Longer life and creating retirement security

John Fitzpatrick and Amy Kessler explain the changes needed to tackle the challenge of increasing longevity

An important gathering of retirement and ageing experts from across the world took place in Geneva, Switzerland in December. Hosted by The Geneva Association, the Life and Pensions 'Four Pillars' conference focused on the future of retirement and explored the primary means by which retirement security can be achieved: social security, pensions, personal savings and employment in retirement.

The key messages from the conference were that pension systems in many countries are on an unsustainable path. People are living longer, spending more years in retirement, depending more on social security than occupational pensions or personal savings and increasingly anticipating the need to work in retirement. The risk is made more acute by the fact that many pension systems are underfunded and require contributions from current workers to support the growing retired population. Demographic shifts show rapid growth in the retired population compared to working-age people. The result is an intergenerational risk that depends on continued population growth, economic growth and real economic opportunity for younger generations. Despite these facts, in country after country, retirement age continues to rise more slowly than healthy life expectancy.

To date, these developments have primarily been viewed as risks, driving many countries toward a looming retirement crisis. In Geneva, however, the conference focused on increasing longevity as an opportunity that could drive economic growth and stability in many countries worldwide, if only retirement systems adapt to avert the crisis and seek a more sustainable path. Presented below are insights from the conference.

The first pillar -social security

Keynote speaker Professor Elsa Fornero, Italian Minister of Labor, Social Policies and Equal Opportunities, focused on the adequacy and sustainability of pension systems and highlighted the achievements of the Italian government in enacting urgently needed reforms in the face of unsustainable public debt and a rapidly ageing population. Italy's experience demonstrates that retirement systems require a healthy balance to maintain the link between economic opportunity for the working-age population, income growth for workers contributing to social security programs and saving for their own retirement; and the retirement security of the growing elderly population.

With longer life expectancy and dramatic increases in the retired population, these challenges are common to many countries with 'pay-as-you-go' social security programmes. Moving toward systems that link retirement age and healthy life expectancy would help many countries avert a looming crisis, in which the working population may not be able to support the growing number of retired persons at their expected benefit levels.

The second pillar – occupational pensions

Swiss Life CEO Bruno Pfister pinpointed the challenges faced by corporate pension schemes facing longer life expectancy combined with low returns, which together result in an accelerating funding gap. The need for pension reforms is hence rising, but politically challenging in that, "a combination of three unpopular measures – increased contributions, lower benefits and a raise in the number of contribution years – must be phased in with support provided to those hardest hit." These same concerns are common across many countries and are particularly acute for state and local public pension funds in the United States, where Krzysztof Ostaszewski (Research Director, Life and Pensions, The Geneva Association) pointed out that many US municipal insolvencies are linked to pension debt and to the unaffordable promise of holding the retirement age constant while people continue to live longer and healthier lives.

Prudential described the many

ways in which the insurance community can help DB schemes seeking a more sustainable risk position. The insurance community offers low risk, low volatility asset management solutions and longevity insurance, which combine to create a more sustainable risk position than most pension schemes have today. Insurers can also offer pension risk transfer solutions, such as buyout and buy-in that transfer pension risk away from the scheme.

Today, DB schemes are increasingly being replaced by DC schemes. Anthony Webb of Boston College's Center for Retirement Research focused on the many ways to help DC scheme participants achieve better outcomes as they save for their retirement, including auto-enrolment to ensure participants save, auto-escalation to ensure contributions increase over time, target date funds to improve investment outcomes and the use of participant data by employers to assess risk tolerance to achieve still better outcomes. Also pinpointed was the need for lifetime income solutions within DC, which address the key risk of outliving one's savings and support individuals in enjoying a secure retirement.

The third pillar – personal savings

The best way to ensure that individuals save enough to maintain a reasonable standard of living in retirement is to encourage the growth of personal pensions with tax advantages and other incentives. Lorenzo Savorelli, Head of Research at Generali Group shared a study demonstrating that a common challenge for personal pensions is the low participation rate, where savers have been deterred by the perceived expense of the programs, procrastination and a lack of financial awareness for how much savings is needed to create retirement security.

Employees must be supported in understanding much more than the savings programmes available to them – individuals should have access to clear information regarding their combined retirement resources (including state provision) and the annual spending that they will be able to support in retirement. This education is the surest path to motivating individuals to ensure their own quality of life in retirement.

The fourth pillar – work in retirement

Despite the challenges, real opportunity comes with today's risk. Harnessing the productive capabilities of silver workers would end 'cliff edge retirement', enhance retirement security and fuel real economic growth. Chris Ball, Chief Executive of The Age & Employment Network shared his insight into silver worker success stories. Leading companies today are developing flexible work arrangements and other ageing strategies that support succession planning, inter-generational knowledge transfer, age diversity and retention of skills and know-how of older workers. These programmes align good business with good outcomes for individuals. Yet in many countries, employment and tax policies need to be modified to encourage this and keep silver workers contributing to economic growth.

The four pillars together – longer life and secure retirement

The biggest questions raised at the conference were summed up by Andrew Rear (Chief Executive, Africa, Asia-Pacific, UK and Ireland for Munich Re) who said: "If current expectations about retirement are too optimistic and many overshoot by retiring too early or drawing too much income, how do we change expectations and behaviour today to aim at a softer landing than the one we are anticipating?"

The answers suggested at the conference included linking the retirement age of social security systems with changes in healthy life expectancy while providing a robust safety net for disabled workers, ensuring that employer sponsored DB schemes achieve a sustainable risk profile and, in the shift to DC, support employees in retirement planning, saving, investing and obtaining a lifetime income benefit. Also providing personal pension savings options with tax advantages and other incentives, with saving encouraged through education and projections showing how much annual spending an individual's resources will support in retirement, and creating tax and employment policies that encourage flexible arrangements for silver workers.

Longer life need not be viewed primarily as a risk. By allowing most individuals to work longer, longer life can be the answer to creating sustainable retirement systems in many countries and secure retirements for individuals.

WRITTEN BY JOHN H. FITZPATRICK, SECRETARY GENERAL AND MANAGING DIRECTOR OF THE GENEVA ASSOCIATION AND AMY KESSLER, SENIOR VICE PRESIDENT AND THE HEAD OF LONGEVITY REINSURANCE AT PRUDENTIAL RETIREMENT IN THE UNITED STATES.

Reinsurance contracts are issued by Prudential Retirement Insurance and Annuity Company (PRIAC), Hartford, CT 06103. PRIAC is not a United Kingdom (U.K.) Financial Services Authority (FSA) authorized insurer and does not conduct business in the U.K. or provide direct insurance to any individual or entity therein. Prudential Financial, Inc. of the United States is not affiliated with Prudential plc. which is headquartered in the United Kingdom.