“Let the Old People Live Good Lives”: Global Trends in Retirement

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Thank you, Dan, and thanks to all of you for joining us here tonight on the eve of ICI Global’s inaugural Global Retirement Savings Conference.

One of ICI Global’s policy priorities is to stimulate a dialogue about the long-term savings and retirement challenges facing jurisdictions worldwide—and to highlight how investment funds can play a key role in the changing retirement landscape.

This is a timely discussion, because systems for building retirement resources have come under pressure around the globe.

Between 2007 and 2012, virtually every member country of the Organisation for Economic Co-operation and Development, the OECD, instituted pension reform measures of some type.

From the United States to Sweden to China, governments, businesses, and individuals are struggling to improve the programs needed to provide economic security to growing populations of the elderly.

Tomorrow, we will spend the day discussing the future of retirement savings systems.

But I have always found it helpful, when considering policy challenges, to look backward as well—to put today's problems in a bit of historical context. And so I have spent some time delving into the history of retirement plans.

"Retirement" itself is in many ways a relatively recent concept.

In societies built around agriculture and handicrafts—which is to say, for 49 of the 50 centuries of recorded human history—workers didn't anticipate an extended period of leisure after their working years.

Life expectancies weren't that long, and the elderly tended to live in extended households where they could contribute even as their strength and skills declined. Your "retirement plan" consisted of your land, your tools, your skills, and your relationship with your family and community, and whatever you could put by to save for later.

The exception to this pattern tended to be the military. Western scholars cite the armies of ancient Rome as the first to offer pensions. When Augustus established the Roman Empire, he created a pension plan that, in outline, would look familiar even today.

Service of 20 to 25 years qualified a legionnaire for a lump sum that could produce an income in excess of two-thirds of a laborer's earnings.

So, too, in China—the military tended to have retirement plans, long before other sectors. It's not hard to see why a society—any society—would have a strong incentive to provide for older soldiers rather than leaving them destitute, angry—and armed.

While our forebears seldom focused on retirement as a distinct financial goal, saving and thrift have long been central moral and societal themes around the world.

In the west, Aesop's fable of the ant and the grasshopper has been passed from generation to generation to stress the importance of setting aside a part of the harvest for bleaker days.

In Japan, schoolchildren still learn about Ninomiya Kinjiro, a 19th Century agrarian reformer who preached "diligence, thrift, and saving." For decades, schools in Japan were decorated with statutes of a studious boy carrying a bundle of firewood, honoring Ninomiya's saying: "Work hard, spend little. Gather much firewood, but burn little."

The teachings of Confucius, in the fifth century BCE, emphasized the importance of frugality and social cohesion—values that took root throughout Asia. Official Confucianism took a dim view of private wealth, but encouraged saving as a moral imperative and as a means of providing for the community.

Families took primary responsibility for care of the elderly, but the community was expected to help out as needed. As Confucius wrote: “Let the old people live good lives, let those in working age contribute to the society, and let children be well-educated.”

Long before the introduction of banks or investment funds, communal granaries and savings societies helped villagers meet emergencies and fund one another’s new enterprises.

The Industrial Revolution changed the nature of work and thus the nature of retirement. Craft work was supplanted by industrial-scale work for wages, while life expectancies increased.

In the 19th Century, both private and public pension systems emerged to help support aged workers who could no longer keep up with the pace of work in factories or offices.

The vast majority of these plans offered “defined benefits,” where the employer and plan bore the risk of delivering on the promise of a regular pension payment for life. And government retirement systems were often created on a “pay as you go” basis, with benefits for current retirees supported by taxes collected from current workers.

In recent decades, those models have come under intense pressure.

Changing demographics have made pay-as-you-go government-provided retirement systems increasingly unsustainable.

Created during a period of rapid population growth, these systems initially had a large number of workers supporting a smaller number of retirees.

When population growth slows, the pool of retirees grows faster than the pool of workers supporting them, undermining the finances of these systems.

Employer-sponsored defined benefit plans, meanwhile, have faced funding pressures as well.

DB plans have proven more expensive—and their costs more volatile—than many employers anticipated. These problems have been apparent for decades, but the twin bear markets of the 21st Century exacerbated and highlighted them.

In the face of these trends and financial stresses over the years, many countries have been reviewing their population’s retirement resources and have sought to reform their retirement systems. Many of those nations have turned to defined contribution approaches, and many more countries may be considering implementing this model in the future.

In a defined contribution, or DC, model, a worker’s ultimate retirement benefits are determined by the amount of contributions credited to the worker—whether from the employer, the worker, or the state—and the investment returns earned on those savings.

Different countries employ DC and DB systems in different ways. DC plan design has been used to replace or supplement employer-sponsored occupational schemes, or to replace or supplement national government-provided systems.

In the United States, the national Social Security system provides the broad-based foundation of our retirement security. It is a pay-as-you-go system with benefits designed to provide higher replacement rates for the lower-paid workers. Among government-sector employers, too, defined benefit plans are still the primary model. But among private-sector employers, the DC model increasingly dominates.

By contrast, in Chile, the DC system has a very different role—their national DC system replaced the government-provided PAYGO system.

In Australia, a mandatory DC system, the Superannuation Guarantee, was adopted in 1992 as the next step in Canberra's effort to improve and expand a century-old occupational pension system that had been largely defined benefit for most of its history.

Now, while I cite this movement to the DC model as a common trend, it's vital to remember that retirement systems differ around the world. Each jurisdiction's method of providing resources for retirement varies, reflecting their unique history and economic institutions.

In particular, DC systems take different forms in different countries—and many countries are in different stages with their own DC systems.

Nonetheless, the DC model has common features that help to address the demographic, fiscal, and workplace issues that have undermined DB pensions over time.

For governments or for employers, one primary advantage of DC plans is that the cost of funding is transparent and predictable.

For workers, DC plans provide ownership of their retirement resources, and the corollary benefit of portability. DC account assets can grow throughout a career as workers move from job to job, whether the account is in a centralized system, left in prior employers' plans, or rolled over into new retirement accounts. This portability fosters a flexible labor market. DC plans also have the ability to generate significant income in retirement.

It's also notable that DC plans have been marked by a high degree of innovation. I can speak primarily for the United States, where employers, investment and service providers, and policymakers have worked in partnership to create and implement innovative plan features that increase participation and contribution rates, improve investment options, and enhance employees' ability to manage their retirement resources.

ICI and ICI Global have a deep interest in the worldwide development of the DC model.

As Dan said, this conference reflects our interest in fostering a global dialogue on the long-term savings challenges facing countries around the world, and about the role that investment funds can play, as part of DC plans, in meeting those challenges. We believe that the funds our members offer can make a significant contribution.

In preparation for this conference, ICI Global reviewed the retirement systems in nine jurisdictions, studying the evolution of their use of the DC model. These DC programs are very different, but we nonetheless found five common themes among them.

First, we see *a growing use of automatic features,* whether to enroll participants, increase their contribution rates, or direct them into default investments. Use of these automatic features recognizes that participants have different levels of interest and expertise—while some may prefer to exert control over their retirement accounts, while others prefer using the systems' default options.

The second theme is that DC plans provide *transparent disclosure and education* to help individuals make the financial decisions necessary to direct their plans.

Defined contribution plan participants generally receive robust disclosures regarding their plans and access to educational materials, whether from national campaigns, individual employers, financial services firms, or regulatory agencies.

Here in Hong Kong, the Hong Kong Securities and Futures Commission launched the Investor Education Centre, or IEC, last November to develop a wide range of public investor education programs and improve financial literacy.

New Zealand's Commission for Financial Literacy and Retirement Income is providing online tools to help citizens manage their personal finances, publishing research on retirement issues, and promoting personal financial education as part of the school curriculum.

And in the United States, both participants and plan sponsors are receiving enhanced fee disclosures under new Labor Department regulations. Plan sponsors and financial service providers have led the way in educating participants through online planning tools and calculators, seminars on investing, and more.

Our third theme: across the globe, we see DC systems offer a *range of investments to savers*. Different countries have approached investment choice in different ways, but DC systems generally have increased the number and range of investment options available to retirement savers.

At the same time, DC systems around the world are bringing greater diversification into default investment options. The practice of defaulting participants into a capital-preservation investment, like a stable-value account or a money market fund, is increasingly being replaced by use of more diversified investments.

In particular, more countries are turning toward lifecycle or target date funds as their defaults. Target date funds are professionally managed funds that are designed to meet a participant's investment objectives based on the number of years a participant plans to remain in the workforce. These funds provide participants with diversification and automatic rebalancing.

Sweden, in 2010, changed the investment strategy of its state-managed default fund to a target date strategy. In the United Kingdom, all of the default funds in the National Employment Savings Trust, or NEST, Programme are target date funds.

In the United States, the growing use of target date funds has helped keep retirement savers in the equity market since the financial crisis, despite an understandable decline in investors' tolerance for risk.

And the chairman of Hong Kong's Mandatory Provident Fund Schemes Authority recently said that Hong Kong should make greater use of target date funds. We'll hear more from the chairman, the Honorable Anna Wu Hung-yuk, our luncheon speaker tomorrow.

The final theme we see is a *rising sensitivity to fees*. Like any other financial service or employee benefit, DC systems incur fees as they provide services to plan participants. Whether fees are set in a competitive market with robust disclosure, or through bidding or rebate systems set by a central plan provider, we are seeing more focus on fees, from Sweden to the UK to the U.S. to Chile.

Obviously, this whirlwind global tour demonstrates that defined contribution plans are growing and evolving as they take a larger role in providing retirement security in jurisdiction after jurisdiction.

In the United States, our industry—investment funds—has played a crucial role in development of our defined contribution and individual account plans, whether 401(k)s or individual retirement accounts. We are rightly proud of the strengths of the 401(k) system and its contributions to a robust retirement system for American workers.

Globally, we believe investment funds can play a vital role in defined contribution plans and in building the future of retirement. The products that our industry has developed contain key features that serve retirement savers well.

Our investment funds are

- professionally managed,
- well regulated,
- transparent,
- diversified, and
- cost-effective.

Fund companies have a long history of interacting with investors and can provide valuable insights into how to reach, educate, and serve retirement savers.

And our industry has a global scope and perspective that can inform policymakers as they consider needed reforms to their pension systems—a crucial motivation for our conference here.

In addition to sharing our knowledge and perspectives, how else can the global investment fund industry help societies around the world meet the need for greater self-reliance in retirement security?

We must do all we can to assist individuals in their efforts to save and invest for their retirement.

That means continuing to educate individuals on the power and importance of retirement savings vehicles, such as DC systems.

That means supporting innovations in DC system design that will improve participants' experiences in these plans and their retirement savings outcomes.

That means helping participants use these plans to their fullest potential, providing tools to make informed investment choices and to manage their resources effectively through their working and retired years.

And the fund industry must embrace and defend public policies that provide structures and incentives to help investors achieve retirement security.

At ICI and ICI Global, we are committed to meeting those challenges. I hope that our meeting tomorrow will help advance the dialogue among all the key parties—funds, policymakers, employers, and workers—to improve retirement security through defined contribution systems around the world.

Thank you.
