

# As populations age, pension reforms become urgent

By David Knox

THE world is ageing at a much faster rate than we previously anticipated even 10 years ago. Following the pandemic, life expectancies are continuing to rise around the world.

We are going to live longer than previously expected. On average, some of the extra years will be spent in good health, but the years in poor health will also rise.

In almost all countries, fertility rates are dropping quickly. Simply put, the world is having fewer babies, with several societal changes driving this outcome.

The table indicates the change in fertility rates in the last 10 years for selected countries, based on data from the United Nations.

Given that a fertility rate of 2.1 is required to replace the population, most countries are now on track towards reduced populations at some point in the future, if one ignores the impact of migration. China's population has already begun to decline.

However, before populations fall, the first consequence will be a rapidly ageing demographic with fewer workers and a higher proportion of people above retirement age.

As the Organisation for Economic Co-operation and Development (OECD) has noted: "The question of how to address the impact of population ageing on pension systems has moved back to centre stage."

It is no longer an option for governments to review their pension

systems; it has become a necessity.

Yet, such reform is never easy because it affects the community's expectations of the future. In particular, it may lead to lower pensions, longer working lives, and/or higher pension contributions or taxes.

My research of pension systems over more than four decades reveals that some reforms have occurred, but that it has often been gradual or haphazard, without a long-term objective.

The 2024 Mercer CFA Institute Global Pension Index (MCGPI) reviewed 48 retirement income systems around the world. It found only four have an A-grade system when assessed on the grounds of adequacy, sustainability and integrity.

They are [the] systems in force in the Netherlands, Iceland, Denmark and Israel.

The MCGPI uses more than 50 indicators with more than half the value of the index using data from international agencies such as the OECD, the UN and the World Bank. The balance of the Index scores relies on inputs from pension experts familiar with the retirement income system in each country.

The better systems within the MCGPI had most of the following features present:

- A state pension for the poor aged, of at least 25 per cent of the average wage for a full-time worker, thereby alleviating poverty among the aged;
- A net pension replacement (including both public and private pensions) of at least 65 per cent for

a median-income earner with a full career;

- Private pension coverage of at least 80 per cent of the working age population, thereby ensuring a balance between public and private pensions for most individuals;

- Pension contributions of at least 12 per cent of wages being invested for the future;

- Current pension assets of at least 100 per cent of GDP;

- A well-governed and well-regulated private pension system

The MCGPI recommended several significant reforms. These will help ensure that future retirees receive an adequate income from systems that can continue to deliver in a manner that encourages community confidence in this changing world.

The recommended reforms include:

- Increased coverage of employees and the self-employed in the private pension system, which should reduce pressure on government budgets in the future.

- A gradual increase in the retirement age and/or state pension age to encourage people to work a little longer, and thereby reduce their retirement period.

- Encouragement or requirement of higher levels of private savings, both within and beyond the pension system, so that workers can spread their consumption across their whole life.

- Reduced leakage from the retirement savings system before retirement, thereby ensuring that the funds are preserved for retirement purposes.



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PHOTO: PIXABAY

## Selected countries' fertility rates

COUNTRY	2014	2024
Australia	1.84	1.64
Canada	1.61	1.34
China	1.59	1.02
India	2.63	1.96
UK	1.89	1.55
USA	2.06	1.63

SOURCE: UNITED NATIONS  
GRAPHIC: DAVID LI, BT

- Introduction of measures to reduce the gender pension gap that exists in many pension systems.

- Improvement in the governance and transparency within private pension plans to raise the confidence level of members.

These reforms will increase the importance of the funded private pension system. The growing ageing population cannot rely heavily

on future governments, given the increasing costs of health, aged care and public pensions. Naturally, increased pension fund assets will also generate new challenges and opportunities for investment managers.

For example, as the world moves away from defined benefit to defined contribution pension plans, investment and other risks will shift from the employer sponsor to the individual members. As the average age of the pension plan members also increases, there will be implications for the investment strategy of pension plans as older members tend to be more conservative.

The education of and communication with pension plan members will need to be done carefully to avoid any negative response from the older population.

One should not assume that the

current investment approaches should continue forever.

The ageing population provides challenges and opportunities for all of us, including governments, policymakers, fund managers, pension plans and financial advisers.

Pension reform is needed in most countries, but the outworking of this will vary between economies.

There is no single solution. Nevertheless, there are important lessons we can learn from one another to ensure that our future aged populations can have both dignity and confidence during their retirement years.

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