OECD / IOPS Global Forum on Private Pensions

Asia-Pacific Pensions 2007 - Systems and Markets

Brigitte Miksa, Allianz Global Investors - Bejing, November 14, 2007

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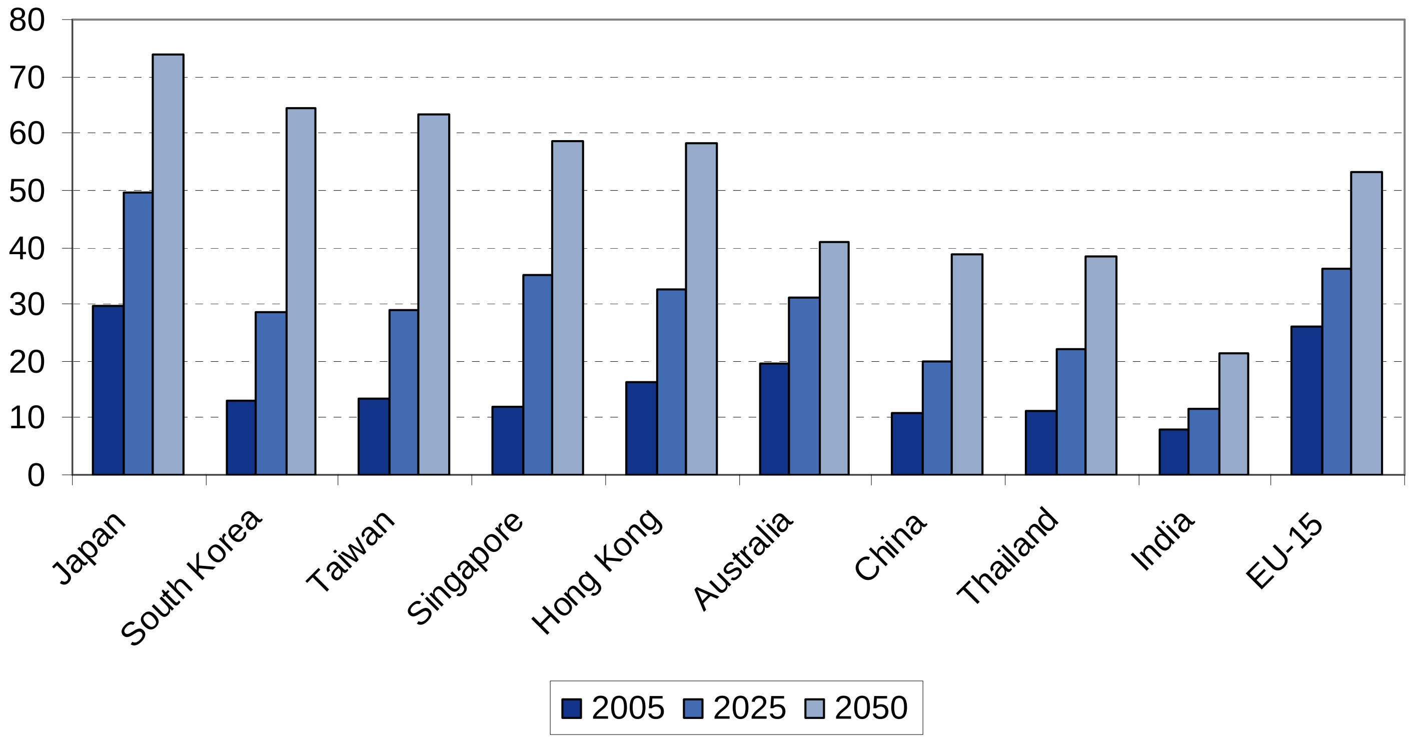
Ageing societies are a challenge for most Asian economies

Old-age dependency ratios in Asia [65+/15-64]

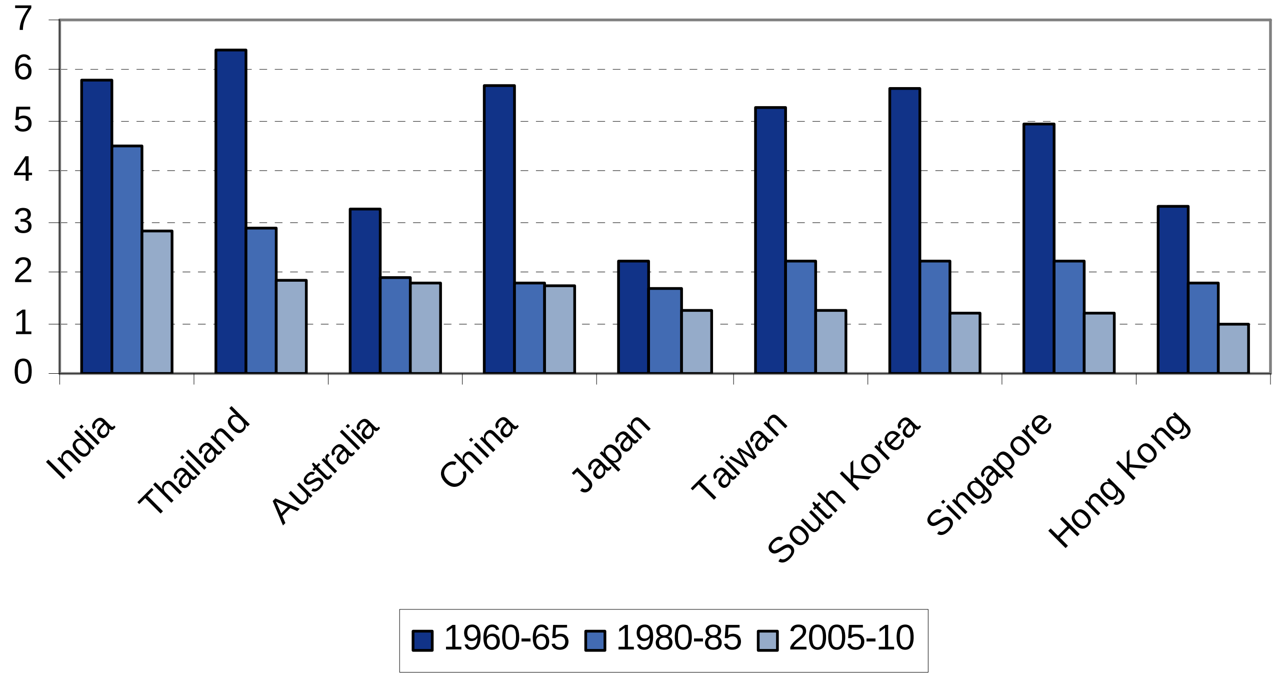


Source: Allianz Dresdner Economic Research, United Nations

Japan / South Korea will be among the oldest countries globally by 2050, China is ageing rapidly

Asia has experienced a dramatic decline in fertility since the 1960s

Fertility rates in Asia [children per women]



Source: Allianz Dresdner Economic Research, United Nations

- To keep population constant, a fertility rate of 2.1 is required
- Life expectancy has vastly increased – over 30 years in Korea and China since the 1950s
- The Chinese working population will peak in 2010 and fall steadily after this date.
- By 2025, the potential labour force will shrink in Japan (-15%), Korea and Taiwan.
- By 2050 only Australia and India have a growing labour force
- By 2050, the absolute population size in Japan, Korea and Taiwan will have decreased compared to 2005.

Main reasons for declining fertility: economic growth, industrialisation, urbanisation, birth control

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In Asia, the design of public pensions differs strongly

Patterns of public pension design

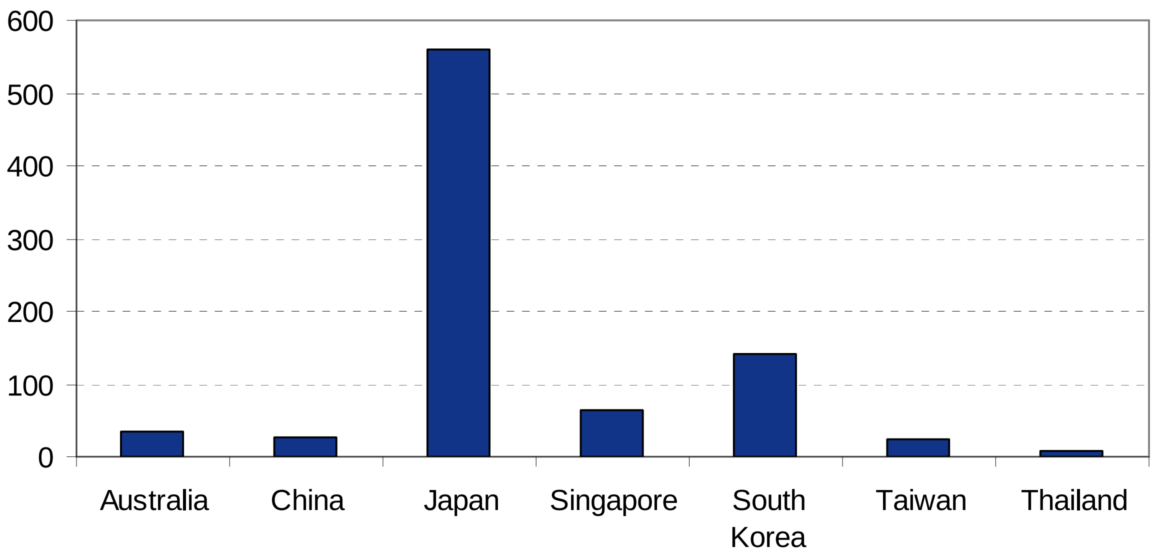
Public pension design

Mature public systems with broad coverage	Public systems in the process of increasing coverage	Social welfare / No public pension pillar
Australia	China	Hong Kong
Japan	Taiwan	India
South Korea	Thailand	Singapore

Consequently, reforms focus on sustainability of pension in the first group and on increasing coverage in the second – no current plans for establishing public pillars in the third group

(Partial) funding of public pensions and introduction of reserve funds led to considerable asset built-up – outsourcing on the rise

Assets of public pension / reserve funds [EUR billion]



Total assets: EUR 858 billion

- **Chinese NSSF** will probably increase assets to EUR 97 billion over the next two decades and is the only 'pure' reserve fund
- **Japanese Government Pension Investment Fund** is the largest pension fund in the world
- **Trends**
  - Retreat from financing function for government projects
  - Increased outsourcing to private asset managers (China, Japan, South Korea, Taiwan)

Source: OECD, National Statistics

Professional asset management can help secure sustainability of public pensions

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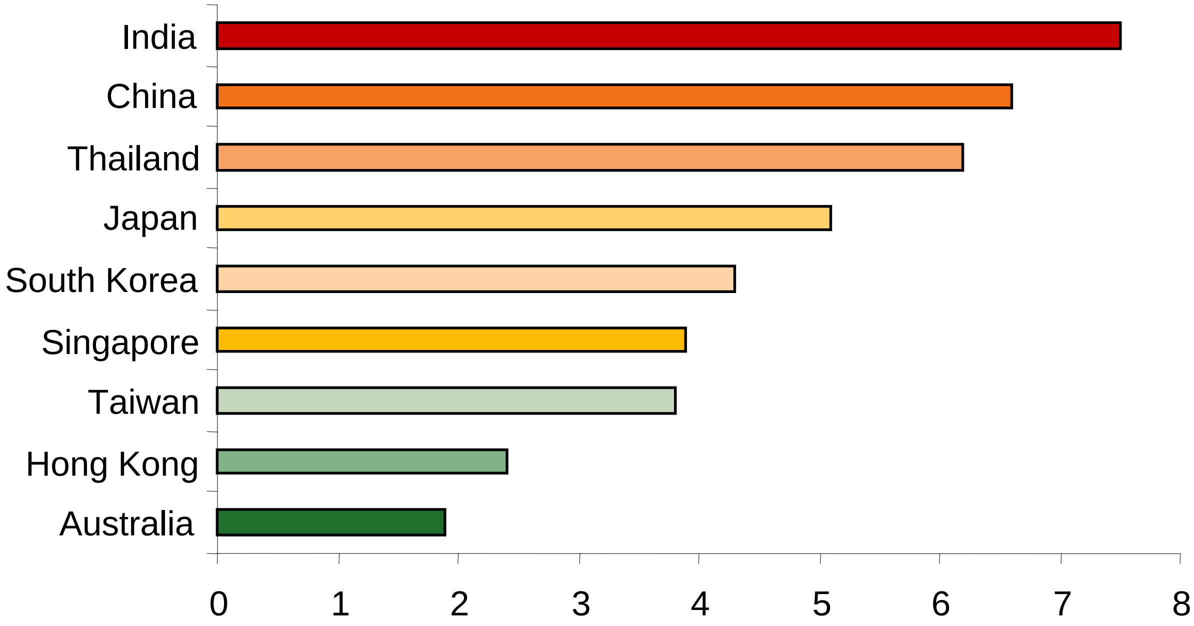
Reform necessity is highest in India and China, reform pressure on Australia is the lowest in the region

Allianz Pension Reform Pressure Gauge 2006



- **Reform Demand Indicator**
  - Current and future demographic situation
  - Size of government debt
  - Coverage rate
  - Retirement age
  - …
- **Reform Progress Indicator**
  - Future impact of reforms already passed

1: low reform pressure, 10: high reform pressure

Source: Allianz Dresdner Economic Research

Low coverage in India and China main reason for further reform necessity, strong funded pillar in Australia and Hong Kong eases need for reforms

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The trend toward defined contribution schemes has accelerated strongly in Asia

Introduction dates of DC schemes

1950s
- Singapore (1955)

1990s
- Australia (1992)
- Thailand (1997)

2000+
- Hong Kong (2000)
- Japan (2001)
- China (2004)
- India (2004)
- Taiwan (2005)
- South Korea (2005)
- Thailand (2008)

- **Main advantages**
  - Transparency
  - Portability
  - Cost control for sponsor
- **DC vs. DB**
  - Higher individual responsibility
  - Investment and longevity risk borne by plan member
  - Prospects for higher returns

In the Western industrialised countries the shift from DB to DC is particularly pronounced in the U.S. and the UK, mandatory DC schemes are widely spread in Eastern Europe and Latin America

These DC schemes cover either the private sector workforce or public servants – mandatory schemes dominate

Type of DC scheme

Mandatory occupational	Voluntary occupational	Mandatory for civil servants
Australia	China	India (voluntary for all citizens)
Hong Kong	Japan	Thailand
Singapore	South Korea	
Taiwan		
Thailand (from 2008 onwards)		

Motivations for introducing DC plans differ

Drivers of DC scheme introduction

Controlling public spending	▪ India ▪ Thailand
Modernising occupational pensions/complement to other systems	▪ Japan ▪ South Korea ▪ China
Higher coverage of occupational pensions	▪ Taiwan ▪ Thailand
DC plans as major/dominant share of retirement income	▪ Australia ▪ Hong Kong ▪ Singapore

Most of Asia's DC systems allow individual choice – which requires financial education

Possibility of individual choice

Yes	No
Australia	China
Hong Kong	Taiwan
India (planned)	
Japan	
Singapore	
South Korea	

Whether or not Thailand will introduce individual choice is not yet decided

- **Advantages of individual choice**
  - Match between individual risk tolerance and investment choice
  - Increased competition among providers/greater choice
- **Importance of financial education**
  - Individual choice increases demand/interest for financial education, but also requires it
  - Financial education needs to be promoted by government and the financial service industry
- **Future issues**
  - Appropriate investment regulation
  - Protection of plan members (individual instead of collective risk management)
  - Pension fund governance
  - Financial advice

Private individual longterm savings in China today
Results from a client survey (2007)

Attitudes and ownership

- **There exists a strong need to save money for the longer term among all consumers**
  - Medical care, retirement, accumulation of a larger sum of money (for purchase of property, car, further investment)
  - Children's education, money to pass to children (married consumers)
- **Advice on how to do it is sought from**
  - Friends
  - Financial magazines
  - Bank's advisors, insurance agents
- **Ownership of various products**
  - Various insurance products, e.g.
    - Life, medical: terms of 10-20 years, regular payment during the term or after the end of the term
    - Insurance with an investment component
  - Children's education funds
  - Term deposits
  - Long term funds
  - Property

Source: Allianz Global Investors AP, Allianz China Life, based on client survey 2007

Longterm savings for old age – customer preferences in China

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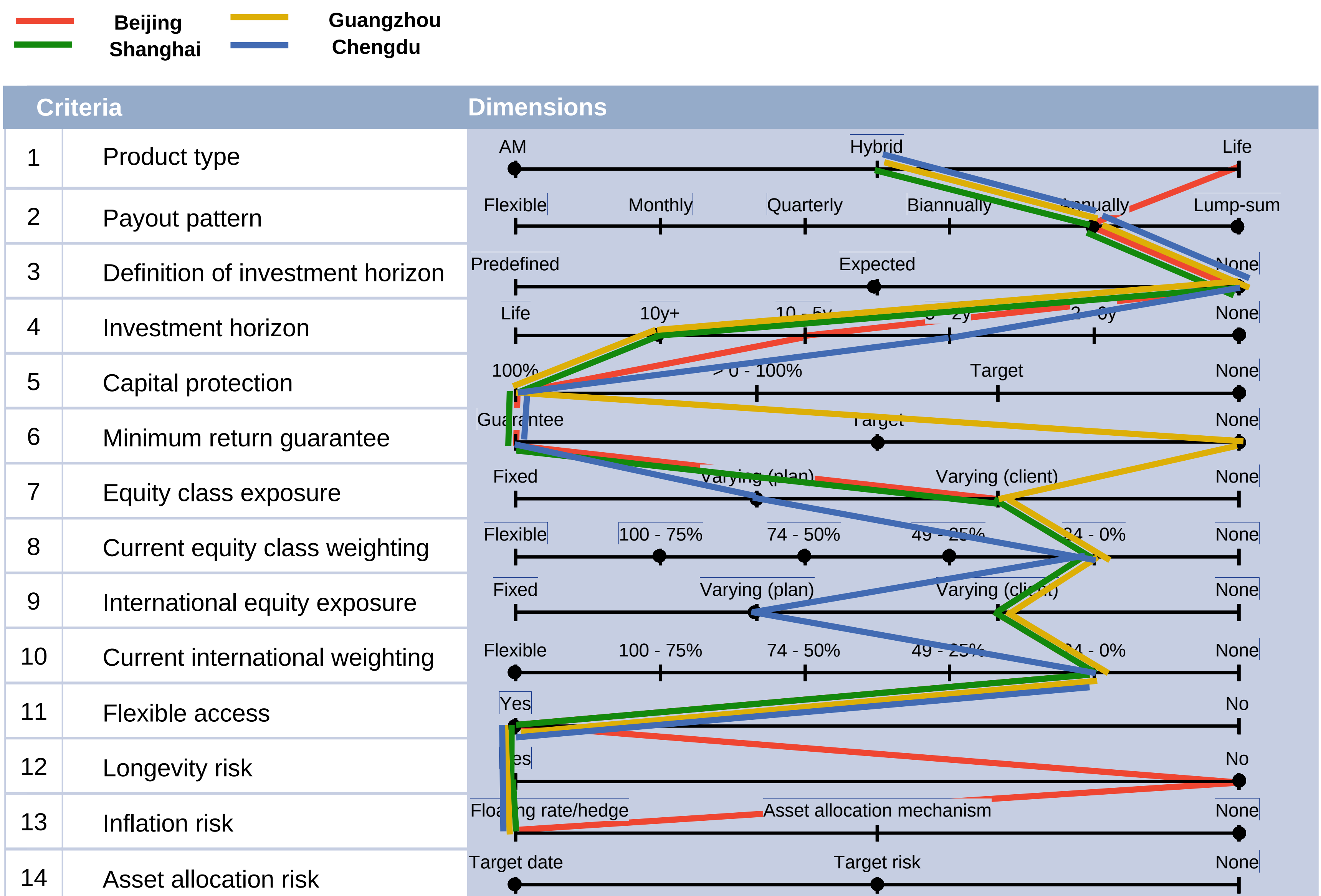
	Criteria	Dimensions
1	Product type	AM / Hybrid / Life
2	Payout pattern	Flexible / Monthly / Quarterly / Biannually / Annually / Lump-sum
3	Definition of investment horizon	Predefined / Expected / None
4	Investment horizon	Life / 10y+ / 10 - 5y / 5 - 2y / 2 - 0y / None
5	Capital protection	100% / > 0 - 100% / Target / None
6	Minimum return guarantee	Guarantee / Target / None
7	Equity class exposure	Fixed / Varying (plan) / Varying (client) / None
8	Current equity class weighting	Flexible / 100 - 75% / 74 - 50% / 49 - 25% / 24 - 0% / None
9	International equity exposure	Fixed / Varying (plan) / Varying (client) / None
10	Current international weighting	Flexible / 100 - 75% / 74 - 50% / 49 - 25% / 24 - 0% / None
11	Flexible access	Yes / No
12	Longevity risk	Yes / No
13	Inflation risk	Floating rate/hedge / Asset allocation mechanism / None
14	Asset allocation risk	Target date / Target risk / None



Source: Allianz Global Investors AP, Allianz China Life, based on client survey 2007

Distributors’ feedback on selling longterm products for retirement
Results from a client survey (2007)

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- **Longterm products are rarely sold through smaller banks and in secondary cities (i.e. CD)**

  “Some of our bank’s customers know little about finance and are not familiar with the long term concept. They have not been with us for a long term. You need to have customers who really trust you as well as the product company to sell such long term products.”

  “We, the NN Bank, have some branches in smaller towns in the outskirt of Chengdu, it is difficult to convince our customers to buy long term products, some of our customers are farmers who don’t see things in this way.”

- **Short term mindset of consumers**

  “To our customers, 1 year is considered long term. How can I sell them long term products of over 3-5 years? Too much time and effort, not really worth it.”

- **Terms & conditions of long term products**

  “Once customers do not clearly understand the terms, they lose interest in the products. I myself even find some of the terms difficult to understand.”

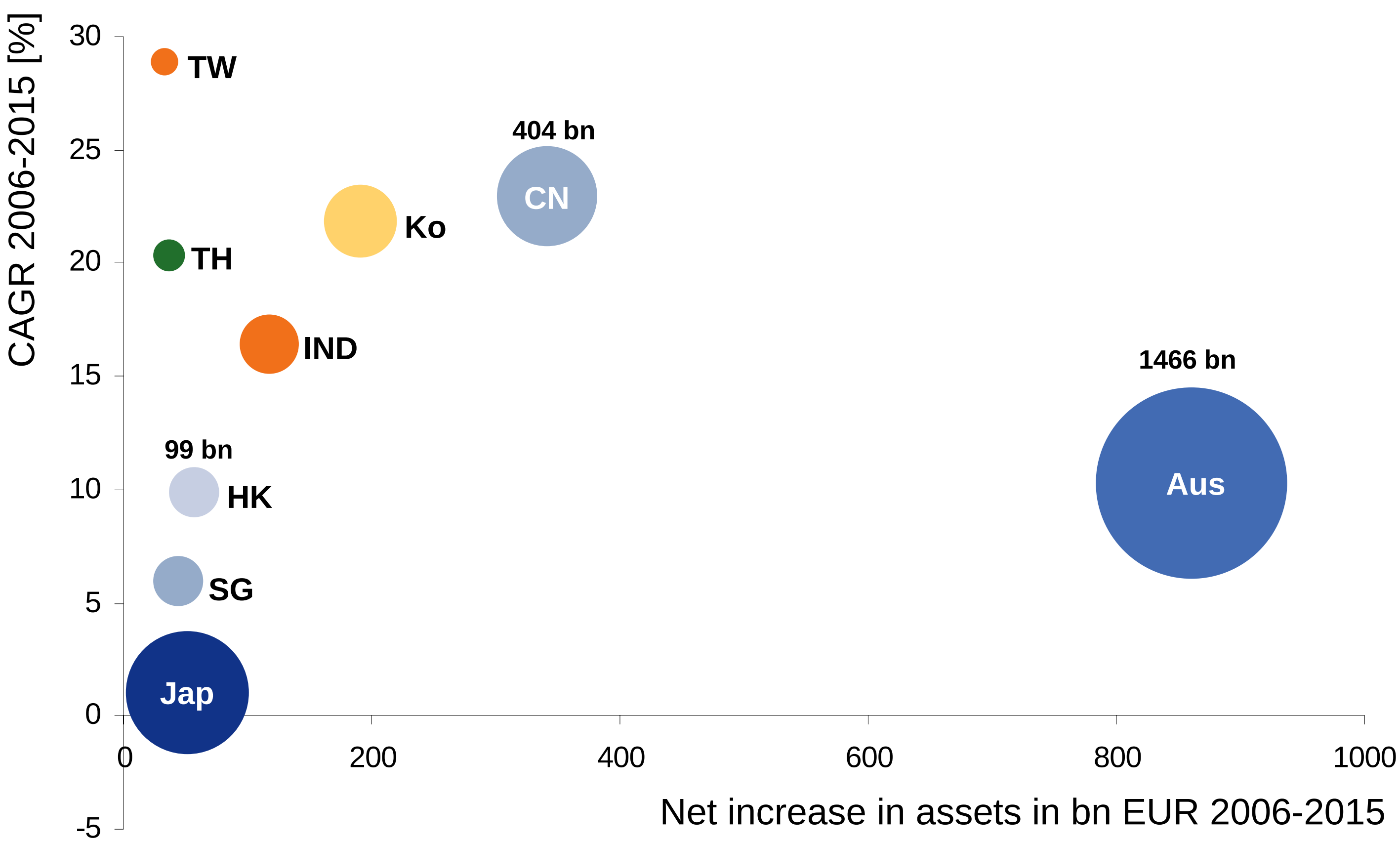
- **Customer concern about whether insurance companies are reliable**

  “Will I really get my money back? In the past, consumers heard of so many cases about not being able to claim money back from insurance companies?”

Source: Allianz Global Investors AP, Allianz China Life, based on client survey 2007

Emerging economies will rapidly built up pension assets – Australia with biggest absolute increase

Development of corporate pension assets in Asia*



- Increase in total pension assets 2006 - 2015: EUR 1,708.5 billion
- Total CAGR: 9.2%
- CAGR emerging markets: 17.2%

Different growth dynamics:

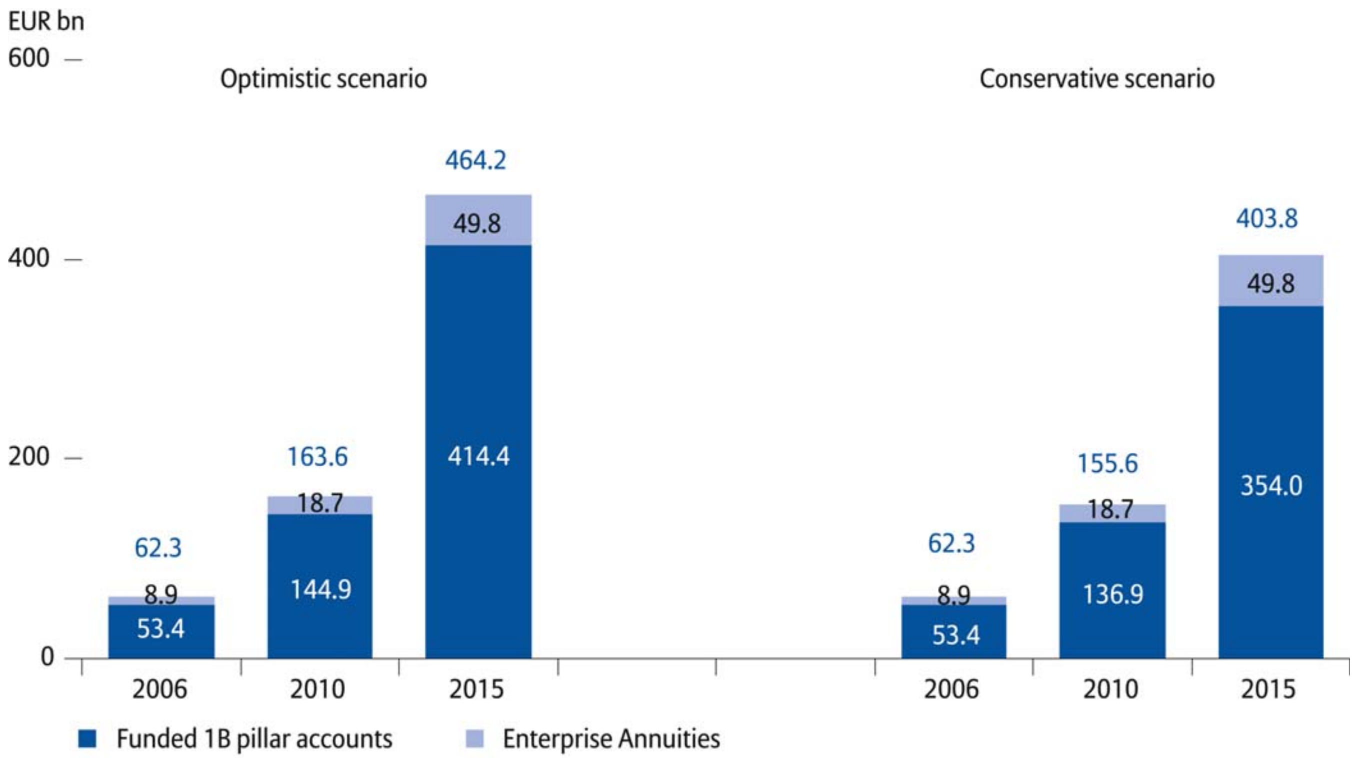
- Increasing coverage in emerging markets
- Performance through high equity share in Australia

* conservative estimates; the size of the bubbles reflects the estimated asset volume in 2015

Source: Allianz Global Investors, Allianz Dresdner Economic Research

China's pension assets will increase at least 6.5-fold over the next eight years

Pension assets under management projections [EUR bn]



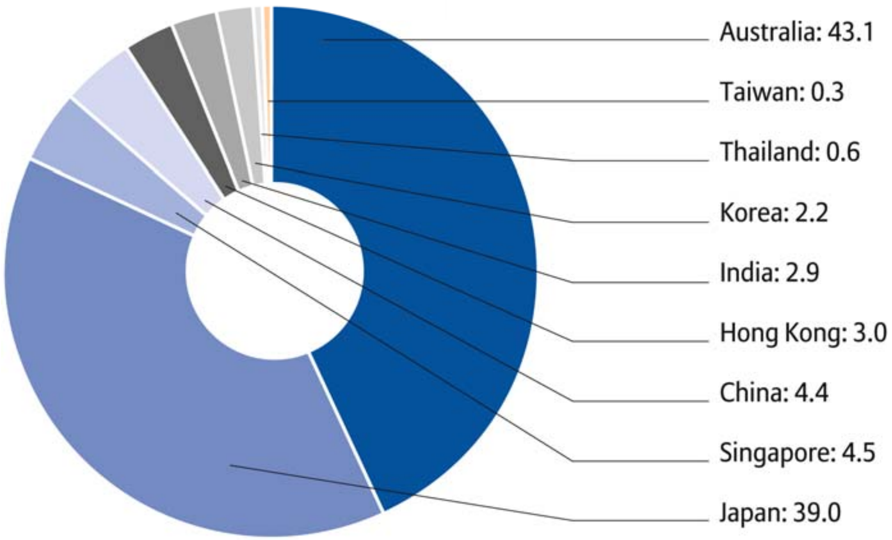
- **CAGR 1B pillar:** 23.4% to 25.6% depending on participation (between 55 and 75% by 2015)
- **CAGR Enterprise Annuities:** 21.2%

Source: Allianz Dresdner Economic Research

Acceptance among SMEs will be crucial for success of EAs

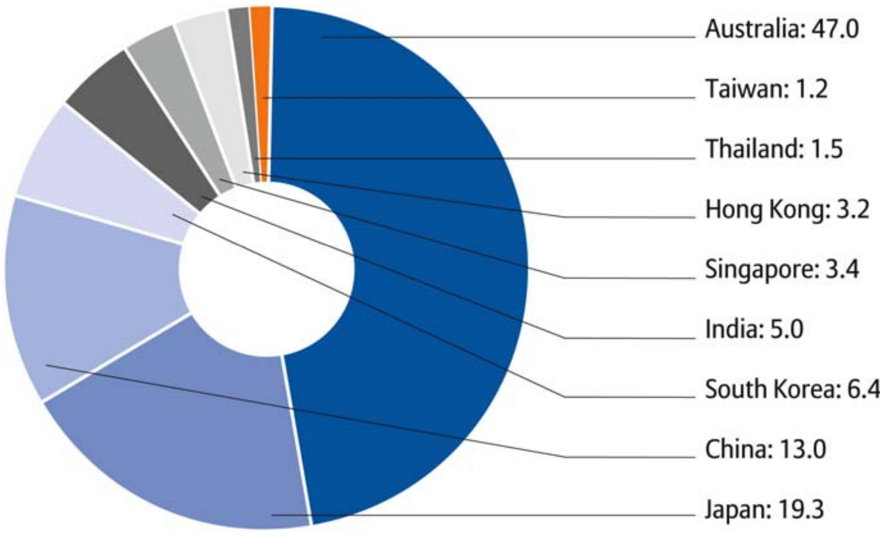
The overall pension market in Asia will more than double until 2015, Australia and Japan currently dominate

Distribution of corporate pension assets in Asia-Pacific 2006 [%]



Total assets: EUR 1,407.5 billion

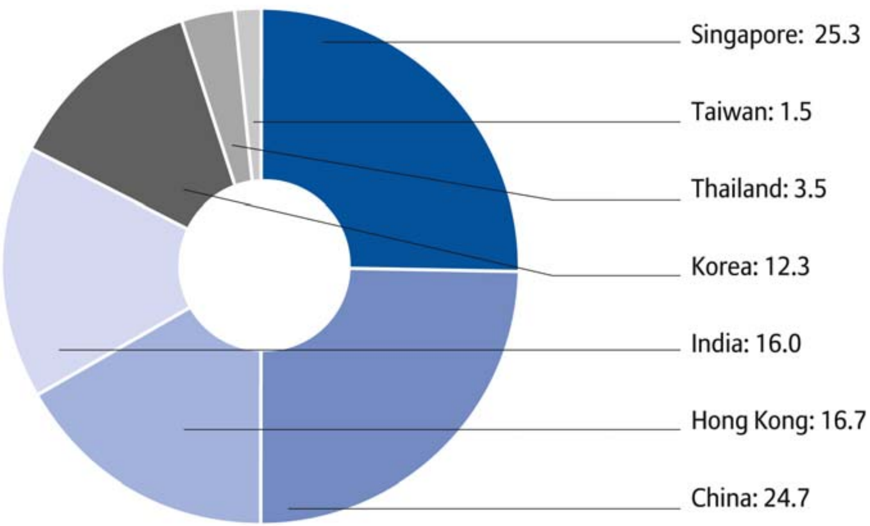
Distribution of corporate pension assets in Asia-Pacific 2015 [%]



Total assets: EUR 3,116 billion

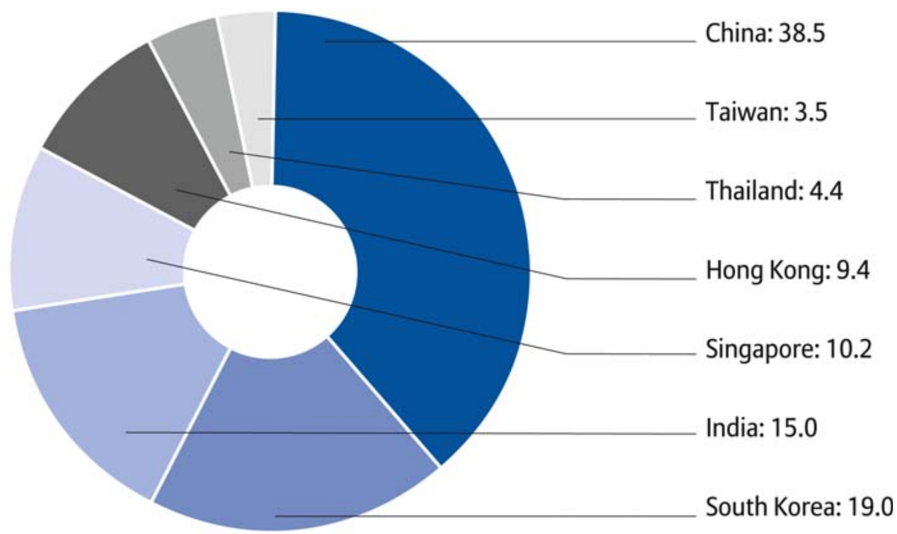
Pension assets in the emerging markets will increase more than fourfold – China's and Korea's share will rise strongly

Distribution of corporate pension assets in Asia's emerging markets 2006 [%]



Total assets: EUR 251.9 billion

Distribution of corporate pension assets in Asia's emerging markets 2015 [%]



Total assets: EUR 1,049.3 billion

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Back ups

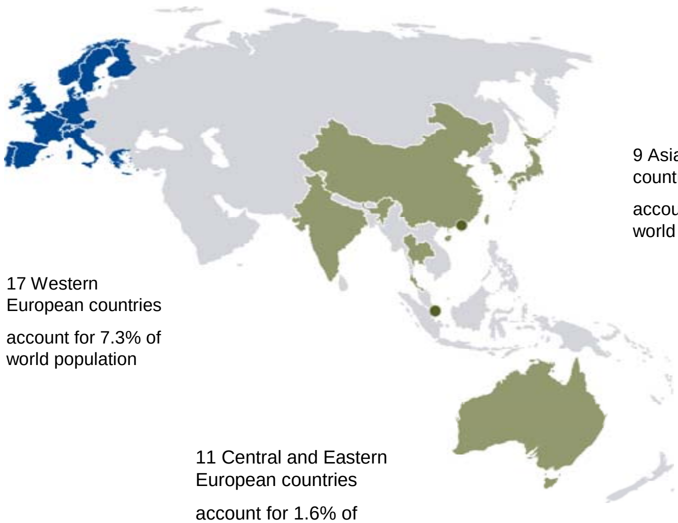
AllianzGI International Pensions
To understand our clients' needs and provide them with the best products

- **Our profile**
  - **Research**
    - analysis of global pension market trends and reforms
    - analysis of pension regulatory régimes and optimal pension investment policies

    in cooperation with the OECD and other partners
  - **Identification of pension related client needs and market demands for product solutions**
    - Initiation of pension solutions for accumulation, decumulation and full life-cycle of pension savings with AllianzGI, risklab germany and

    in cooperation with regional Allianz Life insurance companies
  - **Communication of expertise**
    - Client seminars and conferences
    - Publications
    - Support of OECD pensions research*

The pension market studies – countries in focus



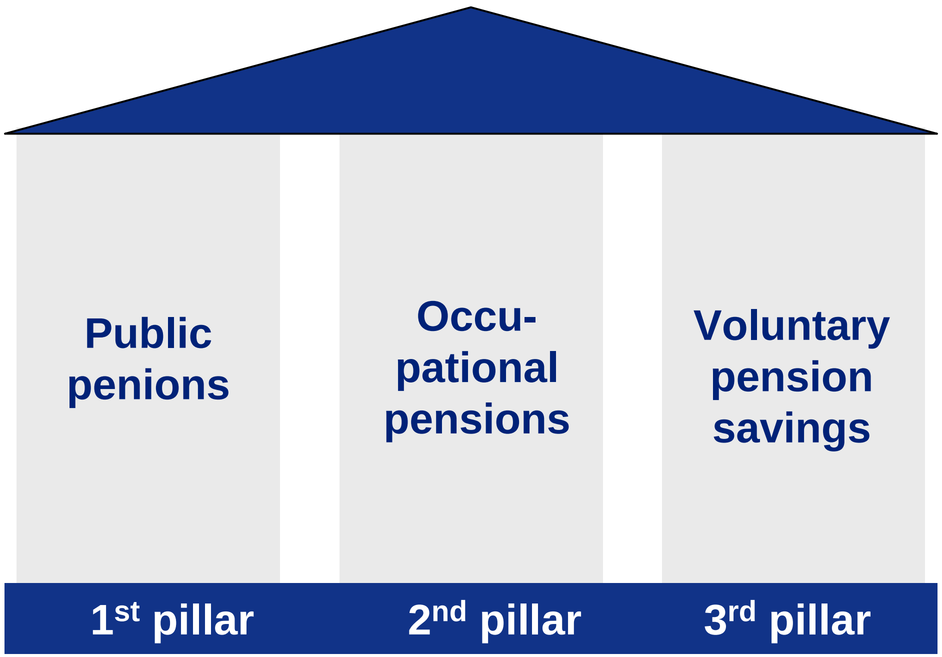
<u>Examples</u>

- Pension market studies on Central and Eastern Europe 2004 and 2007, on Western Europe 2003 and 2005
- Asia-Pacific pension market study 2005 – new edition planned for November 2007
- Pension Conferences 2006/ 2007 in Istanbul, Bejing, Shanghai, Taipei, Seoul, Paris, London, Amsterdam

*just published: Pension Fund Regulation and Risk Management. Results From An ALM Optimisation Exercise. In: OECD, Protecting Pensions: Policy Analysis and Examples from OECD countries. Private Pensions Series No 8, chapter 4

Pension systems basically consist of three pillars

Structure of pension systems



- **The World Bank's three-pillar model**
  - **First pillar:** Publicly managed, financed by general taxes/social security contributions, pay-as-you-go and defined benefit
  - **Second pillar:** Privately managed, funded and mandatory
  - **Third pillar:** Privately managed, voluntary retirement savings
- **Two basic types of occupational / private pension plans**
  - **Defined benefit (DB):** Benefits are defined, sponsor/financial institution bears longevity/investment risk
  - **Defined contribution (DC):** Con-tributions are defined, plan member bears investment/longevity risk

Ageing societies particularly affect the public pension pillar – number of contributors declines, while number of beneficiaries rises so that either contributions must rise or benefits be trimmed

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Reforms in China stick closely to the 3-pillar-model

Design of the emerging Chinese pension system (urban)

Pillar	Contribution rate [%]	Target replacement rate [%]	Financing	Mandatory or voluntary	Status
1A	Enterprise:20 Individual: 0	35	PAYG	Mandatory	In operation
1B (Individual Accounts)	Enterprise:0 Individual: 8	24	Funded	Mandatory	In operation*
2 (Enterprise Annuities)	Max. tax exemption: 4% of employer contribution	20-30**	Funded	Voluntary	In operation
3 (private individual)	n.a.	n.a.	Funded	Voluntary	Not finalised

Pension coverage rates

- Urban pension system: 50%
- Rural pension system: 9%

National Social Security Fund

- Reserve Fund to bolster demographic development (established in 2000)
- Current AuM: EUR 27.5bn (RMB 283bn), expected to grow to EUR 97.2bn (RMB 1tr)

Current reform projects:

- "Refilling" pillar 1B
- Pilot projects to cover migrant workers / larger parts of the rural population
- General harmonisation of the pension system (tax exemption rules for EAs differ considerably as do contribution rates)

Source: Hu (2006), MOLSS (2006), and SDPC of China (2006) * in operation but empty in many cases **estimated by the State Development Planning Commission – SDPC estimates actual replacement rate around 5%