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Modalidades para el Retiro: Opciones de Política

Heinz P. Rudolph

Modalidades Previsionales: Resultados Recientes y Desafíos

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hrudolph@worldbank.org



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Policy Questions for the Payout Phase

On the demand side

- Should the authorities impose restrictions on payout options?
- Should they mandate a single type of retirement product or allow constrained choice from a specified menu of retirement products?
- Should they mandate the use of joint life annuities with guaranteed periods of payment?

Policy Questions for the Payout Phase

On the supply side:

- Should the authorities adopt centralized provision or should they opt for a decentralized competitive market?
- What types of regulations should be applied to the pricing policies of providers of retirement products?
- What types of regulations should be applied to the marketing activities of providers of retirement products?
- What regulations should be applied to ensure the solvency of providers?
- Should the authorities offer guarantees covering minimum returns during the accumulation phase and protecting retirees against provider insolvency?

Self annuitization

- The absence of any restrictions on payout options results in a very limited use of life annuities
- It exposes retirees to longevity, investment and inflation risks. It requires considerable investment savvy by average pensioners, an ability to estimate accurately their life expectancy and retirement needs
- Self-annuitization is especially difficult to manage in advanced old age when pensioners face an increased risk either of outliving their savings or of suffering a significant decline in their standard of living.
- It can be used combined with other retirement products (Switzerland)

Payout restrictions and the presence of public pillars

- Adopting a very liberal approach with no restrictions on lump sum withdrawals and total reliance on self-annuitization is not consistent with a mandatory pension pillar.
- The presence or absence of public pensions is a crucial factor in determining the regulation of payout options.
 - Countries without first pillars may require restrictions
 - Countries with generous public pillars cautions against imposing overly severe restrictions that might result in excessive annuitization.

Menu of Retirement Options

Fixed Annuities

| | Advantages | Disadvantages |
|-----------------------------------|---|---|
| A. Fixed Annuities | <p>They provide protection against longevity and investment risks.</p> <p>They provide certainty of monthly payments.</p> | <p>They prevent participation in the higher, though more volatile, returns of equities and other real assets.</p> <p>They are exposed to annuitization risk.</p> <p>They suffer from wide dispersion in annuity prices.</p> <p>They are exposed to potentially misleading broker influence and marketing campaigns.</p> <p>They require a robust and effective system of prudential regulation and supervision to ensure provider solvency.</p> |
| B. Fixed Real Annuities | <p>As in Panel 1A.</p> <p>They provide protection against inflation risk.</p> <p>They appeal to retiring workers who have a long life expectancy and a low level of risk tolerance.</p> | <p>As in Panel 1A.</p> <p>constant value of the payments in real time.</p> <p>The cost of inflation protection may be high if inflation protection is unavailable.</p> <p>They require access to inflation-linked long-duration debt instruments issued by both the public and private sectors for risk-hedging purposes.</p> |
| C. Fixed Nominal Annuities | <p>As in Panel 1A.</p> <p>They start with relatively high initial payments.</p> <p>They appeal to retiring workers who have a short life expectancy or underestimate their longevity.</p> | <p>As in Panel 1A.</p> <p>They are exposed to inflation risk.</p> |

Menu of Retirement Options

Vaiable Annuities

| | Advantages | Disadvantages |
|--|---|---|
| 2A. Variable Annuities | <p>Protection against diversifiable longevity risk, while sharing non-diversifiable longevity risk among annuitants.</p> <p>Participation in higher returns on equities and real assets.</p> <p>They avoid annuitization risk.</p> <p>They avoid the wide dispersion of prices of fixed nominal and real annuities.</p> <p>They appeal to retiring workers who have a long life expectancy and a high level of risk tolerance.</p> <p>Because providers do not assume longevity, investment and inflation risks, they require lower capital requirements for provider solvency.</p> | <p>They are exposed to investment and inflation risks. They may start with relatively low initial payments. Annuity payments may fluctuate widely from year to year.</p> <p>They are exposed to potentially deceptive or even perverse marketing policies, affecting their risk-sharing arrangements.</p> <p>They require a robust and effective system of regulation and supervision, especially of marketing and profit-sharing policies.</p> |
| 2B. ‘Guarantee and Bonus’ Annuities | <p>As in Panel 2A.</p> <p>They are supported by the offer of minimum guaranteed benefits.</p> <p>Annual bonuses provide protection against inflation.</p> <p>Stable-value asset allocations mitigate exposure to investment risk.</p> | <p>As in Panel 2A.</p> <p>Annuity payments depend on future investment performance and the declaration of bonuses.</p> <p>They depend on the profit-sharing policies of annuity providers.</p> <p>They require a high level of transparency and integrity by annuity providers.</p> |
| 2C. ‘Unit-linked’ Annuities | <p>As in Panel 2A.</p> <p>They are more transparent than ‘guarantee and bonus’ variable annuities.</p> <p>They do not depend on the profit-sharing policies of annuity providers.</p> <p>They may benefit from minimum guaranteed rates of return.</p> | <p>As in Panel 2A.</p> <p>They may be exposed to greater volatility of investment returns and annuity payments.</p> <p>The pricing of the minimum rate-of-return guarantees faces difficult challenges.</p> |

Using joint life annuities with guaranteed periods of payment

- Joint life annuities protect nonworking spouses after the death of the primary beneficiary.
- A useful contribution of joint life annuities is that they mitigate the distorting effects of adopting unisex mortality tables
- Annuities with guaranteed periods of payment provide protection to the dependents and heirs of primary beneficiaries if death occurs during the guaranteed period.

The choice between centralized and decentralized provision

- Centralized provision of life annuities (public or private) has several potential advantages.
 - It allows for a larger base of risk pooling, especially if annuitization is compulsory.
 - It also benefits from scale economies and avoids the heavy marketing costs that are incurred by decentralized providers
- But also disadvantages
 - Potentially weaker incentives for product innovation and operational efficiency that may result from compulsory participation and monopoly power.
 - Risk of interference in annuity pricing and asset management, which may result in transferring the investment and longevity risks back to the state. Robust governance safeguards with high levels of transparency and public accountability would be necessary.

The choice between centralized and decentralized provision (2)

- Decentralized competitive market structures promote competition, innovation and efficiency.
 - These features are particularly important when innovation is risky and socially controversial and small-scale experimentation plays a significant part in testing the feasibility of specific market solutions
- Because of scale economies and high marketing costs, decentralized markets veer over time toward market consolidation and oligopolistic structures.
 - The prevalence of a small number of providers weakens competition as well as the incentives for innovation and efficiency.
 - Decentralized market structures suffer from high administrative and marketing expenses and require a strong regulatory framework to discourage deceptive practices and market abuses

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The choice between centralized and decentralized provision (3)

- The case for a decentralized competitive is significantly weakened when strict restrictions are applied to annuity products and their pricing.
- It is also weakened if annuity providers use common life tables, in which case competition is effectively limited to asset management and marketing campaigns.
- Another possibility is to have decentralized account administration and decentralized asset management with centralized management of the longevity risk.
 - This will address the problems posed by the non-diversifiable component of longevity risk.

Regulation of pricing policies

- The regulatory issues of pricing policies vary between fixed and variable annuities.
 - Fixed nominal or real annuities as well as escalating annuities entail pricing decisions that are made once at the time of purchase.
- A high level of transparency to ensure fairness is required at the time of purchase.
 - Fixed annuities, once the purchase is concluded, the main concern is the long-term solvency of the annuity provider.
 - Variable annuities, pricing decisions are made continuously over the life of the contract. They require a high level of transparency and integrity over the life of the contract to ensure fair treatment of all groups of annuitants.

Regulation of pricing policies (2)

- In the case of fixed annuities, electronic quotation system is likely to reduce the dispersion of annuity prices, especially for contracted prices. This has been introduced with encouraging success in Chile
- The regulation of pricing policies for variable annuities in a competitive decentralized market is a much more complex
 - Temptation to offer annuitants high initial payments in order to attract their business and rely on relatively low, and even negative, bonuses in subsequent years to offset the elevated initial payments
 - To ensure that competition in the variable annuity market is restricted to the level and stability of prospective bonuses, the regulation may specify the calculation of initial payments.

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Competitive concerns

- Prospective investment performance of annuity providers
- The level of operating costs
- Policy of profit distribution

Regulation of Marketing Policies

- **Centralized Providers**
 - The centralized institution needs to respond to enquiries from retiring workers by providing appropriate quotations taking into account the choice of product and age of applicants
 - The main challenge is the creation of a sophisticated delivery system where trained professionals have access to detailed data and are able to respond in a prompt and efficient manner to enquiries from retiring workers
- **Decentralized competitive markets**
 - Need to deter annuity providers from engaging in deceptive practices
 - The adverse effects of these campaigns are magnified by the involvement of brokers and agents

Marketing Issues

- Marketing issues in fixed annuities
 - Brokers tend to have strong incentives to influence the decision of retiring workers to annuitize
 - Adopting an electronic quotation system, such as the one introduced in Chile in 2004, merits serious consideration
- Marketing Issues in variable annuities
 - There is a risk that competition in the market for variable annuities, where longevity risk is shared among annuitants, may on occasion take a perverse form. For example, example female teachers versus Miners

Government Guarantees

- Bankruptcy risk is present in all types of financial products, but is particularly important in the case of life annuities, which are long-term contracts that are neither revocable nor portable.
- In addition to adopting a robust and effective system of prudential regulation and supervision, the authorities should also establish guarantee schemes covering most, if not all, types of annuities and phased withdrawals.
 - The guarantees need to cover 100 percent of payments up to a specified basic threshold and then a very high percentage, perhaps 75 or even 90 percent, of amounts above the threshold up to a reasonable upper limit.
 - In the case of variable annuities and phased withdrawals the guarantees should cover the guaranteed benefits and losses arising from insolvency resulting from fraud and gross negligence but they should not cover investment losses that arise in the normal course of business.

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Gracias!

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