Covid-19: More bad news for retirement adequacy

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EVEN with the vaccine appearing on the Singapore horizon, not all employees will be out of the woods. Unemployment, employees on furloughed schemes, shorter work weeks and lesser gig work brought on by the Covid-19 pandemic have affected employment income in 2020. For those adversely affected, contributions to public and private pension funds as well as personal savings plans would have been disrupted.

Unfortunately, there is more bad news on retirement adequacy. The 2020 Mercer CFA Institute study, which examines 39 retirement income systems and covers almost two-thirds of the world's population, outlined three other factors that will reduce retirements benefits: a fall in investment returns, lesser future government support, and an increase in earlier access to retirement benefits.

The potential effects from Covid-19 – from Mercer CFA Institute Global Pension Index 2020 – are:

Fall in investment returns

As the global economic recession continues to bite, most firms have experienced a fall in profitability. The adverse impact on profit and the need to conserve cash in the face of prolonged uncertainty inadvertently prompted management to decrease or even outright shelve dividend payouts. We have seen calls from regulators in various countries, including Singapore, urging banks to cap dividend payouts.

This prudent move is to ensure there will be sufficient capital in the face of economic uncertainty, including the possible spike in non-performing loans. Yet, the reduction in dividends translates into lesser income for individuals dependent on them for retirement purposes.

Many retail investors in Singapore are also invested in Reits. For these investors, Covid-19 has uncovered the myth of a perpetually stable rental income.

Tenants have sensed that landlords are open to rent reductions, either upon lease expiry or even before. With a diversified portfolio across different assets, geographies and tenant mix, the hit to distribution per unit (DPU), if any, will be mitigated when compared to holding a single piece of real estate.

And this is perhaps the reason why an astute investor will be wary of a Reit portfolio's risk arising from a concentration of revenue and net income. The more diversified the portfolio, the more muted any single event will be on the Reits' DPU.

How about monies in the bank? Bank deposits have not yielded much since the global financial mess in 2008 when central banks have had to prop up the financial system with very accommodative monetary stance. Savers have lamented that time deposits could yield a decent 2 to 3 per cent real return prior to the global financial crisis and are pining for a return of that era.

With the pandemic, Jerome Powell torpedoed that hope by signalling that the US Federal Reserve would keep interest rates near zero for several years to support the economy post by Covid-19. The European Central Bank has adopted a similar route, keeping rates at historical lows. Singapore has not escaped the global environment of low interest rates and savers here have borne the brunt of this phenomenon.

Lesser future government support

There are two developments that can support this position. Firstly, we should have learnt from the 2008 global financial crisis. We did not. Instead of deleveraging, we piled on more debt. Household and corporate debt continued to climb in both absolute terms and relative to GDP for most economies.

Secondly, sovereign debt spiked higher as many governments came out strongly to support the economy hit Covid-19 lockdowns. Spending on transfer payments to affected households and wage subsidies, among others, cushioned the blow from a black swan event that could otherwise have plunged economies into a deep recession. Coupled with a decrease in government revenue due to a recession, many governments are expected to face record deficits which will further add to public debt.

The mountain of a public debt has to be paid off – either by this generation or the next. If the current generation pays off the debt (through various taxes), there will be lesser government support for them as monies need to be used for debt repayment. However, the future generation will benefit by starting off with a clean slate.

If governments kick the debt can down the road (as many have done to appease the electorate), the current generation may receive a little more support from the government but the future generation will inherit the mountain of debt – it can seem unfair but governments do have a tendency to continue kicking the can down the road in order to stay elected.

Singapore has had 20 years of budget surplus to enable it to head off a crisis of a generation. But past reserves are not bottomless. They need to be replenished in anticipation of future crises. This suggests lesser government support than if we did not need to replenish the coffers.

Early access to retirement benefits

In some countries, there may be an option for early withdrawal of accrued pension benefits to provide financial support to those who have suffered reductions in employment income during the pandemic.

In the US, the CARES Act enacted in March 2020 allowed early withdrawals without additional penalty. Nevertheless, if the early withdrawal is not replenished, the individual will be faced with a hefty tax bill, and lesser accumulated retirement fund in the future.

Malaysia has allowed affected workers to tap the CPF-equivalent for funds. The withdrawal limit has been set at RM10,000 (S$3,310) for those whose source of income has been affected by the Covid-19 pandemic. The worry is that a retirement crisis that may hit in the future – more so when many have a modest amount of funds saved up in the state-run employees provident fund.

We do not have early access in Singapore. But before we start asking the same, here is an extract from the Mercer CFA Institute study on the issue:

"These examples raise the question of the purpose of a funded retirement income system and whether, in extreme circumstances, a limited portion of the assets accrued by an individual should be available before retirement. There is no single answer to this question but the prefunding of pensions provides the opportunity to ease the financial pressures on pension plan members in such circumstances.

"On the other hand, easy access to an accrued benefit is a very attractive option for many individuals, who may have limited understanding of its impact on their future retirement benefit. Therefore, as the International Organisation of Pension Supervisors (IOPS) notes: 'Early access to pension savings should be limited, temporary and proportionate to actual needs.'"

The OECD goes even further: "Access to retirement savings should remain an exceptional measure based on individual specific circumstances and based on regulations already in place for that purpose."

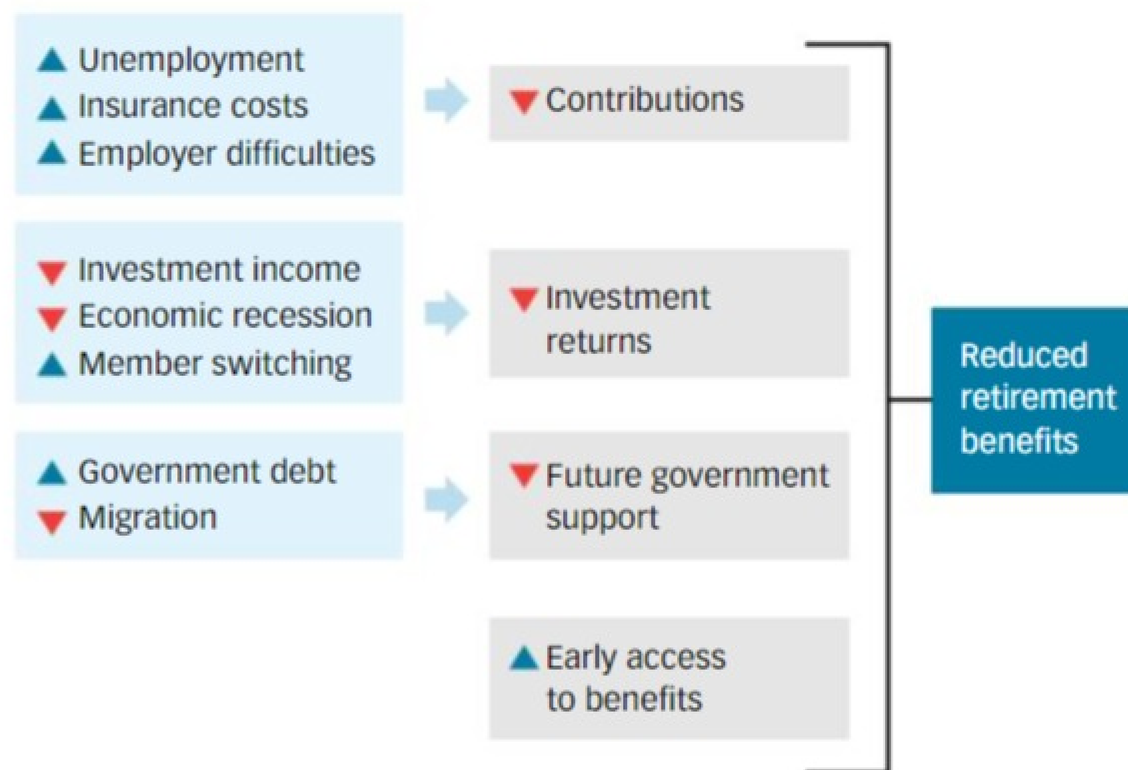
It is interesting to note that the top two retirement income systems in this report, namely the Netherlands and Denmark, have not permitted early withdrawals, even though the assets of each pension system are more than 150 per cent of the countries' GDP.

All is not lost

There is no doubt that Covid-19 has brought chaos upon us. There will be an immediate impact for those adversely affected. We acknowledge that the financial position of many retirees and those near retirement have deteriorated. The same goes for those saving for retirement. But all is not lost. There may be remedial steps that some can take to alleviate the situation. We also want to stress that saving for retirement takes place over an extended period and there is time to recoup losses over the longer term.

Taking a hit

Potential effects of Covid-19 on pension systems



Source: Mercer CFA Institute Global Pension Index 2020

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