

Pension Reform and Retirement Outcomes in South East Asia

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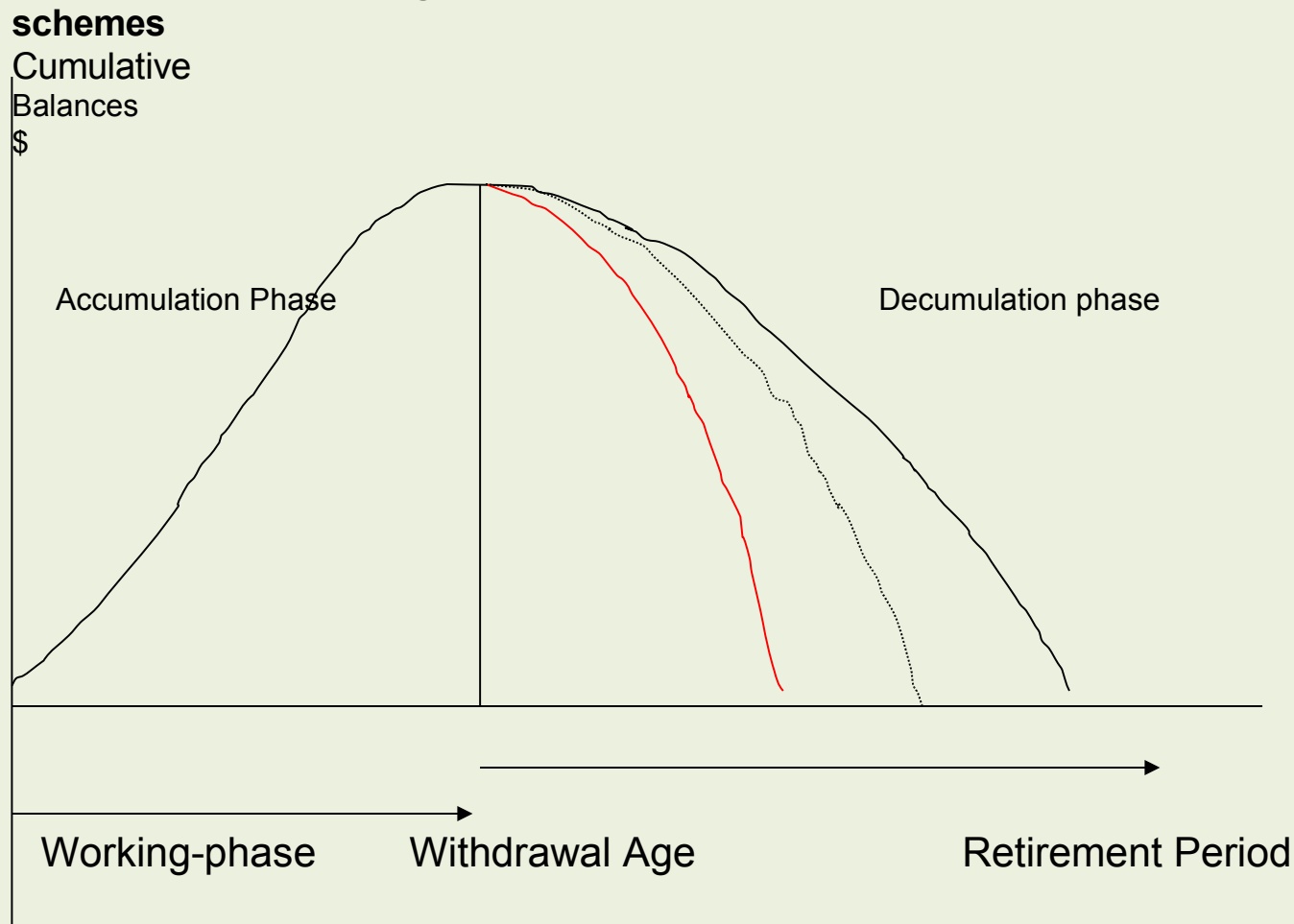
Introduction /1

- This presentation provides an update on recent developments in pension systems in Hong Kong, Singapore, and Thailand.
- Singapore almost exclusively relies on mandatory savings scheme (administered by its Central Provident Fund, CPF) to finance retirement.
- Hong Kong relies on mandatory savings scheme, administered by the Mandatory Provident Fund Schemes Authority (MPFSA) for bulk of the retirement financing. But it also has significant private occupational schemes, and a public assistance or social pension component.

Introduction 2

- Thailand has a complex multi-tier system. It has accepted the principle of social risk pooling for both the public and the private sector employees.

Figure 1: Accumulation and decumulation phases of DC



Cumulative Balances = Net contributions (contributions minus withdrawals), plus interest credited on accumulated balances.

Decumulation phase: the funds accumulated can be spent rapidly or slowly. Death may occur before the funds are exhausted or reverse is also a possibility. So need to protect against longevity risk. As it is the purchasing power of the funds that is relevant, protection against the inflation risk is also desirable.

Source: Author

Table 1: Selected Indicators of Provident and Pension Funds in India, Malaysia and Thailand

Country	Organizations	Contributors as Percent of Labor Force	Contribution Rate (early 2008)	Wage Ceiling (early 2008)	Member Balances (USD Billion), % of GDP
Hong Kong	<i>Mandatory Provident Fund (MPF)</i>	59.0 (2007) ¹	10.0	HK\$20,000/month	33.9, 16.3 (2007)
Singapore	<i>Central Provident Fund (CPF)</i>	80.2 (2007) ²	34.5	S\$4,500/month	90.4, 56.2 (2007)
Thailand	<i>Social Security Organization (SSO)</i>	22.0 (2007)	6.0	B15,000/month	20.0, 11.0 (early 2005)
	<i>Government Pension Fund, Thailand (GPF)</i>	3.0 (2007)	6.0	Yes	12.1, 5.9 (December 2007)

Note:

¹ However 96 percent of those required are in the MPF (total contributors 2.13 million as of December 2007). Another 17 percent have joined other retirement schemes; and 10 percent were not required to join MPF. These include domestic employees above 65 years of age.

² Refers to resident labor force, i.e. citizens plus permanent residents. Singapore's total labor in 2007 was 2.75 million. The foreign workers however cannot be members of CPF.

Source: Compiled by Authors from Various Official sources.

Recent Developments and Implications /1

HONG KONG

- The MPF system was introduced in December 2000. Its basic structure has remained fairly constant.
- Each member chooses the schemes and constituent funds.
- Hong Kong has now a well-developed pension fund industry.
- The MPF contributions cannot be withdrawn until age 65. Voluntary contributions are also possible.
- At age 65, the withdrawal is in a lump sum. There are no annuity or phased withdrawal requirements.

Recent Developments and Implications *12*

- The overall allocation of funds as of September 30, 2007 was 65 percent in equities, 20 percent in debt securities, and 15 percent in deposits and cash.
- Geographically, 57 percent of the MPF assets were invested in Hong Kong, 15 percent in Europe, 12 percent in North America, 9 percent in Asia (ex Japan), and 7 percent in Japan.
- The annualized internal rate of return (net of fees and charges), a method commonly known as dollar-weighted return, was 9.9 percent for the period 1/12/2000 to 31/12/2007.

Recent Developments and Implications β

- The MPF system has been continuously reviewed:
 - 2002: Operational and technical issues were addressed in a legislation;
 - 2004: Code on disclosure for MPF investment funds;
 - 2005: Publication of set of compliance standards for the MPF trustees;
 - 2006: Amendments related to investment regulations were undertaken.
- In March 2008 conference in Hong Kong, the following 3 areas were suggested as future focus areas for MPF reform:
 - investor education;
 - support for voluntary contributions via tax incentives;
 - Introduction of member choice of master trust schemes.

Recent Developments and Implications /4

- The MPF system is relatively recent, and its investment portfolio is fairly aggressive, with moderately high returns. Even then, Comprehensive Social Security Assistance (CSSA) scheme will become increasingly important as its population ages rapidly (Hong Kong's TFR is about 1.0)
- CSSA provides elderly persons (aged 65 and above) flat rate monthly allowance which varies depending on age and the extent of disability.
- While Normal Old Age Allowance (NOAA) for those between ages 65-69 are means tested, others are not.
- In 2005-06, social welfare expenditure was 14.6 percent of the government budget (Pai, 2006).

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SINGAPORE

- The CPF system is not aimed primarily at retirement objective. The CPF contributions are channeled to three accounts.
 - Two-thirds are channeled to the Ordinary Account (OA) which can be used for housing and investment schemes.
 - 19 percent are channeled to the Medisave Account (MA) which can be used for hospitalization expenses, and for catastrophic health insurance.
 - The remaining 14 percent is channeled into Special Account (SA), which is can be used for retirement and other purposes.
 - Contributions to withdrawal ratio has averaged 82.6 percent between 2001-2006, leaving relatively little for retirement.

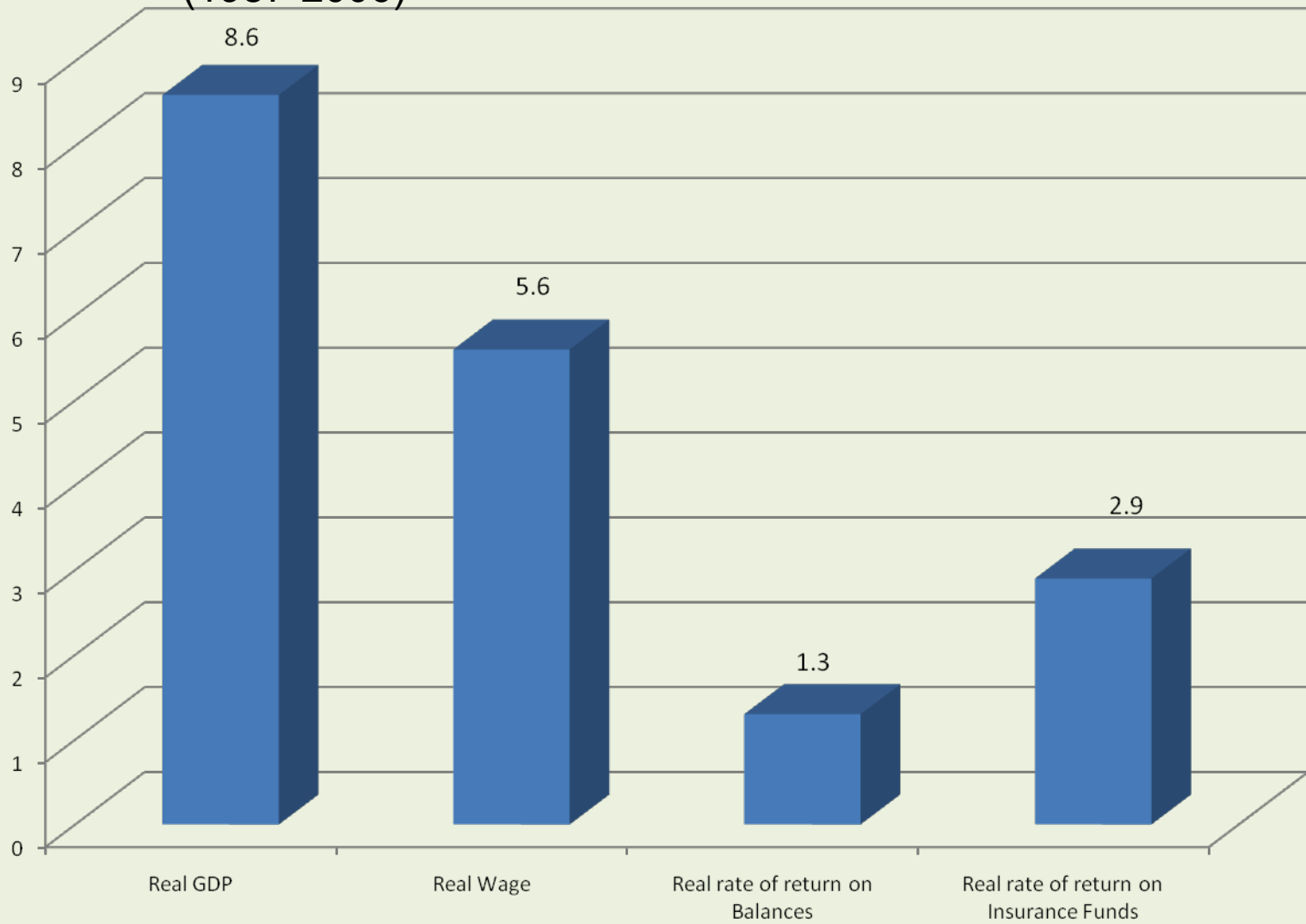
Recent Developments and Implications /6

- Under the CPF Investment Scheme (CPFIS), a member may invest (under certain conditions) with approved fund managers, with potential universe of more than 400 different funds. Very few of these are index-linked, ETFs (exchange traded funds) or lifecycle funds. There are no inflation protected instruments.
- About 30 percent of the members have invested S \$34.2 billion under it as of December 31, 2007.
- Koh et al. (2008) find the following about CPFIS :
(Journal of Pension Economics and Finance, 7, pp.37-65)
 - Between October 1, 2003 and September 30, 2006, under investments from the OA (forming 80 percent of the total), only 20 percent of the members obtained higher than 2.5 percent nominal guaranteed CPF rate; 33 percent made positive but less than or equal to 2.5 percent; and 48 percent made losses.

Recent Developments and Implications //

- They find that a major reason was high transaction cost. For equities, the average sales load was 4.9 percent, and expense ratio 2.07 percent; the corresponding figures for balanced portfolio were 4.8 and 1.93 percent respectively; and for income portfolio 2.1 and 1.12 percent respectively.
- In 2007, the average balance per member of \$43,224 was less than per capita GDP of \$52,994. This is quite inadequate as an average person will require financing for at least two decades during retirement.

**Figure 2: Singapore: Real rates of Growth and CPF Returns
(1987-2006)**



Note: The return on insurance funds is from 1987-2004
Source: Author's Estimates

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- In August 2007, the government announced changes in the administered interest rate arrangements, effective from 2008.
- For the first \$60,000 of CPF balances, a member will receive an additional 1 percentage point over the normal rate.
- However, instead of paying 1.5 percentage points more than the normal rate on balances in MA and SA accounts, the rate will be pegged to rate of 10-year Singapore government securities plus 1 percentage point.
- The increase in the age from 62 to 65 years, at which a member can withdraw the minimum sum in monthly installments, will not make additional resources available during retirement

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- The National LIFElong Income Scheme
 - With the launch of CPF LIFE in 2013, members will receive a monthly income from age 65 for as long as they live. CPF members, aged 50 or younger in 2008, who have at least \$40,000 in their Minimum Sum at age 55, will be automatically included.
- CPF Board will also set up the new LIFE Scheme. There will also be provision for part-refunding of the principal sum used to purchase annuity, if a member dies before the stipulated age.
- There will be no social insurance. Each age cohort will form a pool, with annuity price varying by age, and gender. Women will pay more, as they live longer.

Recent Developments and Implications /10

- The annuity amount is in nominal terms.
- The Board has not indicated the implied rate of return on the life annuity, and therefore its desirability cannot be evaluated.
- The above changes will have relatively minor impact on the adequacy of the CPF system. In particular, absence of inflation risk protection will create severe hardships.

Recent Developments and Implications / 1 1

- From a macro perspective, Singapore's rapidly ageing population requires more public and private resources to be devoted to the aged.
- But the proposed measures will not increase such resources in any significant manner.
- Singapore will have to move to a multi-tier system with vastly increased importance of the zero-tier (social pensions financed from the budget) and introduce social insurance principles.
- The longer it delays reform in the above directions, the more the legitimacy of the current pension arrangements will be undermined.

Recent Developments and Implications /12

THAILAND

- In Thailand, the private sector workers are covered a social insurance scheme, administered by the Social Security Organisation (SSO).
- The first pensions will be provided in 2014.
- Its investment portfolio is fairly conservative, i.e. mostly in domestic debt instruments.

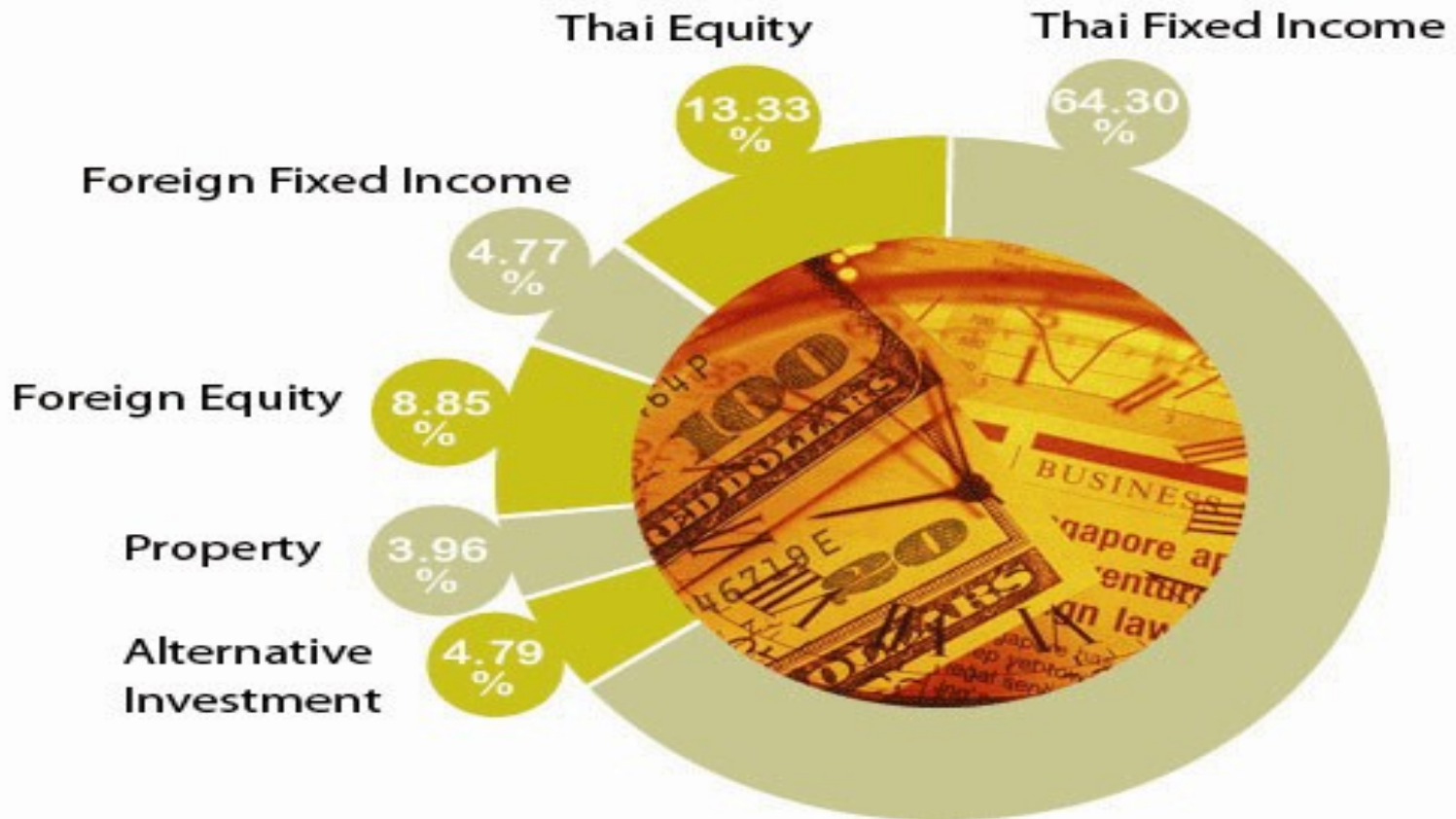
Recent Developments and Implications / 3

- The employees in public sector or state enterprises are covered by a provident fund at each enterprise level.
- The civil servants receive defined benefit, non-contributory pensions, financed from current revenue.
- In addition, they also are a member of a mandatory savings scheme, with contribution rate of 3 percent each from employee and employer. This is administered by the Government Pension Fund (GPF).



Asset Allocation

As at December 2007



Source: GPF Website (<http://www.gpf.or.th/Eng/perform.asp>)

The net rate of returns to member, compared to average deposit rate, inflation rate and benchmark yield

As at December 2007



Source: GPF Website (<http://www.gpf.or.th/Eng/perform.asp>)

Recent Developments and Implications / 4

- The GPF therefore has been fairly aggressive in its investment strategy. Its membership of only 1.2 million civil servants however suggests that the benefits of such strategy are not widely available.
- Close relationship between the GPF and the Ministry of Finance also raises corporate governance, principal-agent, and potential contingent liability issues.
- Thailand has been debating introducing a mandatory national provident fund system. The military coup in December 2006 slowed the momentum towards pension reform in Thailand.
- Recent elections in Thailand may be positive for pension reform.

Concluding Remarks /1

- In all 3 countries, the defined contribution mandatory savings schemes play an important role.
- The structure of the payout phase needs to be improved to better address longevity, inflation, and survivors' benefits risks.
- The transaction costs of investments when undertaken individually in Singapore are particularly high. The MPFSA in Hong Kong has been particularly proactive in attempting to minimize the investment management fees, and has given fiduciary responsibility relatively high priority.

Concluding Remarks 2

- Thailand faces a greater challenge of ensuring adequate coverage. All three countries will need to increase the role of social pensions or assistance schemes, financed through the budget.
- Thailand needs to consider a more systematic national provident fund scheme which consolidates existing provident funds.