

# Preparing for the challenges of retirement

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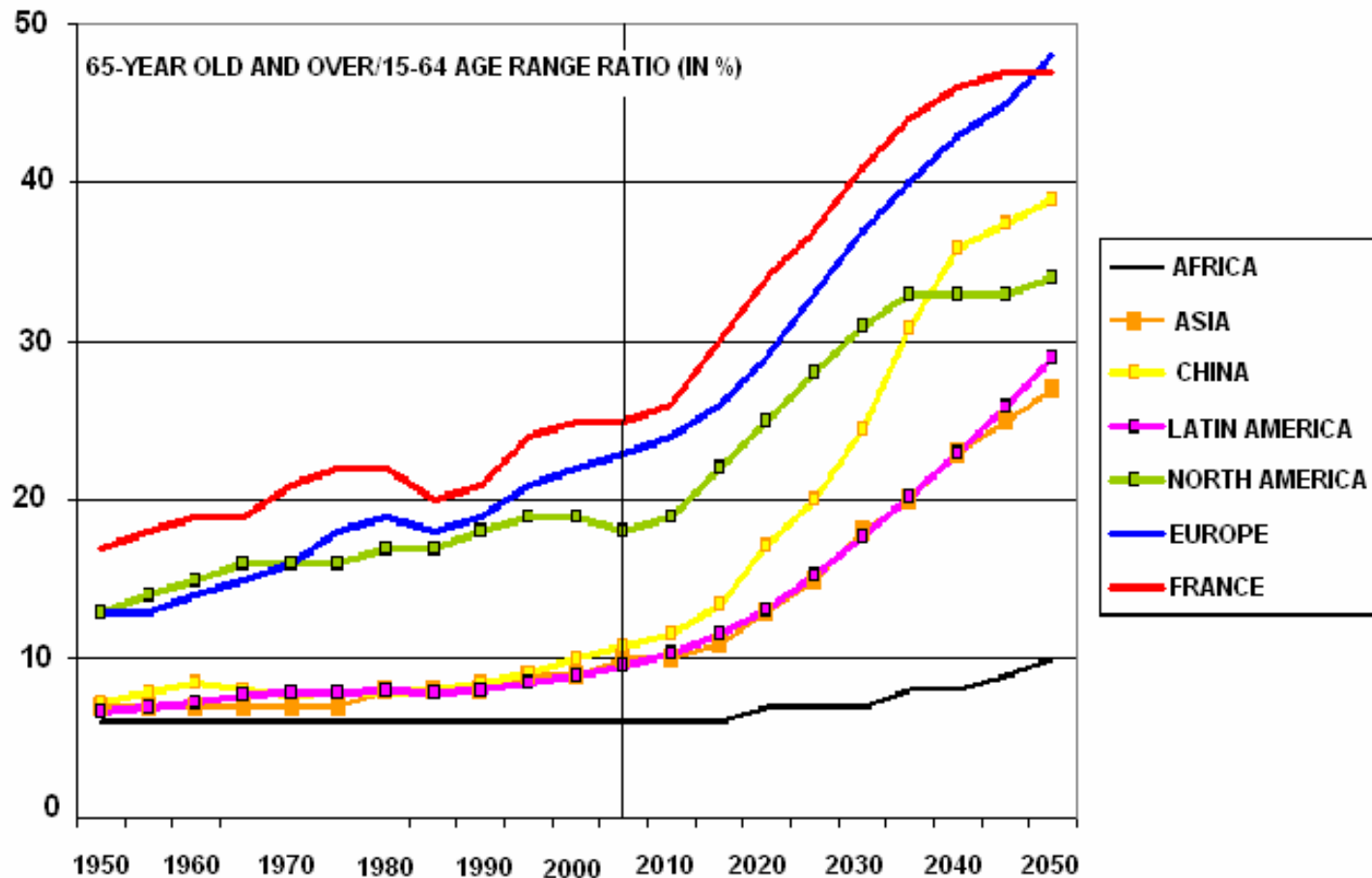
- The demographic challenge
- The retirement challenge
- No magic bullet or miracle cure
- Necessary changes
- Proposing new solutions

# The demographic challenge



- Through AXA Retirement Scope, population groups are showing that they understand the stakes related to demographic shift.
- This demographic shift will be major:
  - ➔ Slowdown in population growth, but uncertainty with respect to world population: estimated to grow to between 7.7 and 11.6 billion by 2050, based on UN scenarios.
  - ➔ Demographic aging is inevitable.
- Three major forces:
  - Declining birth rate
  - Increasing life expectancy
  - Counter Baby Boom

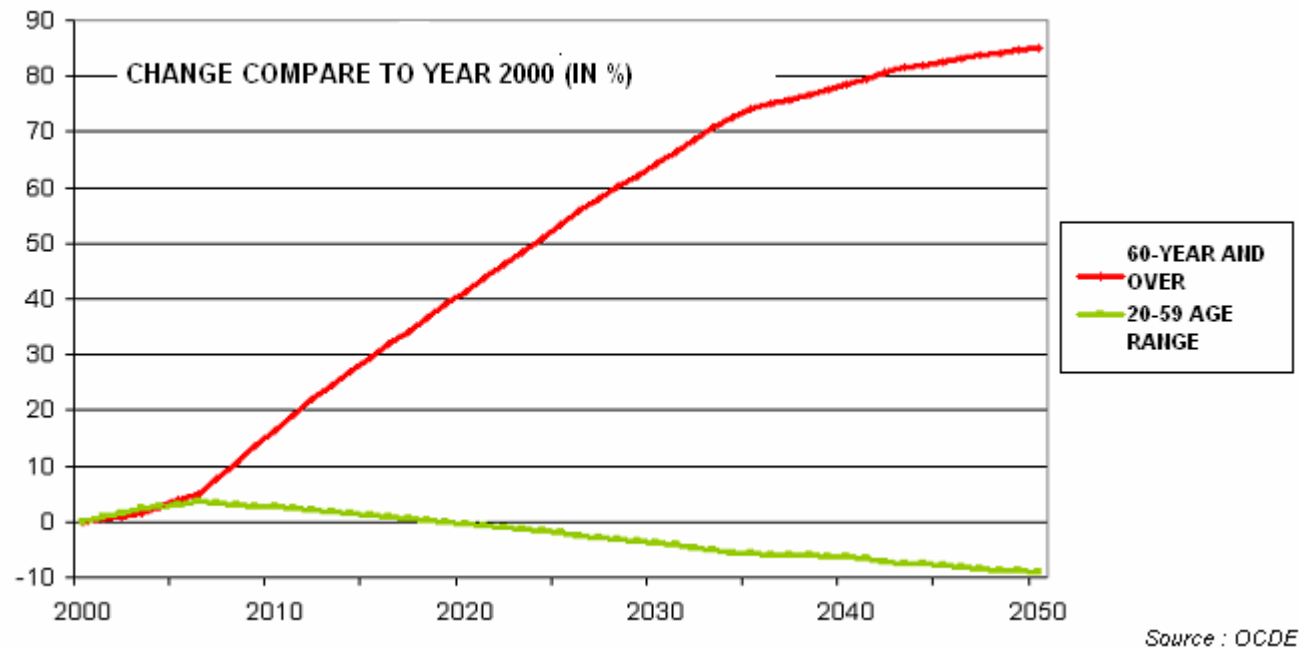
# Demographic aging is inevitable...



Source: OECD

... but the pace and starting level are very different

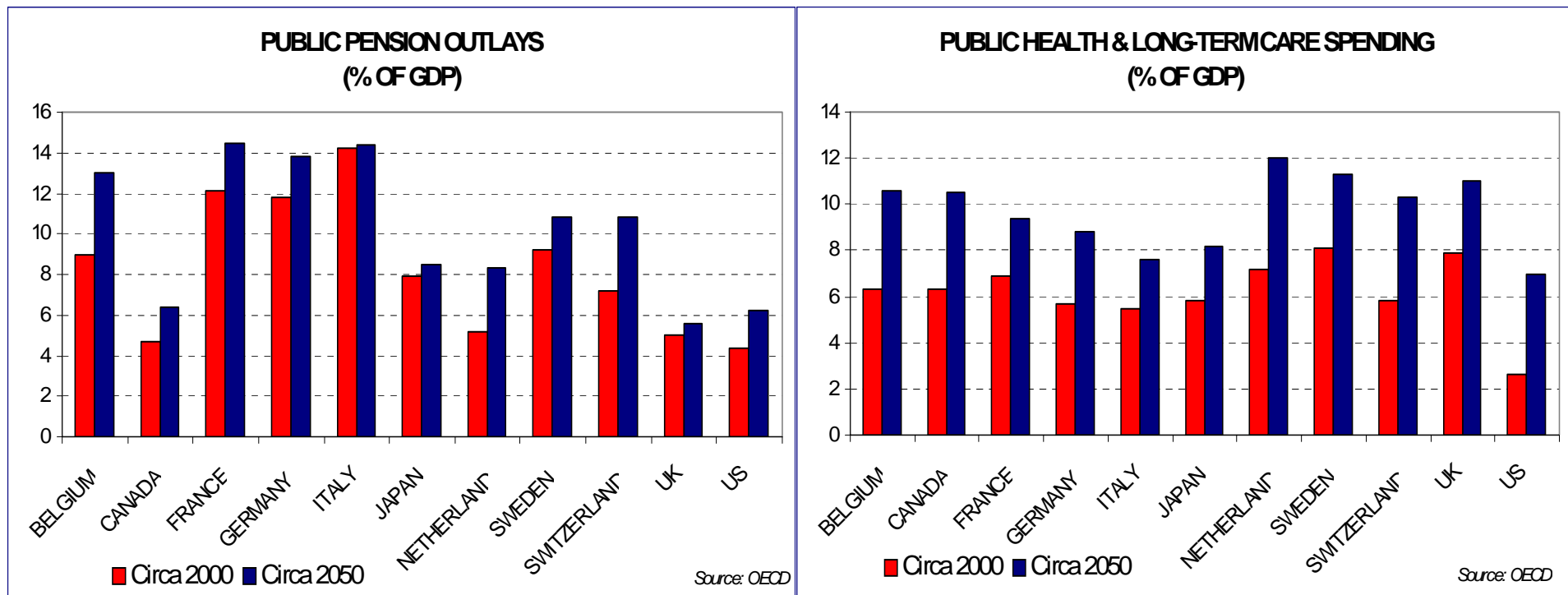
- In France, it would be risky to place bets on whether the population will be higher or lower than it is today...



**... but one thing is sure: it will be older.**

# The challenge of retirement

- Demographic trends will not prevent growth, but they will lead to tensions over how to share the fruits of expansion:
  - The mounting cost of retirement pensions and health care will compete with other spending needs (in education, research, etc.).



# The challenge of retirement

- Governments are already starting to adjust to this new deal but we still have a long way to go.

	MANDATORY PENSIONS					LAST MAJOR REFORM	
	DATE OF LAST MAJOR REFORM	CONTRIBUTION RATE (EMPLOYER PLUS EMPLOYEE) IN %	GROSS REPLACEMENT RATE AT AVERAGE EARNINGS (2002) IN % <sup>2</sup>	PUBLIC PENSION BENEFIT <sup>3</sup>	MANDATORY PRIVATE REGIME	CHANGED LEVEL OF DB	INCREASED CONTRIBUTION RATES
BELGIUM	1997	16.4	41	DB	NO	REDUCED	
CANADA	1997	9.9	43	DB, P	NO	NO	YES
FRANCE	2003	16.5	53	DB	NO	REDUCED	YES
GERMANY	2001	19.5	46		NO	REDUCED	YES
ITALY <sup>4</sup>	2004	32.7	79	NDC		ABOLISHED	NO
JAPAN <sup>5</sup>	2004	18.3	50	DB, NF	NO	REDUCED	YES
NETHERLANDS	2004	28.1	68	DB	QUASI	REDUCED	YES
SWEDEN <sup>6</sup>	1998	18.9	65	NDC	QUASI	ABOLISHED	NO
SWITZERLAND	2003	23.8	58	DB	YES	REDUCED	NO
UK <sup>7</sup>	2004	23.8	37	DB	NO	NO	NO
US	1983	12.4	39	DB, NF	NO	--	NO

<sup>1</sup> The coverage of pension spending is less homogenous across countries than over time.

<sup>2</sup> The wedge between gross and net replacement rates varies substantially across countries.

<sup>3</sup> PD: Prestations définies ; CND: Contribution nationale définie ; CP : Capitalisation nominale ; C : Capitalisation

<sup>4</sup> For people retiring after 2010. In 2004, Parliament passed a framework law allowing the government to introduce implementing legislation to reduce the fiscal burden of pensions, including reforms to encourage later retirement and to augment the main pension with a supplementary pension.

<sup>5</sup> The end-point of the projection is 2025 instead of 2050.

<sup>6</sup> Assumes a revaluation factor of 1.6%.

<sup>7</sup> The contributions also finance other social programmes.

Sources: OECD (2005a); Social Security Administration (2001a, 2004b, 2005)

# No magic bullet or miracle cure



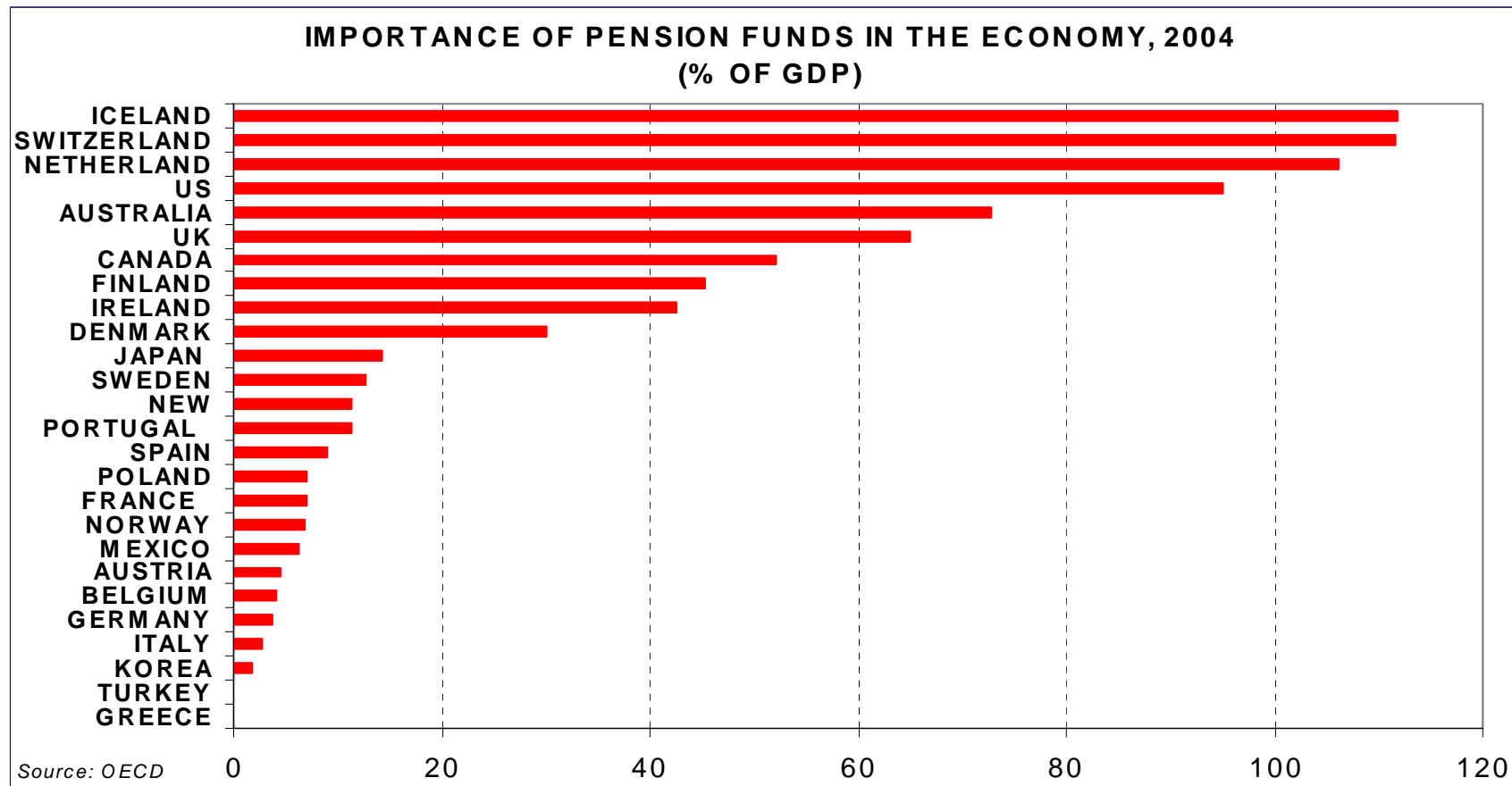
- Adjustments to tomorrow's challenges are being made without disrupting existing social traditions.
- As AXA Retirement Scope demonstrates, the level of individual and collective responsibility varies substantially from one country to the next. In English-speaking countries, where pension funds are far more developed, the individual component is much stronger.
- As the literature now indicates, there is no clear-cut economic advantage for funded pensions over pay-as-you-go systems. In any case, both must deal with the same demographic shock.

# [ No magic bullet or miracle cure

- Despite the diversity of the dominant retirement systems, reforms are all pointing in the same direction.
- Two primary objectives:
  - Redistribution of income to prevent the pauperization of retirees
  - Attempts to maintain a certain standard of living for retirees (adequate replacement of earnings stream from work)
- Orienting systems toward three-pillar framework:
  - State management with mandatory participation (solidarity based to guarantee a minimum pension for retired workers)
  - Private management with mandatory participation (funded pensions)
  - Voluntary retirement savings

# No magic bullet or miracle cure

- As the role of pension funds demonstrates, considerable differences in terms of the systems of choice will no doubt persist.



# Necessary changes

- In pay-as-you-go systems, a few well-known sources of leverage:
  - Higher contributions
  - Diversified funding methods (funded pensions)
  - Later retirement

APPROXIMATIVE CHANGE IN FINANCIAL PROMESSES GIVEN THE RETIREMENT AGE											
AGE OF RETIREMENT		58	60	61	62	63	64	65	66	67	70
"RETIREMENT WEALTH", IN RELATION TO THE BASE SCENARIO (%)*	MEN	24.5	17.5	10.5	7.0	3.5	3.5	0	-3.5	-7.0	-17.4
	WOMEN	22.2	16.1	9.8	6.6	3.3	3.3	0	-3.3	-6.7	-16.9

\*The base scenario is of a 65-year old retirement

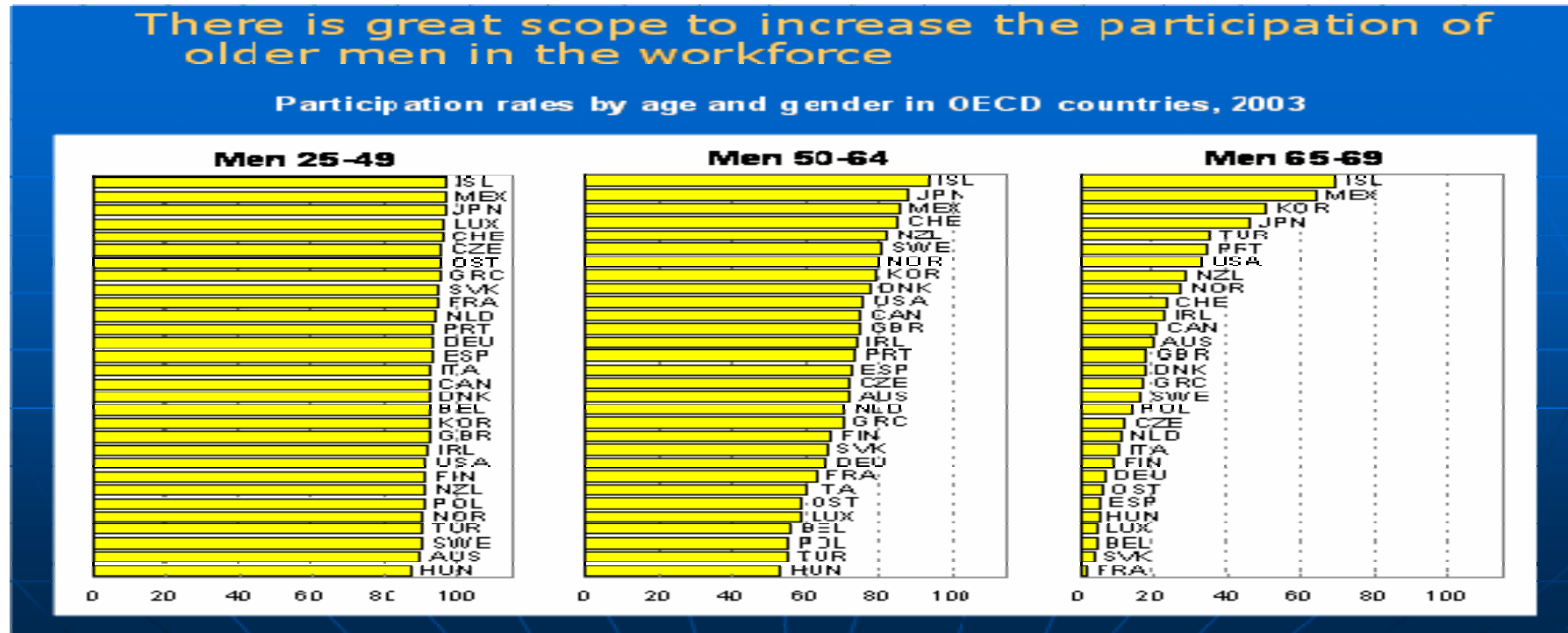
Source: OECD

- Note that among OECD countries, only France and Turkey are maintaining the right to retire at age 60.

# Necessary changes

- Other than working the primary sources of leverage to make it possible to finance demographic aging, major structural changes could ease demographic pressure on the fruits of expansion

## Escaping retirement apathy



# Proposing new solutions



- The new demographic deal demands that both private and public sector players create the necessary conditions to enable individuals to find viable financial solutions that will lead to successful retirement.
- Develop savings vehicles that allow people to manage the uncertainty factors related to aging.
  - products with long maturities on the part of capital seekers (government and business).
- Help leverage illiquid assets more effectively, in particular housing, which is the main source of household wealth:
  - Develop use of reverse mortgages (already the case in the United States and the United Kingdom).