Pension funds in emerging Asia

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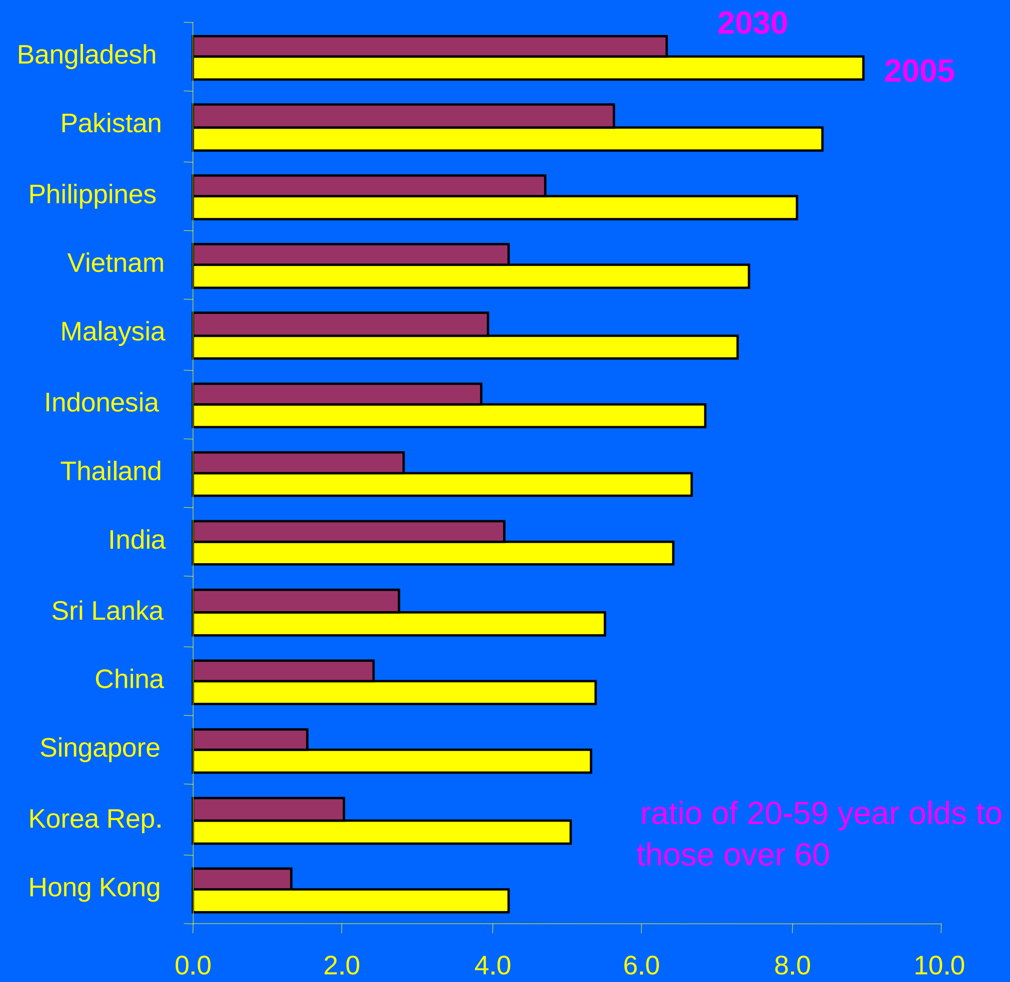
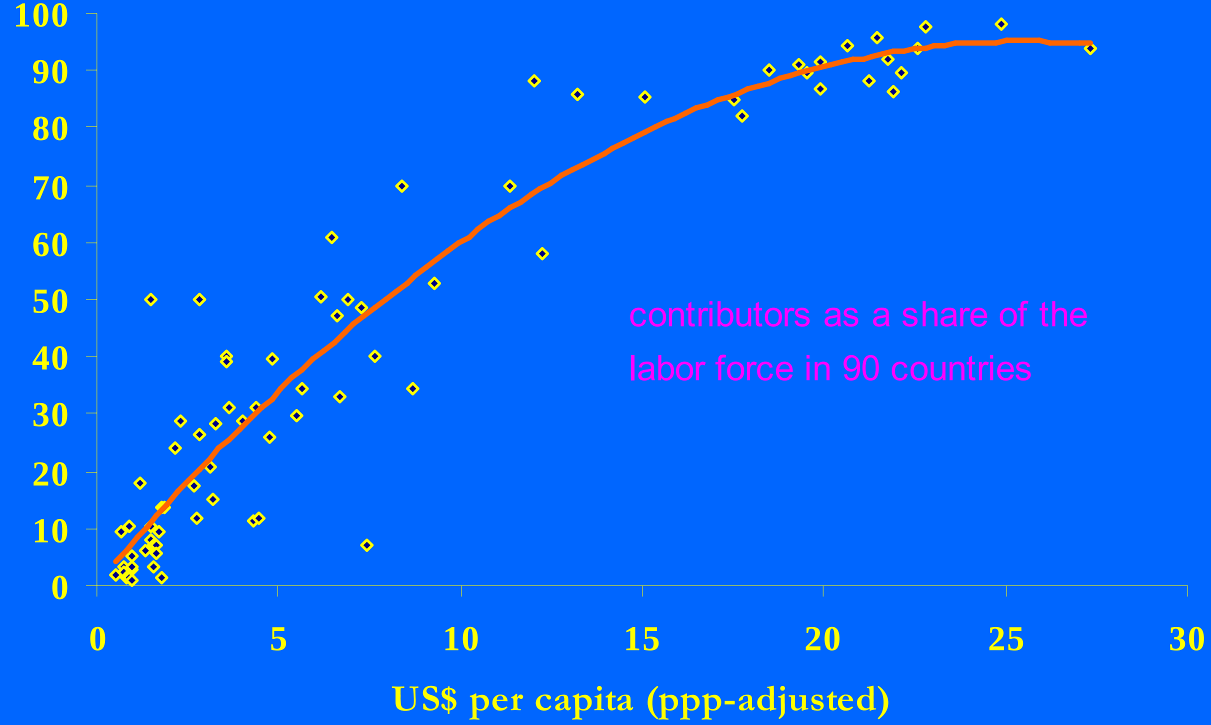
Asia is aging



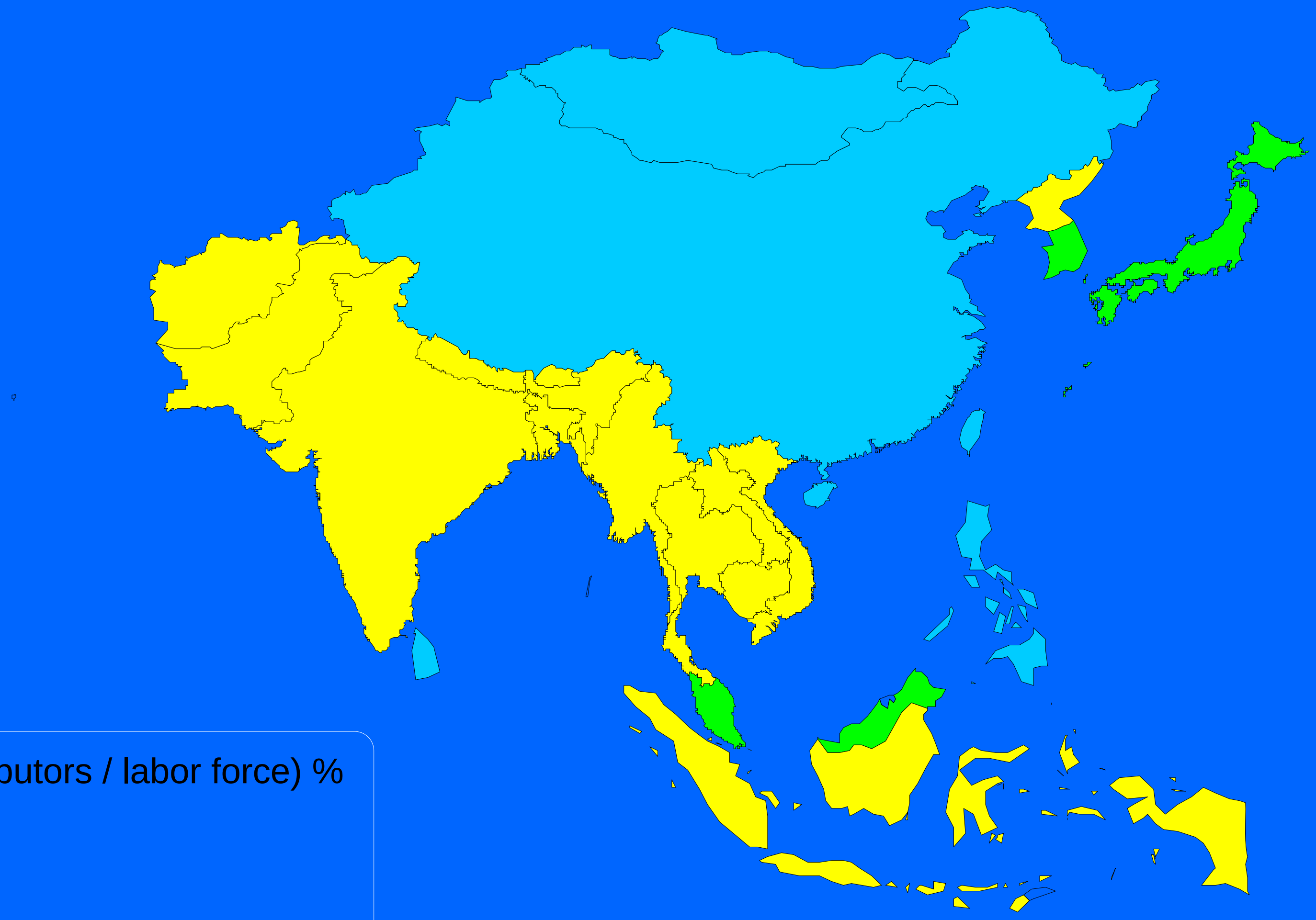
Are pension systems ready…

- Low coverage
- Mostly unfunded liabilities especially for public sector
- Questionable secondary impact on economy
  - Discourage formal sector work
  - “Fake funding” undermines saving
  - Missed opportunity for positive impact on capital markets

Pensions - coverage



Pensions - coverage



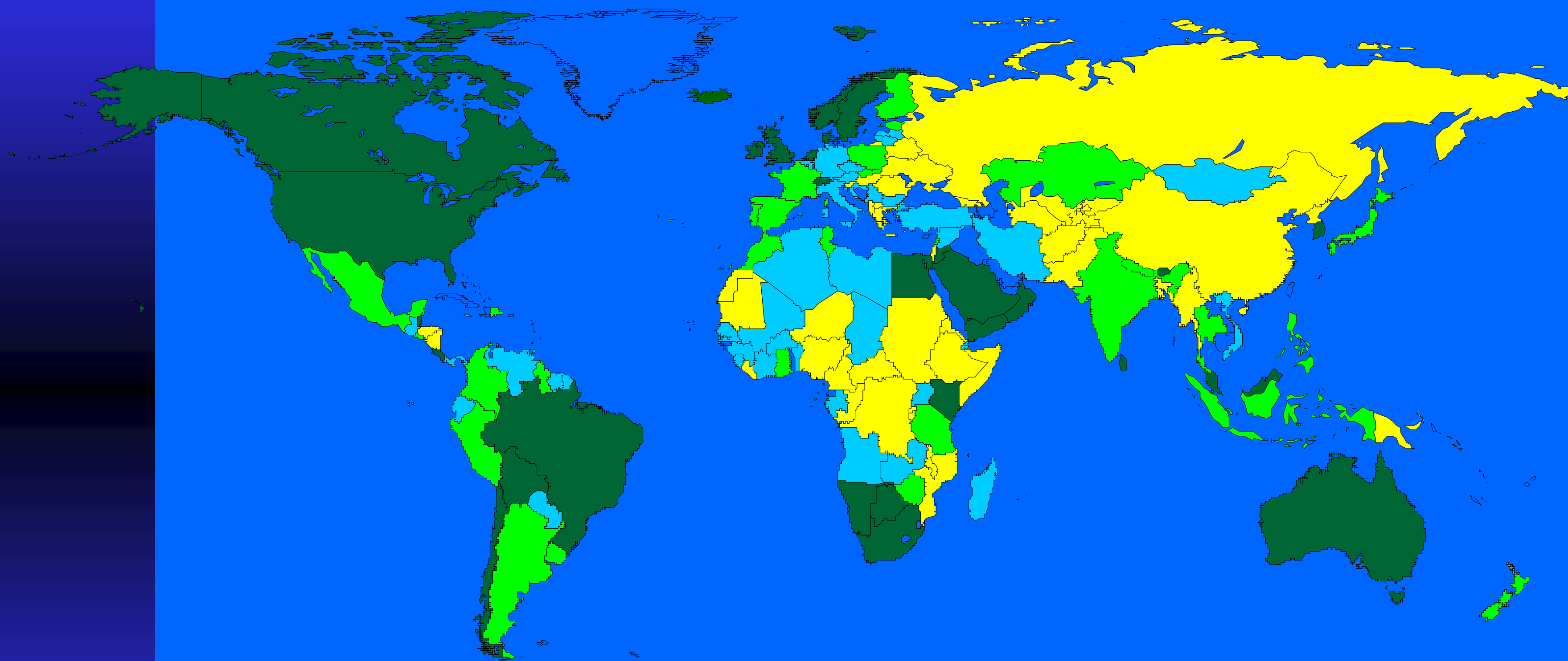
Coverage (contributors / labor force) %

- 0 to 15
- 15 to 49
- 49 to 100

Pensions - coverage

- Even with good growth, low coverage today means most elderly will have limited or no pensions. This leads to several problems:
  - Heavy reliance on family support
  - Growing number of “aged deserving poor”
  - Increased disparity between the elderly haves (with pensions) and have nots
  - Unfunded pension liabilities for few financed by taxes on the many – i.e. inter/intragenerational inequity
- Pressure to expand coverage to informal sector

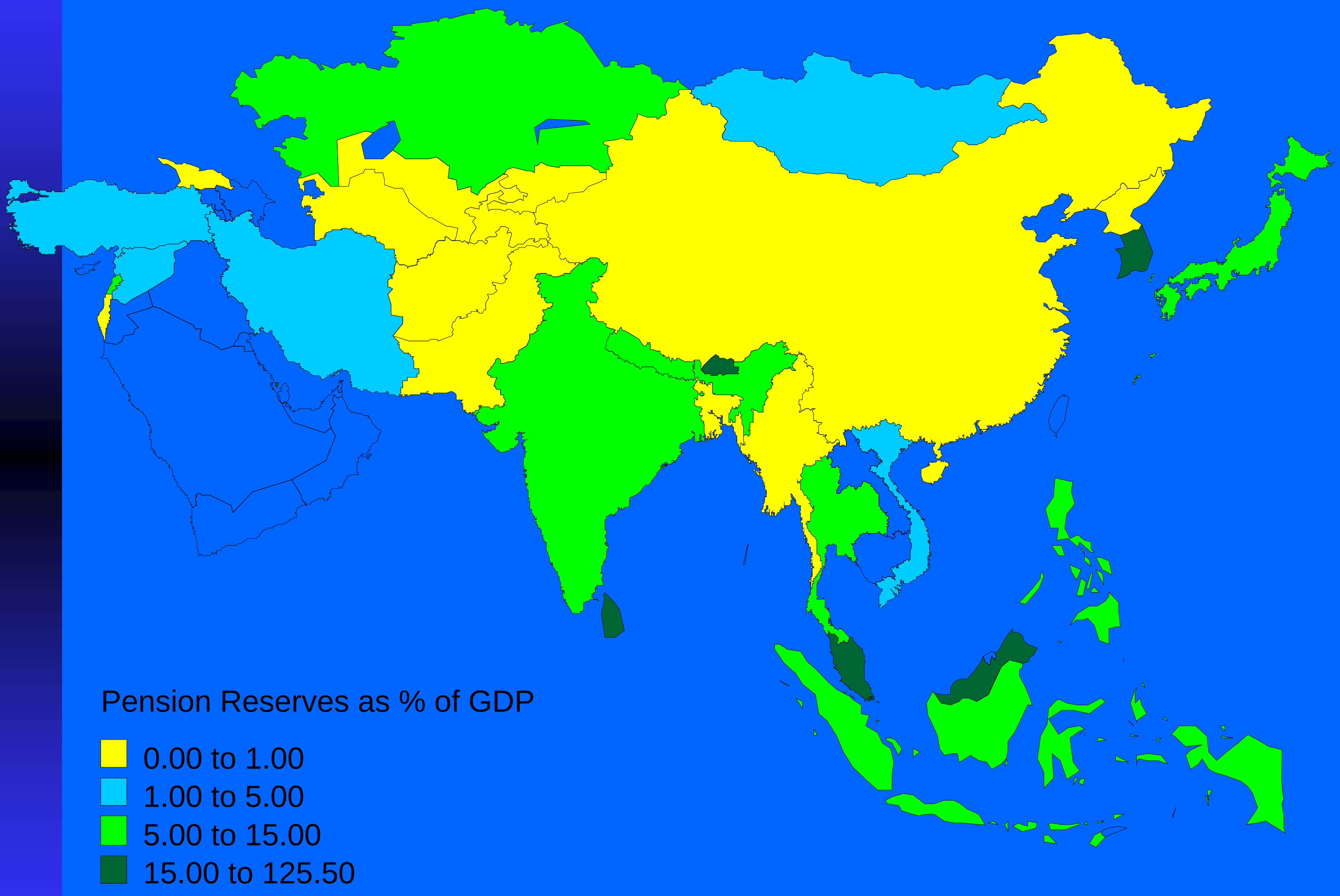
Global Pension Fund Assets



Pension Reserves as % of GDP

- 0.00 to 1.00
- 1.00 to 5.00
- 5.00 to 15.00
- 15.00 to 125.50

Asian pension funds



Pensions - funding

- Three major approaches to funding mandated pensions represented in Asia
  - Partially funded DB schemes in India, Korea, Pakistan, Thailand
  - Centrally managed DC schemes in India, Malaysia, Nepal, Singapore and Sri Lanka
  - Decentralized, private DC schemes in Hong Kong, Pakistan (voluntary) and proposed in India

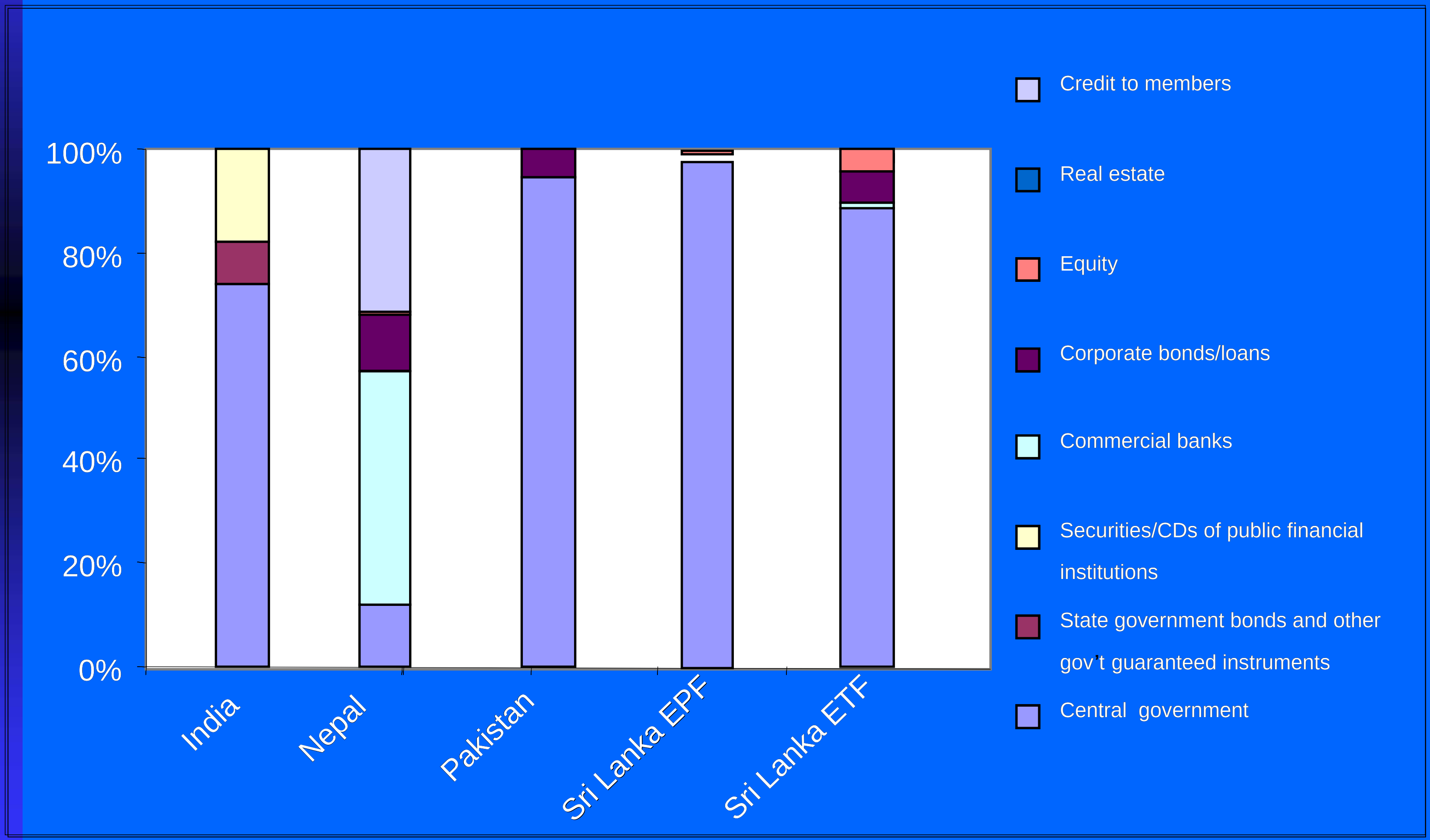
Pensions - funding

- Civil service pension schemes are non-contributory, generous and unfunded in most of developing Asia
  - By one definition, 25-60% of GDP in South Asia
- Several countries have liabilities growing for non-civil servant schemes (EOBI Pakistan, EPS India, SSO Thailand and China)
- Even provident funds probably do not add savings
- A few countries are moving towards true funding including India, Thailand and/or expanding their funded, voluntary pension sectors as in China, India and Pakistan

Pensions – secondary impact

- Pension funds can have a positive secondary impact on economy by increasing savings and contributing to capital market development
- If savings are borrowed toward extra government consumption, then this positive effect is negated
- Publicly managed funds are more likely to be ‘captured’ and more problematic to invest through capital markets

Pensions – investments



Looking forward

- Funding can help meet the challenges of aging:
  - Growth – harnessing a pool of long term savings that contributes to capital market development and limiting burden on fisc
  - Consumption smoothing – allowing individuals to diversify risks (wage growth vis a vis domestic and international capital returns)
  - Sustainability – encouraging discipline and transparency in order to avoid pressure for a sudden increase in pension liabilities
  - Coverage – providing a fiscally sustainable way to expand coverage to informal sector

Looking forward

- However, the approach to funding chosen will largely determine whether these benefits materialize
  - Public management has historically tended to result in lower returns
  - ‘Fake funding’ can be the result when government borrows most of funds and increases consumption (especially for DB schemes)
  - Private decentralized management requires superior design to minimize costs and truncate risks for typical workers – default portfolio key
  - Coverage expansion to informal and rural sectors more likely to succeed with DC

Looking forward

- What policy choices are more likely to yield the benefits of funding?
  - Diversification of portfolios and international investment for countries with small markets
  - Governance arrangements that limit political capture of pension funds (a la CPPIB-Canada)
  - Changes to DB accounting to reflect liabilities in fiscal accounts
  - Careful design and strong supervision for private decentralized schemes
  - DC schemes that can be used to expand coverage, perhaps with direct subsidies

Looking forward

- Some encouraging examples:
  - India’s proposed NPS
  - Thailand’s GPF and proposed ‘second pillar’
  - Honk Kong’s MPF and China’s individual accounts (if it moves to true funding)
  - Vietnam proposing subsidized, voluntary DC scheme for informal sector
  - Corporate pensions in Korea
  - Voluntary, privately-managed pensions in Pakistan