Lessons from Overseas

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Chile

- Population: 15.2m
- Currency: Chilean Peso
- Language: Spanish
- Area (sq km): 736,905
- GNP per capita: $11,700
- Interesting fact: has the lowest death rate per capita from motorcycle accidents

Lesson 1 - Chile

<table>
<thead>
<tr>
<th>SINGLE PILLAR</th>
<th>OLD SYSTEM pre 1981</th>
<th>NEW SYSTEM from 1981</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provision</td>
<td>State social security</td>
<td>Mandatory private</td>
</tr>
<tr>
<td>Type of benefit</td>
<td>Defined benefit</td>
<td>Defined contribution</td>
</tr>
<tr>
<td>Financing mechanism</td>
<td>PAYG</td>
<td>Funded individual account</td>
</tr>
<tr>
<td>Contributions</td>
<td>In excess or 20%, 67% er/33% ee</td>
<td>Employer Nil Employee 10%</td>
</tr>
</tbody>
</table>

Lesson 1 - Chile

OLD SYSTEM pre 1981:

- Administratively complex SS system:
  - circa 50 administrative agencies
  - different old age pension systems
- Benefit circa 70-100% covered earnings
- PAYG system
- Total contributions in excess of 20%*, circa 2/3rds employer financed

* For long term benefits: retirement, disability and survivors
Lesson 1 - Chile

NEW SYSTEM from 1981:
- Reform of SS system, including pensions
- Move to private DC pension provision
- Administration by regulated authorised providers, AFPs
- Compulsory 10% employee contribution, further 10% employee voluntary contribution permitted
- All contributions tax deductible
- One-off salary increase of 17% of salary 1 March 2001
- Flexibility at retirement to:
  - Transfer funds to another provider
  - Purchase annuity, do income draw-down or a combination

Lesson 1 - Chile

Outcome:
- Simplification of former complex system
- Reduction of state and employer burden/risk:
  - Shift from state to private provision
  - Shift from PAYG to funded individual account
  - Shift from employer to employee financing
  - Shift from defined benefit to defined contribution
- Greater transparency of new system to employees
- Catalyst for growth of investment and insurance services/markets

Australia

- Population: 18.8m
- Currency: Australian Dollar
- Language: English
- Area (sq km): 7,682,300
- GNP per capita: $19,870
- Interesting fact: has the highest level of coal consumption per capita
Lesson 2 - Australia

THREE PILLARS

<table>
<thead>
<tr>
<th>1st PILLAR</th>
<th>State old age pension</th>
</tr>
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<tr>
<td>2nd PILLAR</td>
<td>Mandatory Superannuation Guarantee (SG)</td>
</tr>
<tr>
<td>3rd PILLAR</td>
<td>Occupational and private personal supplementation</td>
</tr>
</tbody>
</table>

Lesson 2 - Australia

1st PILLAR – State Old Age Pension:
- Means tested
- PAYG defined benefit system
- Financed out of government general revenues
- Retirement age 65
- Full pension circa AUD 12,000
- Income/asset test for eg single homeowner:
  - Full pension if income circa < AUD 3,000 pa and assets < AUD 140,000
  - Nil pension if income circa > AUD 31,000 pa and assets > 285,000

Lesson 2 - Australia

2nd PILLAR – Mandatory Superannuation Guarantee (SG):
- Introduced 1992
- Little compulsory provision prior to that
- Funded defined contribution and defined benefit (but defined benefit in decline for some time)
- Financed through individual employer superannuation schemes or industry-wide funds
- Individual employer funds in significant decline
- Normal retirement age 65
Lesson 2 - Australia

2nd PILLAR – Mandatory Superannuation Guarantee (SG):

- Compulsory minimum employer contribution of 9% of salary
- Employers/employees can make contributions in excess of SG minimum requirements and often do
- In recent years trend to offer members choice of different investment options
- Highly regulated system

Lesson 2 - Australia

2nd PILLAR – Mandatory Superannuation Guarantee (SG):

- Preservation/locking-in of benefits until retirement
- Tax concessions apply for benefits to Reasonable Benefit Limit (RBL*) – now A$619,000 as lump sum
- SG contributions not tax deductible, but fund is paid as a tax free lump sum at retirement (few members opt for an annuity) within RBL
- Above SG, members can contribute pre or post tax
- Benefits in excess of RBL taxed at member's highest marginal rate

Lesson 2 - Australia

Outcome of SG:

- Creation of 2nd Pillar compulsory system
- Minimum level of preserved retirement provision for all
- Reduction of state and employer burden/risk:
  - Shift from state to private superannuation provision
  - Shift from PAYG to funded provision
  - Shift from defined benefit to defined contribution
- Increased transparency of new system to employees
- Increased employee choice/control of retirement savings
- Has fuelled growth in domestic capital markets and financial services sector in general
- Broad acceptance of the need for, and value in, SG legislation
Lesson 2 - Australia

Outcome of SG:

- Current 9% SG contribution under scrutiny – increase widely debated
- Property boom has lead to bricks and mortar being the long-term investment of choice though
- Self-Managed funds (similar to SSAS/SIPP) likely to be the big winners from Choice of Fund legislation – direct property investment opportunities main driver
- Choice of Fund catalyst for change within the funds themselves (along with trustee licensing). The market is sensitive to fee levels and this is a key competitive driver between funds. Consolidation is inevitable and many have already merged

Singapore

- Population: 4.0m
- Currency: Singapore Dollar
- Language: Malay/English
- Area (sq km): 647
- GNP per capita: $26,910
- Interesting fact: highest oil consumption per day per 1000 people

Lesson 3 - Singapore

COMPULSORY PROVIDENT FUND (CPF):

- Set up in 1955 to provide basic welfare benefits
- Evolved into comprehensive social security/savings scheme
- Compulsory defined contribution/savings system
- Financed by employer and employee contributions (some government subsidies)
- Funded individual savings accounts
- Account savings used to provide a range of benefits including:
  - Retirement
  - Healthcare
  - Home Ownership
  - Family Protection
Lesson 3 - Singapore

COMPULSORY PROVIDENT FUND (CPF):

- Contributions based on monthly earnings up to circa SGD 6,000
- Total contribution circa 33% of earnings (under age 55): 13% employer, 20% employee
- All contributions tax deductible
- Total contributions allocated to three separate savings accounts:
  - Ordinary Account circa 20%
  - Special Account circa 6%
  - Medisave Account circa 7%

Lesson 3 - Singapore

CPF Accounts:

- Medisave Account – Savings used to meet healthcare costs (variety of medical insurance schemes including Medisave, Medishield, Medifund and other approved medical insurances)
- Ordinary Account – Savings available for property purchase, retirement, investment, education and purchase of CPF death/disability insurance
- Special Account – Savings reserved primarily for retirement

Lesson 3 - Singapore

CPF Retirement:

- Ordinary and Special Account savings can be invested cash, bonds, shares, insurance products, unit trusts and exchange traded funds
- Up to 35% can be invested in shares and corporate bonds
- Members can withdraw savings - and effectively retire - from age 55, provided they set aside a Minimum Sum in their Ordinary Account to provide old age benefits
- The Minimum Sum is currently circa SGD 80,000 and must be used to provide a monthly income from normal retirement age 62 – either by income draw-down or annuity purchase
- Benefits taxed as income
Lesson 3 - Singapore

Outcome:

• Comprehensive fully integrated state/private funded system
• Decreased retirement burden/risk for state and employer
• Transparent individual account system
• Great degree of control for employees over their savings
• Catalyst for growth of investment and insurance services/markets
• Some aspects of administration remain relatively complex
• Some investment restrictions remain
• A potential gap in coverage for employees with earnings above CPF monthly earnings limit of SGD 6,000 – government recently introduced new Supplementary Retirement Scheme (SRS) vehicle

Switzerland

• Population: 7.4m
• Currency: Swiss Franc
• Language: French/German/Italian
• Area (sq km): 41,284
• GNP per capita: $26,340
• Interesting fact: lowest number of 20 year old women who gave birth to a child whilst in their teens

Lesson 4 - Switzerland

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<tr>
<th>THREE PILLARS</th>
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<td>1st PILLAR</td>
<td>Federal old age pension (AHV)</td>
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<td>2nd PILLAR</td>
<td>Mandatory minimum private pension (BVG) from 1985</td>
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<tr>
<td>3rd PILLAR</td>
<td>Occupational and private personal supplementation</td>
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Lesson 4 - Switzerland

1st PILLAR – Federal Old Age Pension:

• Per AHV SS legislation 1948
• Many revisions since, most recent to align retirement ages males and females and widow/widower pensions
• PAYG defined benefit system
• Employer and employee contributions circa 5% of total earnings
• Benefit based on covered earnings circa CHF 13,000-76,000
• Minimum pension circa CHF 13,000, maximum pension CHF 25,000
• Inadequate income replacement on earnings CHF 25,000-76,000

Lesson 4 - Switzerland

2nd PILLAR – Mandatory minimum private pension:

• Per BVG legislation 1985
• Intended to address gap in replacement income on earnings in excess of CHF 25,000
• Funded “quasi defined contribution” system
• In reality a defined benefit arrangement – a “cash balance” style plan with annual guaranteed minimum investment return and fixed annuity conversion rates
• Financed through individual employer pension foundation or collective/multi-employer foundations provided by insurance companies/other financial institutions
• Contribution salary is AHV covered earnings between CHF 25,000-76,000

Lesson 4 - Switzerland

2nd PILLAR – Mandatory minimum private pension:

• Age related mandatory minimum total pension contributions range from 7% (age 25-34) to 18% (age 55-65) of earnings
• At least 50% of total contribution must be met by employer
• Accumulated member’s account at retirement converted to pension at rate of 7.2% (fixed 1985-2004), lump sum payments also possible
• Annual guaranteed minimum investment return prescribed by Federal Council:
  - 1985-2002 (inclusive) = 4%
  - 2003 = 3.25%
  - 2004 = 2.25%
  - 2005 = 2.25%
Lesson 4 - Switzerland

Outcome:

• Risks associated with investment return and annuity conversion guarantees poorly understood by stakeholders
• Market conditions 1985-2002 ensured apparent success of BVG system:
  - Positive investment performance, easy to meet 4% return guarantee
  - Surpluses developed, foundations crediting returns in excess of 4%
  - Interest rates/bond yields reasonably supported annuity conversion rates

Lesson 4 - Switzerland

Outcome:

• By 2002 apparent many foundations in trouble:
  - Market crash had turned historic surpluses into deficits
  - Asset strategies misaligned to deliver minimum return guarantees in current market conditions
  - Low bond yields unable to support annuity conversion/insurance rates
  - No processes/strategies in place to address deficits
  - Many Swiss employers provided similar plans for earnings in excess of CHF 76,000, compounding the effect

Lesson 4 - Switzerland

Outcome:

• Reactions 2002-2005:
  - Material reduction to historic investment return guarantee
  - Awakening to need for risk management strategies
  - Alignment and tightening of investment strategies
  - Revision of annuity conversion/insurance rates to reflect market conditions and increased longevity
  - Implementation of processes/strategies to address deficits
  - Many employers, for first time in history, did not provide minimum investment return on plan above BVG minimum
• Related valuation and accounting issues under IAS 19/FRS 17
### Sweden

- Population: 8.9m
- Currency: Krona
- Language: Swedish
- Area (sq km): 449,964
- GNP per capita: $18,770
- Interesting fact: highest number of seats in parliament held by women (as % of total).

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### Lesson 5 - Sweden

#### THREE PILLARS

<table>
<thead>
<tr>
<th>PILLAR</th>
<th>Description</th>
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<td>State old age pension (Old AFP/ATP and New System)</td>
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<tr>
<td>2nd PILLAR</td>
<td>Mandatory private sector pensions – ITP and SAF/LO</td>
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### Lesson 5 - Sweden

**1st PILLAR – Old Age Pension under AFP/ATP:**

- Prior to 1999
- Applies to all born pre 1937, transition arrangements for those born 1937-53
- PAYG defined benefit system
- Benefits determined by reference to annual Base Amount (BA), circa SEK 40,000
- AFP flat rate pension based on earnings up to 1 x BA
- ATP earnings related pension based on earnings between 1 and 7.5 x BA
- After a full career aggregate AFP+ATP pension circa 60-65% of covered earnings (to 7.5 x BA)
Lesson 5 - Sweden

1st PILLAR – Old Age Pension under New System:

- Introduced 1999
- Applies to all born 1954 or later
- Mixed system:
  - Mainly centrally managed PAYG "defined contribution" system
  - Small externally funded defined contribution component
- Total contribution of 18.5% of total salary, shared between employer and employee
- Of this, 18.5% of salary up to 7.5 x BA directed to retirement benefits as follows:
  - 16% registered in notional individual national account (but actually used to finance current pensions in payment, PAYG)
  - 2.5% paid into private personal savings plan with a provider of the employee's choice

- Notional individual account annually increased with an index linked to economic growth
- Private personal savings plan increases with investment returns
- At retirement both accounts used to provide an annuity
- After a full career new system expected to deliver a pension of circa 50-55% of covered earnings (to 7.5 x BA)

Lesson 5 - Sweden

2nd PILLAR – ITP plan:

- Since 1960
- Covers most private sector salaried employees
- Defined benefit system
- Primarily insured with central provider Alecta
- Larger employers may choose to use book reserving method (FPG/PRI)
- Covered earnings up to 30 x BA
- Alecta determines individual participating company contribution rates, which are fully paid by employer
- Replacement ratios from ITP approx:
  - Salary up to 7.5 x BA 10%
  - Salary band 7.5 to 20 x BA 65%
  - Salary band 20 to 30 BA 32.5%
Lesson 5 - Sweden

2nd PILLAR – SAF/LO plan:

- Covers most private sector wage earners
- Funded defined contribution system
- Replaced former DB plan for wage earners (STP) in 1996
- Covered earnings are total gross salary
- Employer pays 3.5% of employees wages to an insurance contract of the employee's choice
- Main insurer is AMF but there are a number of other authorised insurer offering both with-profits and unit linked products

Lesson 5 - Sweden

Outcome 1st Pillar New System:

- Recent redesign
- Some reduction of state burden/risk:
  - Shift from defined benefit to “defined contribution”
  - Partial shift from state to private
  - Partial shift from PAYG to funded provision
- True employee understanding of new “defined contribution” system will be judged in time

Lesson 5 - Sweden

Outcome of 2nd Pillar ITP and SAF/LO:

- In recent years pressure from employers to move from defined benefit to defined contribution to better control costs
- SAF/LO defined contribution system has reduced burden/risk on employer replacing former defined benefit commitments
- Employee perception of ITP as old fashioned and inflexible
- Employer perception of ITP as difficult to manage/understand costs
- Ongoing discussions on redesign of ITP, likely switch to defined contribution
- Related ITP valuation and accounting issues under IAS 19/FRS 17
The Lessons

Trends:
• Shift from state SS to compulsory private provision
• Shift from state PAYG to private funded arrangements
• Shift from defined benefit to defined contribution designs

Not one magic solution:
• Chile – Big bang, simple and transparent compulsory private solution
• Australia – Minimum level of compulsion to start with
• Singapore – Is it a savings or pension scheme
• Switzerland – Danger in mixing defined contribution with defined benefit guarantees without understanding/managing risks
• Sweden – Employers increasingly uncomfortable with lack of control/understanding of cost of insured ITP. Too early to tell on social security plan,