate to substantial reduction in contributions, but temporary, and • Prospects of partial recovery of contributions 	<ul style="list-style-type: none"> • No changes; or • Temporary reduction in contributions followed by full recovery
Countries	Argentina Bolivia Hungary	Poland Russia Slovakia	Estonia Latvia Lithuania Romania	Bulgaria Chile Colombia Costa Rica Croatia Dominican Republic El Salvador Estonia Kazakhstan Kosovo Macedonia Mexico Peru Uruguay

Main Drivers of Reform Reversals

- **Main driver: fiscal pressures**
 - Second pillar was seen as part of the fiscal problem (large deficits, debts)
 - Transfer of contributions and assets to first pillar was expedient solution
 - Myopic policy decision in several cases
 - The fiscal deficits of reforming countries were due to many factors, and the “transition deficit” was frequently not the dominant factor
 - Multi-pillar system may still be the best design in the long-run in many cases
- **High fees and/or low returns in several countries**
 - Valid criticism in many countries, requiring effective solutions
 - Global financial crisis aggravated the performance of new systems
 - But some reversals occurred where new pillar was performing well
 - Example: Poland
- **Poor contribution of new systems to the economy**
 - Valid criticism in many countries, but reflects problems discussed above

Policy Agenda for the Future: Strengthening of Existing Second Pillars

- **Comprehensive agenda for a better performance**
 - More supportive fiscal policies
 - Adequate contributions, lower costs and fees, longer investment horizons, capital market development, payout phase
- **Agenda for increasing contributions**
 - Depends on other pillars, but second pillar contribution rates remain too low in several countries
- **Agenda for reducing costs and fees**
 - Centralization of collection and account management
 - “Smart” caps on fees, auctions for new entrants, switching rules
 - A bolder move towards the Swedish second pillar?
 - Central collection, recordkeeping, blind accounts, default portfolio

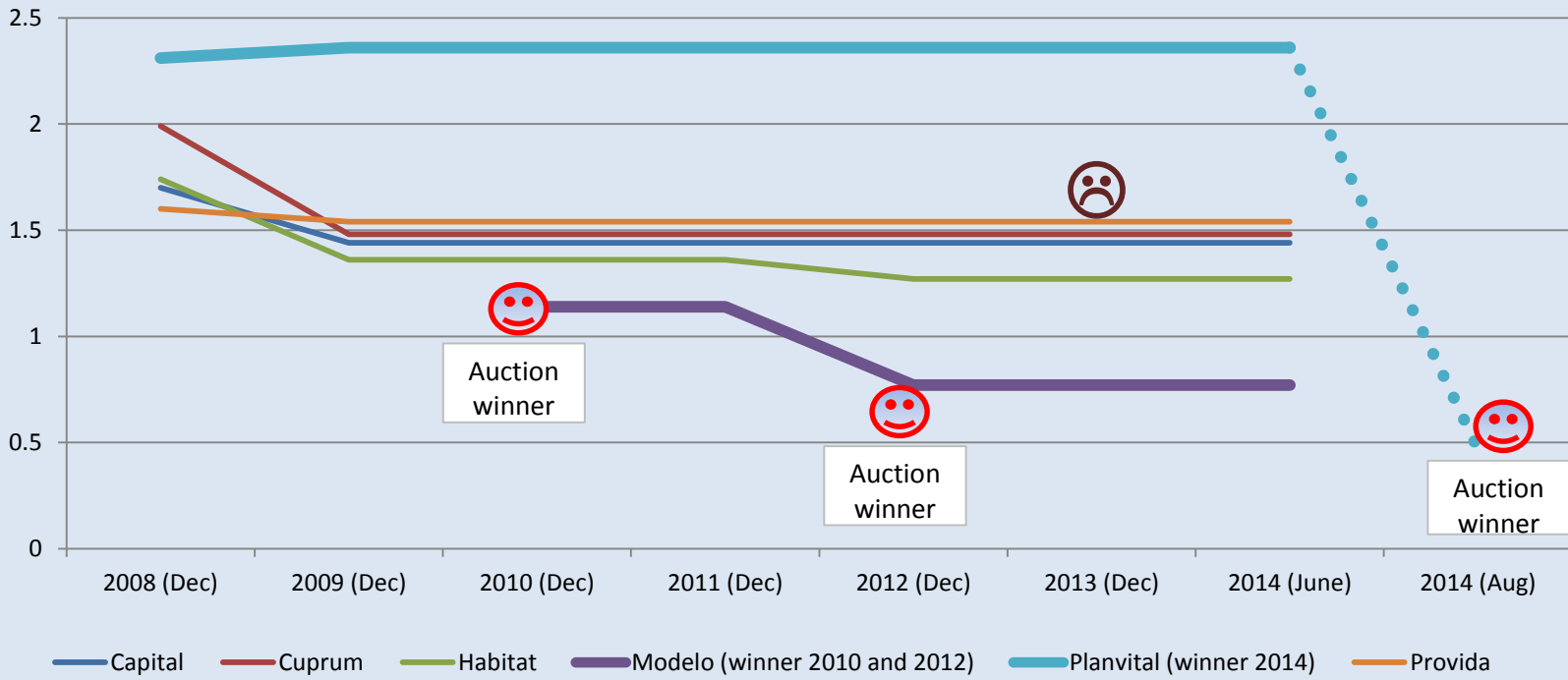
Policy Agenda for the Future: Strengthening of Existing Second Pillars

- **Agenda for portfolios with longer horizons**
 - General trend towards multi-funds, lifecycle portfolios is welcome, but progress is slow and largely insufficient in most countries
 - New approach: well designed benchmarks entailing lifecycles with diversified equity (including foreign), price-indexed fixed income with longer durations, alternative assets (e.g. infrastructure)
 - Effort to introduce default portfolios along these lines
- **Agenda for capital market development**
 - Need for a more pro-active agenda to develop instruments
- **Agenda for the payout phase**
 - Adequate menu of products, including risk-sharing annuities

Illustration of Possible Policy Measure to Reduce Fees: Auctions of New Entrants in Chile

Good initiative, but limited initial spillover effects due to inertia
Peruvian variant of auction may generate stronger spillover effects

Fees charged by Chilean AFPs, 2008 - 2014 (% of salary)



Sources: IOPS, Chilean Pension Supervision Agency

Policy Agenda for the Future: Promotion of Voluntary Third Pillars

- **The agendas for reforming and developing the second and third pillars have common basic objectives**
 - Good coverage, low fees, efficient portfolios, adequate returns, availability of retirement products
- **But the third pillar agenda is more challenging**
 - More challenging to expand coverage without a mandate
 - More challenging to organize effective centralized arrangements to exploit economies of scale
 - Greater risk of withdrawals – implications for ALM, asset portfolios
- **The agenda that has been discussed for developed countries is a good point of departure for emerging countries**
 - But need to adapt the agenda for ECs due to initial conditions, trade-offs

Promotion of Voluntary Third Pillars:

Elements of an Agenda for Emerging Countries

- **Availability**
 - Greater need for simplicity/standardization for SMEs/individuals
 - Examples: SIMPLE and SEP (US), Superannuation Clearing House (Australia), NEST (UK), Kiwisaver (NZ), Open pension plans in life insurance sector (Brazil)
- **Financial Incentives**
 - Tax incentives: Traditional EET may not be enough for ECs
 - Lower tax rates in EET according to maturity?; TEE?; Government matching?
 - Matching contributions by sponsor with reasonable vesting rules
- **Automatic Enrollment**
 - Preferably with reasonable default contribution rate
 - Automatic escalation clauses
 - Non-discrimination tests (more coverage of low income workers)
- **Automatic Investment (default portfolios)**
 - Regulation/standardization of defaults (lifecycles with minimum durations)
- **Combination of Insurance Products**
 - Private pensions and health coverage at retirement?
- **Financial Education**
 - Need also to train courts, to address potential liability of automatic/default rules