

financial & private sector development

Retirement Products and the Payout Phase: Policy Issues, Constraints and Options

Heinz P. Rudolph, World Bank
Mexico DF, June 8, 2011



THE WORLD BANK



Objectives

- Address complex issues in designing the payout phase.
- Analyze pensioner and provider risks.
- Assess advantages and disadvantages of different types of retirement products.
- Discuss implications of different market structures and elaborate on regulatory challenges.

Pensioner and Provider Risks

- Pensioner risks: complex and pointing in opposite directions (longevity v bequests, investment v liquidity).
- Provider risks opposite to those of pensioners.
- General lack of adequate instruments to hedge longevity and inflation risks.
- Risk sharing through variable participating annuities but complex regulatory and supervisory issues.

Product Shortcomings

- Nominal annuities cover investment and longevity risks but are exposed to inflation risk.
- Real annuities cover all three risks but require access to inflation-linked securities, issued by both the public and private sectors.
- All fixed annuities are exposed to annuitization risk.
- Variable annuities avoid annuitization risk but may be exposed to high investment and inflation risks.
- Phased withdrawals are exposed to longevity, investment and inflation risks.

Menu of Retirement Products in Selected Countries

	Lump-Sums	Term Annuities	Lifetime PWs	Fixed Nominal Life Annuities	Fixed Indexed Life Annuities	Variable Annuities
Australia	Yes	Yes	Yes	Yes	No	Yes
Chile	No *	No	Yes	No	Yes	Yes, not implemented
Denmark	(1) No (2) No *	(1) No (2) Yes	(1) No (2) Yes	No guaranteed benefit only	No conditional bonus only	Yes
Sweden	(1) No (2) No	(1) No (2) Yes	(1) No (2) Yes	No guaranteed benefit only	No conditional bonus only	Yes
Switzerland	Yes *	No	No	Yes	No Conditional	No

Lessons: Menu of Options

- Degree of annuitization largely explained by restrictions
- If a high degree of annuitization is a policy objective, the menu has to be regulated accordingly
 - However, it is important to avoid over-annuitization
- Optimal menu is country-specific
 - Chilean approach of restricted menu is reasonable for countries where second pillar plays a key role
 - Countries with larger zero pillars and/or first pillars should adopt a more flexible menu
- Menu regulation needs to consider the supply of instruments and hedging tools
- A default option should always be specified

Lessons: Marketing Rules

- Countries with open fixed annuities markets should consider adopting an electronic quotation system (Chile)
 - In countries with variable annuities, electronic quotation systems might not be efficient
- Broker activity/financial advice may need to be regulated to prevent abuse

Lessons: Institutional Arrangements

- Decentralized structures require vigilance over growing oligopolies.
- Centralized provision (single provider):
 - Possible advantages:
 - Large risk pooling
 - Scale economies
 - Possible disadvantages:
 - Interference in annuity pricing
 - Interference in asset management/weak innovation
- **Transfer of investment and longevity risks back to the State**

financial & private sector development

Thanks!

hrudolph@worldbank.org

SAVE THE DATE

**V World Bank Contractual Savings Conference
January 9–11, 2012 Washington DC**



THE WORLD BANK

