What makes some pension systems better than others?

Pensions and politics are in an uneasy mix the world over, Kobus Hanekom* has found

I recently participated in a panel discussion of the International Pension & Employee Benefit Lawyers Association in Prague under the topic: “Pensions Crises: Many jurisdictions report that significant percentages of their populations are unable to retire with the level of dignity they would have liked and that future prospects for many fund members appear to be weakening.”

High-level participants agreed on certain conclusions:

The jurisdiction with the best results has

- A significant contributory state old-age pension, supplemented by occupational pensions arranged on a group basis;
- Strict rules to enforce financial disciplines and avoid leakages;
- Significant economies of scale with limited individual choice.

Jurisdictions with poorer results have

- Less significant (contributory) state old-age pensions, supplemented by occupational pensions arranged on a group basis;
- Fewer rules to enforce financial discipline and avoid leakages;
- Smaller economies of scale with more individual choice and retail options at retail prices.

Most significant challenges worldwide include

- **Longevity:** The solution adopted by most appears to be postponement of the retirement date. Many jurisdictions are already at age 66 and are phasing in age 67 or older. The challenge is to find ways to prepare and protect stakeholders during the transition phase;
- **Blurring contrast between work and retirement:** The general principle “earn and contribute to your retirement fund for a period of around 40 years so you can retire and live on your pension for a period of around 20 years” is making way for a more gradual progression from work to retirement. Members who have not saved enough to retire

often have no choice but to find ways to earn an income for longer. Retirement funds must adjust to serve these needs. Many jurisdictions will allow members to continue to belong and contribute to their previous employer's occupational fund.

Demographics are changing in first world countries. OECD statistics suggest that during the 1950s there were 7.2 persons between ages 20 and 65 for each person older than 65 on average. By 2010 it reduced to 4.1 and is predicted to reduce to 2.1 by 2050. It is therefore no longer possible for affected jurisdictions to grow out of any funding shortfall by way of a pay-as-you-go model. The only sustainable solution is financial discipline. The state and or the members have to make sufficient contributions to the fund over the required period for the pensions system to be sustainable.

The world of work is changing. The "on-demand economy" – fuelled by interconnectivity, new technology and different needs of the younger generation – is already impacting. The current retirement fund models must shift even further from being employer-centric to more member-centric. Retirement funds will have to focus more on the needs of the individuals they serve.

It is predicted that, by 2020, more than 40% of American workers will be freelancers. The shift in Europe appears only marginally lower. The on-demand economy seems particularly to suit millennials who might, for example, prefer using Uber than to buying a car. Also, permanent employment is harder to find. Changes driven by technology may put a significant part of the population at an even bigger disadvantage, so they will require more state support. Categorisation issues may cause a reduction in taxes and levies (think retirement funds, unemployment insurance and workmen's compensation), putting greater pressure on the funding of pensions and social security.

Key strategic approaches

When retirement-funding systems are reviewed in the context of these challenges, the better results should be shown by:

- Compulsory fund membership (combination of a state pension and occupational retirement funds);
- An alignment between the taxation model and contribution payments;
- Aligning levels of standardisation to dynamic thresholds.

But there are significant differences between first world jurisdictions and SA. The number of South Africans who carry the tax burden in relation to the number who need assistance is so significant that a state old-age pension at much higher than present levels cannot realistically be supported.

Because of high unemployment, many South Africans will simply be unable to enjoy a significant pension. Further, there's the systemic risk associated with putting everyone's savings into one state-controlled fund such as the proposed National Social Security Fund.

It doesn't mean that we shouldn't create appropriate infrastructure for those who earn an income and can be required to make provision for their own retirement.

We should make it compulsory for all those who earn over a certain threshold to contribute a minimum amount to a retirement fund. We should allow the private-sector retirement fund industry to develop practical and cost-effective solutions to serve this market effectively. Were a fund to fail, the UK has shown how it can be handled with state support.

Culture and balance of power

One comes away from an international conference with the sense that development of a country's retirement system often has more to do with its culture and the balance of political power than with its academic understanding of the most appropriate model.

In the Czech Republic, for example, we were told that it has only a state old-age pension. Legislation to provide for occupational pensions (to align with the rest of Europe) was withdrawn by a government which feared it would be voted from power if the contribution burden shifted from employer to member.

The position in Greece could have been much more workable if the party in power did not agree to pensions that were so rich that the country simply could not afford it. In Belgium, compulsory annuitisation was scrapped in favour of lump sums because it increased the government's short-term tax income and helped balance the budget.

In SA, auto enrolment and compulsory fund contributions will increase the cost of labour. It will also reduce the take-home pay of those affected. Some pushback must be expected when these measures are introduced.

It will take a great deal of political will to implement a more sustainable SA pension-fund system. Is there that will?

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