



Linking the accumulation and payout phases

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Agenda

1. Stating the policy objective(s)
 2. Product and menu options
 3. Provider options
 4. Distribution issues and options
 5. Regulation and supervision
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Objectives

- Consistency of objectives between payout phase and accumulation phase is important but not always in place
 - Is it a pension scheme or a savings scheme?
- Usual trade offs and constraints lead to choices along a continuum

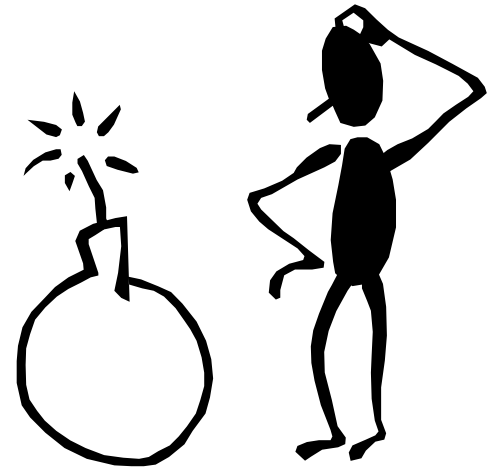
- Examples:
 - Is your objective to work toward the minimum number of people falling into poverty in extreme old age? Or that all members will have the opportunity for a stable, secure, adequate retirement income? Are you concerned about informality eroding coverage or a low density of contributions?
 - Depending on the decisions, you would have a different payout phase design?





Other objectives

- Some will be important expressions of the core objective:
 - Treatment of widows and orphans
- Some will be critical to the design
 - Deliver wage indexed outcomes in retirement
 - (for example, in several countries where the minimum pension is linked to the minimum wage, or in Australia where the social contract led to wage indexation of the basic pension)
- Some are useful, relevant but subsidiary.
- Examples:
 - Develop long term fixed interest markets
 - Reduce annuity rate risk for retirees.





Pay-out Options

Options	Country
Lump sum only	HK India Philippines
Lump sum / PW	China, Indonesia, Malaysia
Lump sum/ PW/ annuity	Australia, Brazil, Denmark, Japan, Spore
Lump sum / Annuity	Greece, Spain, Belgium , Czech, S Africa, USA
Partial lump sum + annuity	Germany, Italy, Portugal, UK
Annuity/ PW	Canada, Chile., Costa Rica, Mexico, Norway Peru
Annuity only	Austria, Bulgaria, Colombia, Croatia, Netherlands, Poland, Russia, Sweden Uruguay



About the products

- Annuities:
 - Many jurisdictions define the type of annuity to make it more standard, aligned to objectives, and clear to potential buyers.
 - For example:
 - Lifetime or do we allow some limited durations, Guarantee periods, Deferral periods, Joint or single life, Indexation, Return of some capital on death
 - PW Products
 - Several types depending on formula and how it is implemented.
 - Fixed benefit rule: Determine the annuity that would have been purchased and then make this the annual amount that is taken as a drawdown.
 - Fixed percentage rule: a percentage of the fund is determined in advance and applied to the fund value at the time of the withdrawal.
 - The “1/T” rule: the percentage withdrawn varies with “T” the expected remaining duration of the product. So the withdrawal fraction increases with age. Could be determined by a maximum age or by life expectancy.
 - Factor basis updated once account is in place? Or only at issue.
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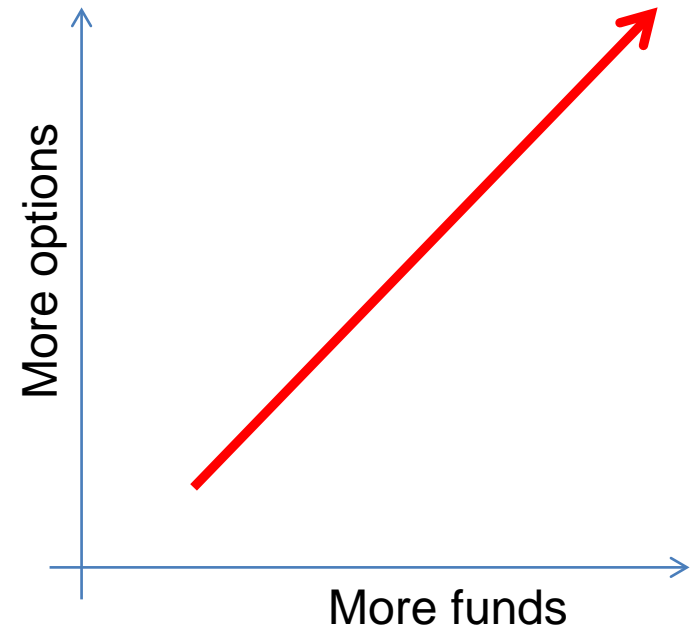
PW Products continued

- When tables or factors include a mortality table (explicitly or implicitly) need to consider how factors will be changed when new tables are produced?
 - New versus existing PW recipients
 - Treatment of those that switch PW providers in future
 - Flexibility in the PW designs needs to be balanced against considerations of income (and taxation) deferral or advancement (income security risk)
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Product Menu Options

- Many countries adopt a “minimum pension” objective.
- Those that accumulate sufficient funds to be able to guarantee themselves a minimum pension by taking an annuity can do so
- The additional risk associated with investments in PWs means that the guarantee of a minimum pension might be more difficult – so can require an uplift factor.
- Those with more funds can consider more options.
- Note the role of any first pillar or voluntary approach is also relevant
- Can combine these rules into the early retirement conditions
- What to do with those that never accumulate enough?





Before Retirement

- Disability and Death Benefits
 - might also be provided through same income products; or annuities only
 - Some countries leave these as part of the “old system”, eg Mexico
 - Earlier step encourages earlier development of markets and products
 - Might be at a defined level (funded by the accumulation fund plus an insurance payout)
 - Purchase decision not price sensitive for beneficiary
 - Early Retirement
 - Can encourage development of market due to volume
 - Usually with tighter conditions of income provision than normal age retirement
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Who should provide products?

- Lump sum/ PW can be paid out by pension funds or life insurance companies
 - Insurance company standards needed for providers of annuities
 - Longevity risk calculations
 - Solvency guarantees behind promised (more guaranteed) benefit
 - Others
 - Social Security or Government Operated Pension Fund
 - Some other central provider
 - Dedicated retirement license, separate accounting and assets, or comingled with other business?
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Examples Annuity Providers

Insurance Company	Pension Fund	Insurance Company or Pension Fund	State Provider
Chile Italy Mexico South Africa UK	Brazil Bulgaria Czech Republic Switzerland	Hungary USA Australia Denmark	Bolivia Singapore Sweden



The artificial break

- Shifting providers creates a sale and reinvestment when both are long duration
 - Liquidity imposed at a cost
 - Creates additional reinvestment risk
 - Introduces market discipline and competition benefits
 - “Annuity rate risk” needs to be considered
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Key questions

- Who can distribute products?
 - Clients will need advice about choices
- What information will be provided to clients?
 - Clients need to be provided with information that
 - Clearly highlights key differences between products (risks, expectations for income, coverage of contingent payments)
 - facilitates fair comparison
 - Does not artificially bias one product over another
- Note: The less choice people have, the less complex this area of regulation can be





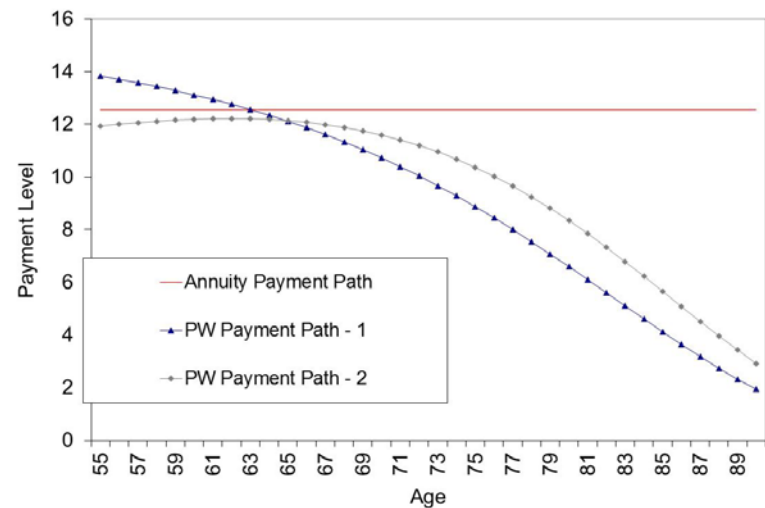
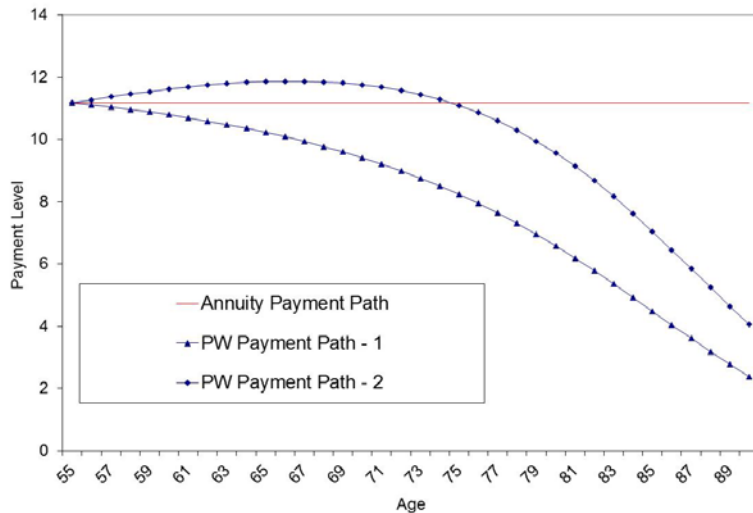
Illustrating Benefits

- Comparing the “year 1” payout is an insufficient comparison but how to stop clients from focusing on it?
 - Challenge of demonstrating later year effects
 - Overcoming client under-estimates of their own longevity risk and high discount rate of time value of money.
 - PW illustrations depend on parameters
 - Even if prescribed, interest rate assumptions will be artificially different to annuities offered.
 - Skilled marketers can bias one product over the other to suit their own motives:
 - Regulate costs? Commissions? Limit choices open to providers?
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Payout path illustrations

- Challenge to get an illustration to show real differences but not false virtues. Examples show ease of manipulation
- Challenge, even with good regulation, is how to get the same initial payment when that is the situation





Challenges in Selecting Products

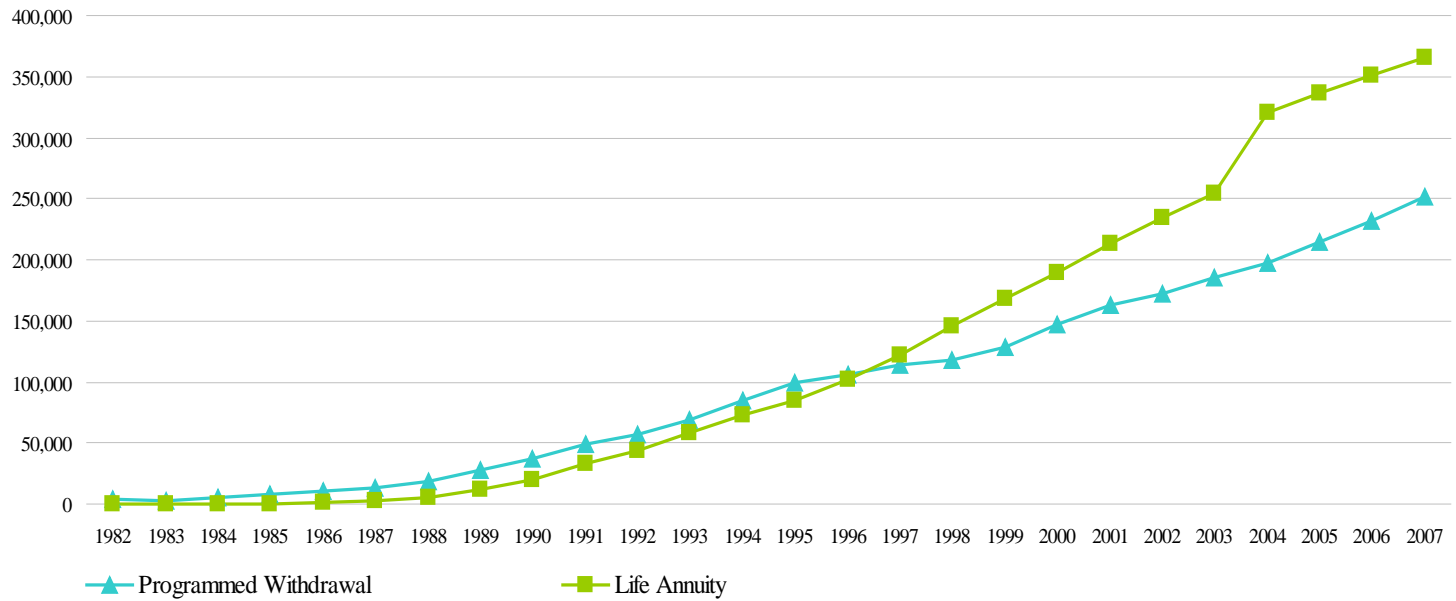
2. Ensuring Best Annuity price

- Where annuitization compulsory, ensuring the best price is the challenge (may be 'locked in' to provider from accumulation phase can't shop around)
- Several countries provide centralized system for comparing annuity prices
- Such systems can help to increase knowledge and understanding - particularly when coupled with some product explanation or advice
- They may also deliver cost savings and efficiencies (via potentially lower marketing and distribution costs for providers) and also assist with the timing of an annuity purchases
- In most countries, comparative annuity quotations can be obtained via third-party advisor or brokers
- But they may be paid by commissions, be tied to one provider, may not be able to provide advice, or be unwilling to take on clients with small balances
- Impartial advice provided by public sources is preferred



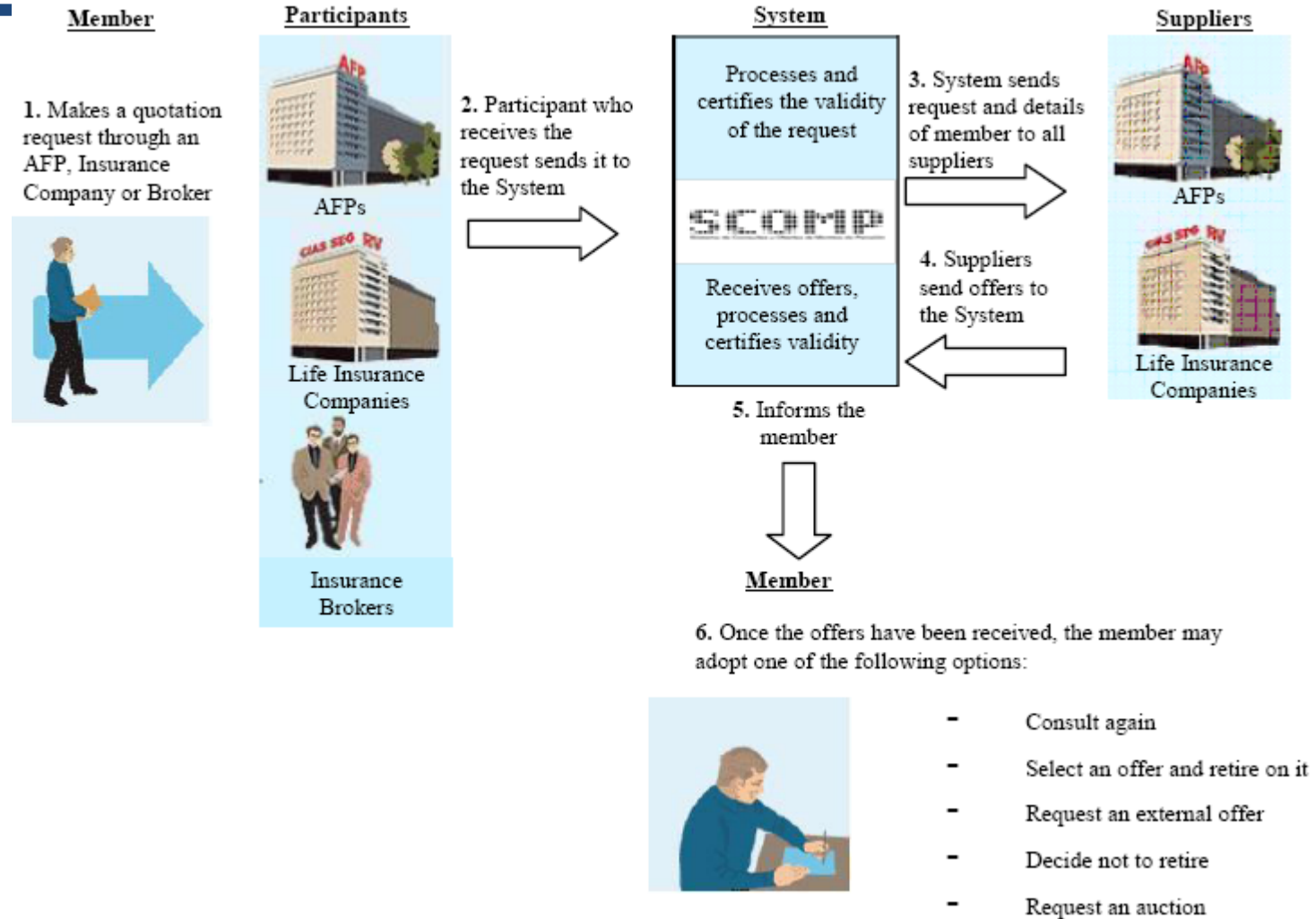
CHILE

Number of Pension by Mode *Source SAFP*





How SCOMP Operates





Requirements depend on choices made

- Capital and solvency, including ALM matching, liquidity, concentration and reinvestment risk requirements
 - Investments
 - Data collection and providing it to the market
 - Individual level data to facilitate analysis requires analysts as well as data
 - Developing statistical information for pricing and provisioning *and* also for PW parameters
 - Yield curves, investment valuation and risk assessment capacity
 - Mortality and longevity, and mortality improvement
 - Distribution and Illustration rules
 - Treatment of products in case of provider failure
 - For PWs, transfer between providers post purchase
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