

Roundtable on the pay-out phase and retirement income

David Tuesta
Chief Economist of Global Trends Unit
Economic Research Department

OECD

Directorate for Financial and Enterprise Affairs

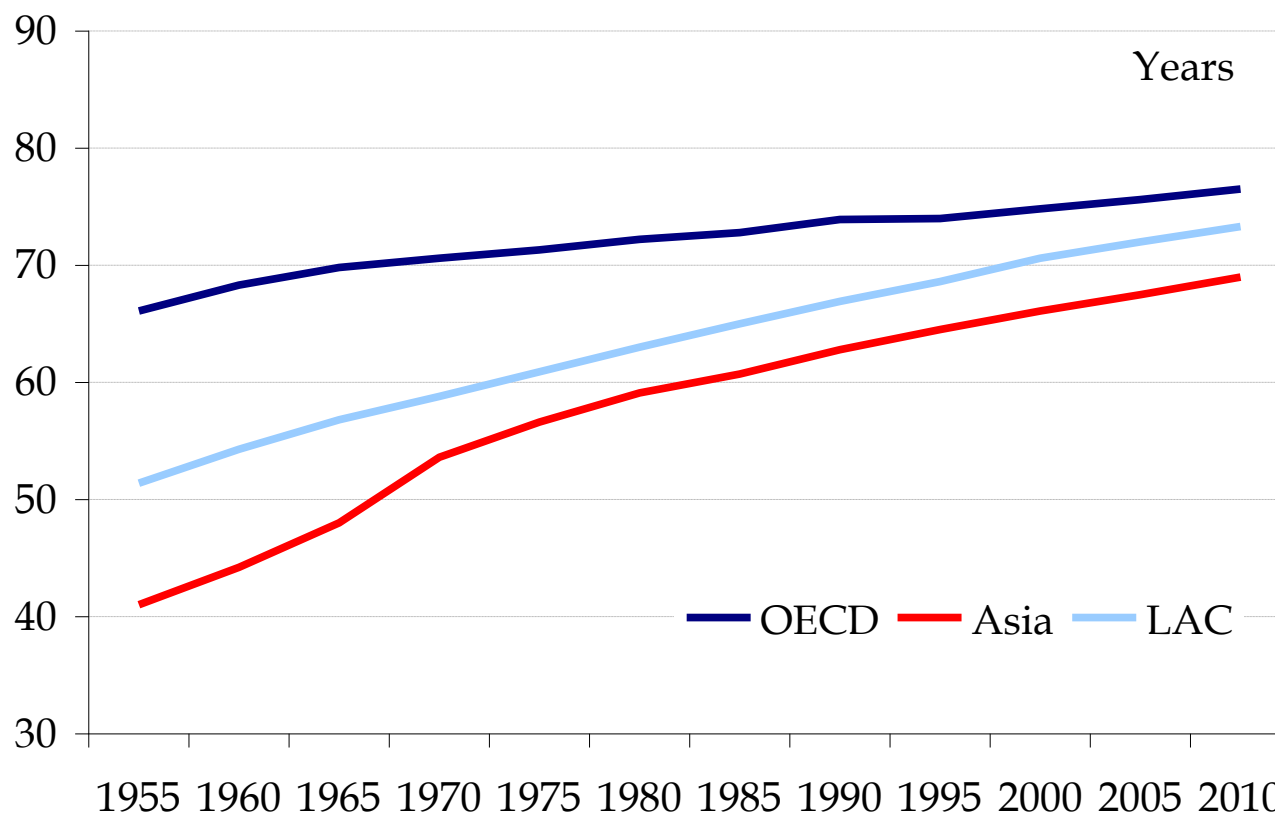
Committee on Financial Markets

The Payout Phase of Pensions, Annuities and Financial Markets

Paris, November 12th 2008

Worldwide ageing

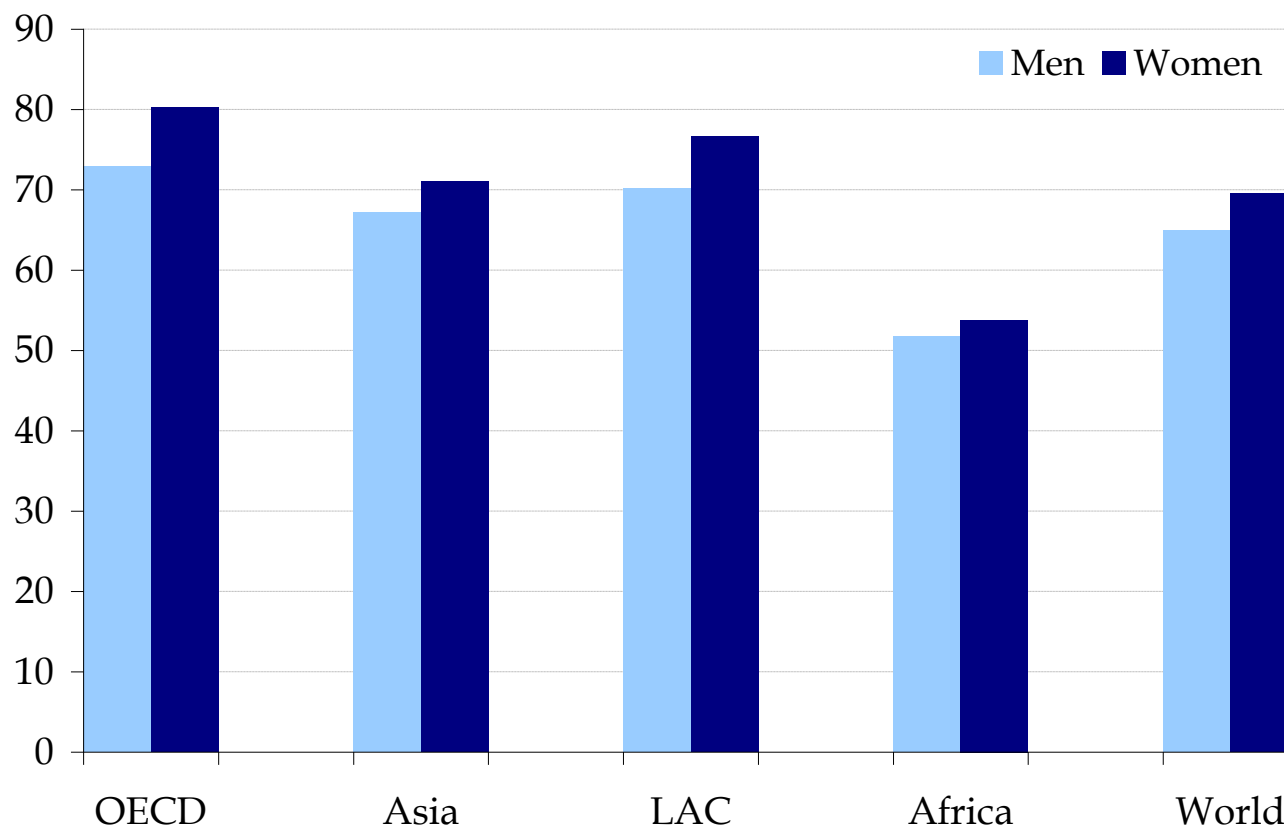
Life expectancy at birth



Source: UN

Worldwide aging

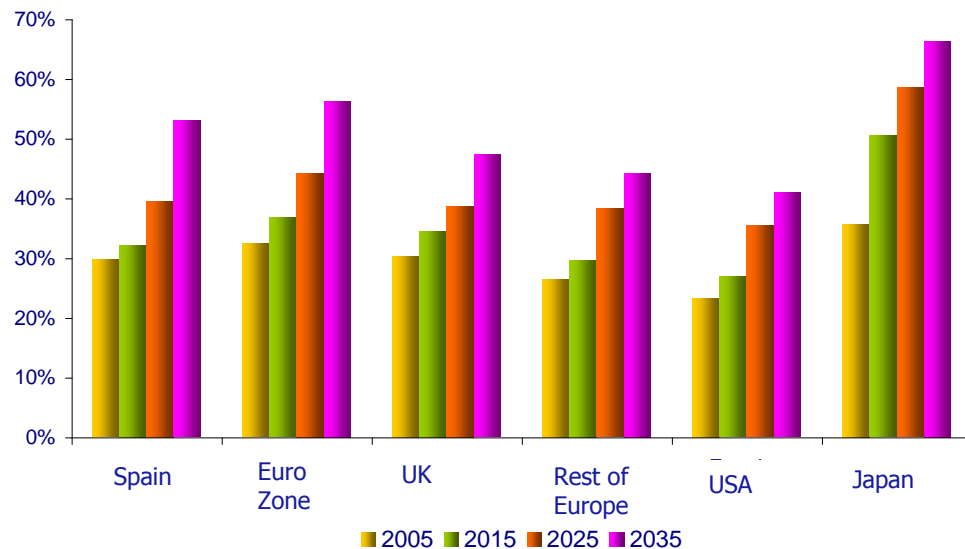
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Worldwide aging

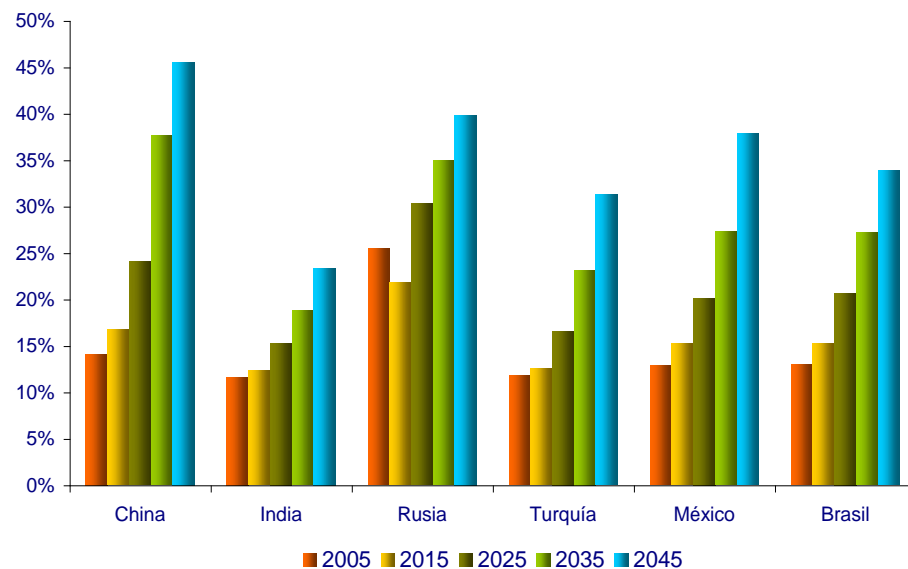
Dependency ratios in developed countries



Defined benefit schemes in Europe will face difficult situations. Parametric adjustments have not been enough.

In emerging countries, Russia and China are the most problematic. Some countries have reformed their systems but have low coverage.

Dependency ratios in emerging countries



How much will longevity risk increase?

- There are different perspectives.
- Pregnancy and delivery conditions at birth are fundamentals for longevity.
- There are new discoveries about the factors that explain longevity.
- Real possibilities of breakthrough in biomedicine for longevity.

How to live forever

Jan 3rd 2008

From *The Economist* print edition

It looks unlikely that medical science will abolish the process of ageing. But it no longer looks impossible



Annuities: Flexibility and/ or protection to longevity risk

- The context is very important (tradition, history, political economy, etc.).
- Socioeconomic considerations impacting the accumulation phase are also relevant (level of income, time of contribution, rate of contribution, structural factors such as informality and labor regulation).
- Financial depth.
- Institutional factors.

How to convince to get an annuity when there is aversion?

- Generous defined benefit schemes crowd out annuities.
- Annuities are believed costly.
- Flexibility to use financial resources.
- Retired workers think they could manage their money better than an expert.
- Underestimation of life expectancy.
- Bequest.

Notwithstanding what experts recommend (longevity risk serious consequences), it is important to allow some choice

- Bequest and the necessity of liquidity are good reasons (and factors) for many people to be better off.
- Considering some kind of soft compulsion to spur annuities, it is necessary to develop all kind of products tackling different objectives:
 - (i) life annuities;
 - (ii) enhanced or impaired annuities (non standard annuities could generate adverse selection);
 - (iii) advanced life deferred annuities (If retire people have enough funds for their next twenty years (from 65 to 85 years old)) it is an excellent alternative / a combination between flexibility and longevity risk at a reasonable cost);
 - (iv) variable annuities with guarantees (e.g. inflation).
- Other alternatives to see: long term care insurance and reverse mortgage.

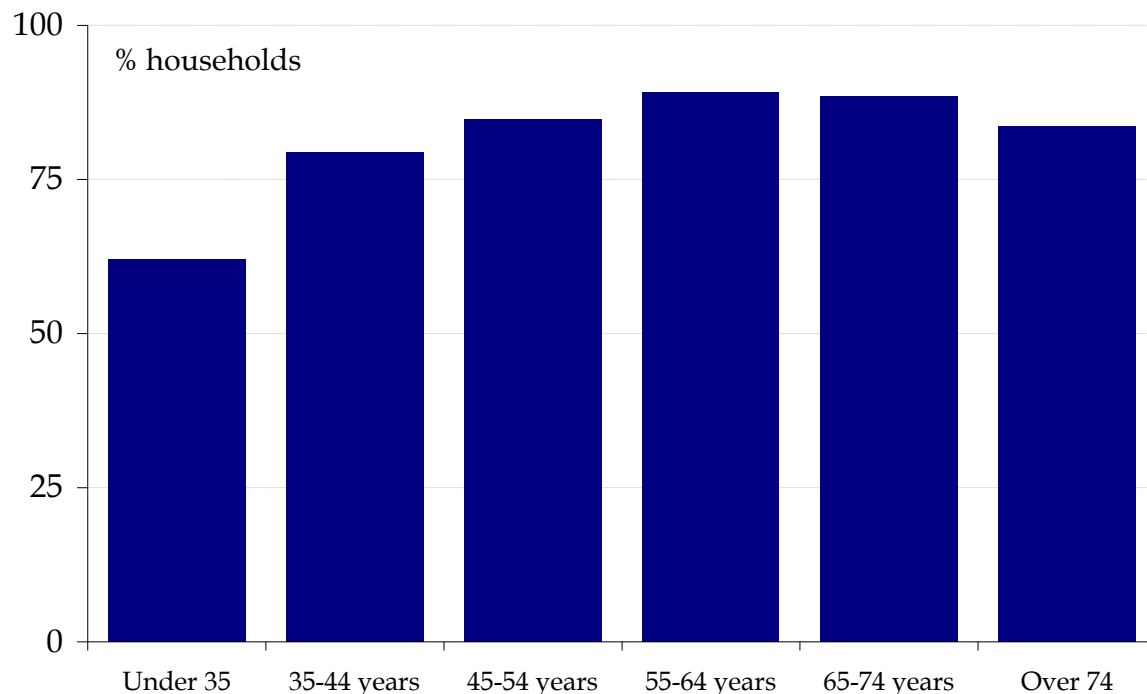
Reverse mortgage: an enormous potential market

- An small market but rapidly increasing in the United States, the United Kingdom, Australia and New Zealand.
- The penetration market rate relative to the owner-occupied house among the elderly is 1.8% in the United States and 1.5% in the United Kingdom.
- Spain has established a precise legislation for inverse mortgage in December 2007.

The potentiality of reverse mortgage in Spain

- Close to 80% of old age population owns a house (vs. 67% in OECD countries).
- Considering longevity risk (and low pensions), reverse mortgage could be a natural product to be spurred in Spain.
- However some short and long-term constraints remain:
 - Supply: young and incomplete regulation, adverse housing cycle.
 - Demand: cultural aversion to indebtedness, low returns, confidence in traditional state-run pension schemes.

Owners of primary residence

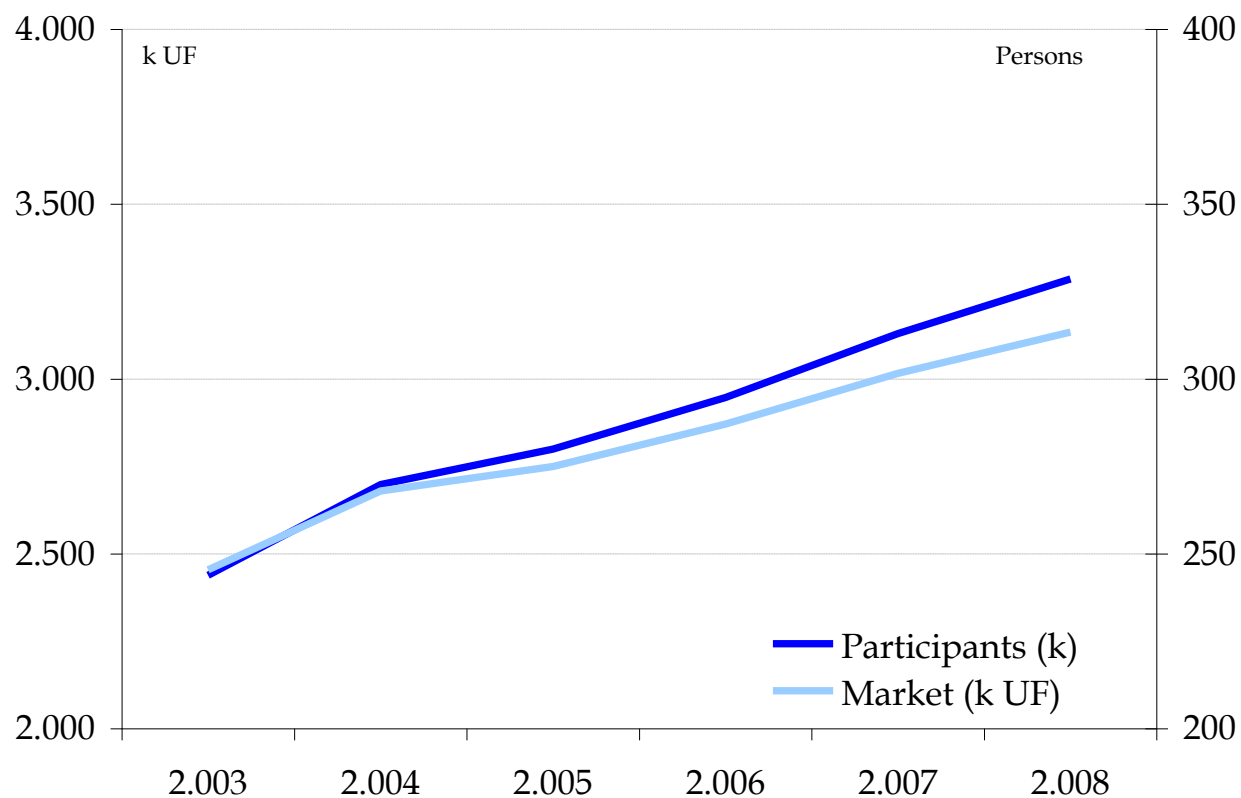


Source: Bank of Spain

From Chile we learnt the importance of state intervention and an annuity-biased regulation to spur annuity market.

- Chilean pension system is mature.
- The regulation (both the general and the phase-out related) has been cautious from the start, spurring competition and consumer protection.
- Compulsory legislation to annuity products, with a limited availability of lump sum payments (almost fully used).

Annuities market in Chile, 2003-2008

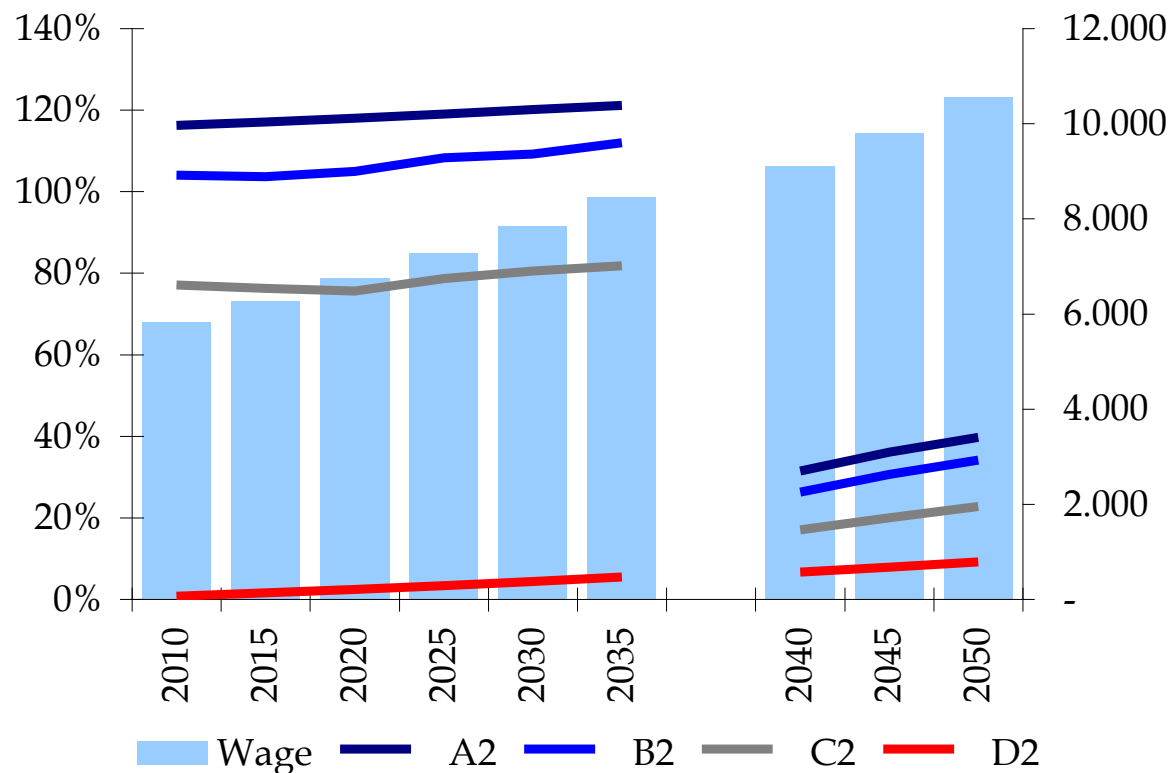


Source: SAFP

From Mexico we find it economically rational the absence of an annuity market nowadays, and foreseeable the absence of a deep market in the future.

- Mexican pension transition rules allows affiliates participating in the labor market prior to 1997 to retire under the old (and generous) DB rules.
- Among the transition cohorts, the potential annuities market is limited to survivors and disability pensions.
- After transition (2035 aprox.), low densities and contribution rates anticipate a limited capital accumulation.
- In absence of second generation reforms (contribution rates), the system will face political challenges.

Projected replacement ratio in Mexico
(by densities of contribution)



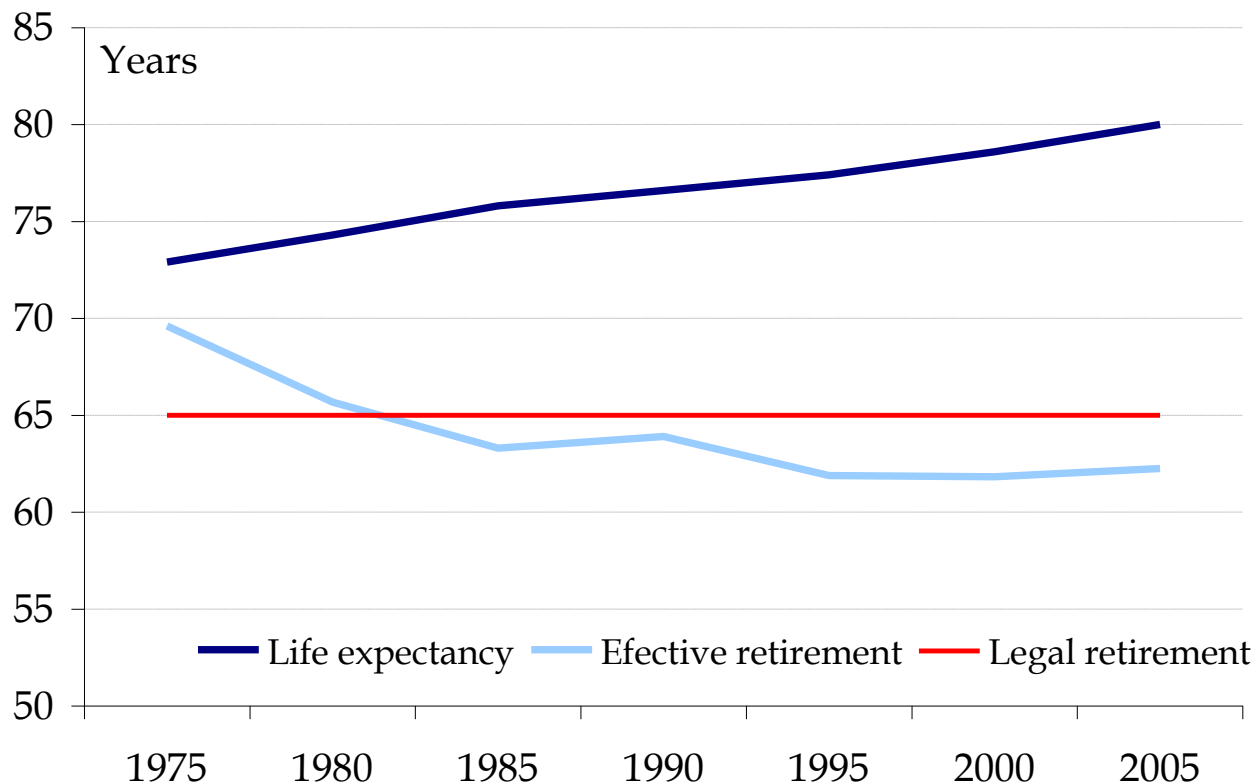
Percentage over 10-year salary. Average male worker.
Source: BBVA

Annuity markets need a sound labour market regulation that faces the challenge of increasing life expectancy

- It is necessary to generate consensus among policy makers about the necessity to increase effective retirement age. That is the key factor to assure more savings and better pensions in an life expectancy increasing society
- Effective retirement age depends not only on legislation but also on adequate incentives (both in the supply and the demand side).
- Productivity considerations are important (excessive unit labor costs among elderly workers?).
- Probably it would be necessary to implement more flexibility in employers and workers labour decisions about salaries, time at work, and work conditions

Annuity markets need a sound labour market regulation that faces the challenge of increasing life expectancy

The case of Spain



Source: UN and OECD

Recent financial turmoil and annuities

- How protected are the population under the threshold of retirement?
- A sensitive topic. Everybody (experts and politicians) has an opinion and a reform under his arm.
- The case of Chilean multi-funds: soft-compulsion. Affiliates are free to choose their fund, but:
 - From 56/51 years (men/women), affiliates cannot chose Fund A (40-80% in equities).
 - Pensioners cannot choose Funds A and B.
 - Default options decrease the equity composition of the portfolio as the affiliate ages (from B to D).

Affiliates by pension multi-fund in Chile, 2008

	Under 20	+20 -25	+25 -30	+30 -35	+35 -40	+40 -45	+45 -50	+50 -55	Over 55
Fund A	8,7%	21,1%	18,4%	15,1%	12,6%	11,1%	8,3%	4,0%	0,7%
Fund B	7,6%	18,1%	22,0%	23,6%	21,7%	2,2%	1,4%	1,6%	1,7%
Fund C	0,1%	0,6%	1,1%	1,5%	22,4%	26,9%	23,8%	16,4%	7,2%
Fund D	0,0%	0,1%	0,5%	0,9%	1,1%	1,3%	1,3%	27,1%	67,7%
Fund E	0,3%	1,8%	5,9%	10,2%	12,9%	15,1%	15,4%	14,2%	24,2%

Source: SAFF

Conclusions

- Longevity risk demands to develop the annuities market worldwide.
- In search of an optimal combination of (soft) compulsion and freedom.
- Develop a rich set of alternatives
- Reforms should be designed in a general equilibrium framework: coherent with other pension regulations, and combined with other market reforms (financial and labor markets).

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