The AMBACHTSHEER Letter
Sustainable Pension Design • Effective Pension Management

November 2020

BENCHMARKING THE QUALITY OF THE GLOBE'S RETIREMENT INCOME SYSTEMS: WHAT ARE WE LEARNING?

"What gets measured gets managed."

Often attributed to Peter Drucker

"It is critical that we learn from each other and understand what 'best practice' may look like, both now and into the future. This 12th Edition of the Global Pension Index compares 39 retirement income systems which encompass a diversity of pension policies and practices."

Dr. David Knox, Senior Partner, Mercer

Benchmarking the Globe's Retirement Income Systems

The controversy as to whether Peter Drucker ever said "what gets measured gets managed" continues. If he did, he probably added "for good or evil". There are lots of 'real world' examples confirming that if we get the benchmark wrong, then we will be managing towards (and paying for) the wrong outcomes.[i] Indeed, any single metric is unlikely to be able to tell the full success/failure story in complex systems such as retirement income generation. Effective benchmarking in such systems will require thoughtful multiple metrics. This is not a new idea. Kaplan and Norton introduced the "balanced score card' concept in their 1992 HBR article "The Balanced Scorecard – Measures that Drive Performance".

Keeping the balanced scorecard idea in mind, how might we benchmark the quality of a country's retirement income system (RIS)? Twelve years ago, the creators of the *Mercer CFA Institute Global Pension Index* (*MCGPI*) decided three dimensions were important: **Adequacy** (does the system provide an adequate level of post-work income?), **Sustainability** (will it be able to continue to do so in the decades ahead?), and **Integrity** (does it operate in the best interest of system participants?). To their credit, the creators also understood that complex systems must be adaptive to changing circumstances to be sustainable. So over the course of the last 12 years, the *MCGPI* has been tweaked continuously to reflect those changing circumstances.

On a personal note, I attended the initial launch of the *MCGPI* in Melbourne in 2009.[ii] The technical force behind its design and production was (and continues to be) the global Mercer organization, ably led by *MCGPI* project initiator David Knox. Monash University has provided academic support since inception, including the creation of an Advisory Board, of which I am a member. Until recently, Australia's state of Victoria provided financial support for the project. This aspect has been taken over by the global *CFA Institute*, the world's largest organization of financial professionals. *CFA Institute* has astutely recognized that the *MCGPI* project fits well into its vision of building global wealth and well-being.

CFA Institute CEO Margaret Franklin recently noted: "*Pension funds are a primary source of retirement income and are enormously influential in financial markets. We believe it is important to join forces with those in business and government who are working to improve pension systems globally and to enhance investors' knowledge of pension issues.*"[iii]

Looking under the *MCGPI* Hood

Saying that a country's RIS quality index should be based on its Adequacy, Sustainability, and Integrity scores is one thing, actually creating those scores for 39 countries is another. An important framing component is the *World Bank*'s 3-Pillar RIS decomposition into a universal government sector (Pillar 1), a workplace-related sector (Pillar 2), and an individual retail sector (Pillar 3). With that 3-Pillar framing in mind, the *MCGPI* builders identified six Adequacy drivers, six Sustainability drivers, and five Integrity drivers. They are set out in Table 1.

Table 1 17 Drivers of the Quality of a Country's RIS

Adequacy	Sustainability	Integrity
System Design	Demographics	Regulation
Benefits	Public Expenditure	Governance
Savings/Debt	Government Debt	Protection
Home Ownership	Economic Growth	Communication
Growth Assets	Total Pension Assets	Operating Costs
Government Support	Pension Coverage	

Source: *Mercer CFA Institute Global Pension Index 2020*

The index-creation process uses over 50 indicators related to these 17 RIS quality drivers to create Adequacy, Sustainability, and Integrity scores for each country on a 0-100 scale. For the 39 countries covering 64% of the world's population, the range of Adequacy scores in 2020 was 82-37, the range of Sustainability scores was 83-22, and the range of Integrity scores 94-35. The final step is to create an overall system score. Based on their judgement of the relative importance of the three RIS dimensions to be 40%, 35%, and 25% respectively, the Total score range was 83-41.

The *MCGPI* in Numbers

The stated goal of the *MCGPI* project is to understand 'best practice' in RIS design and management, and to use that understanding to improve RIS performance around the world. Let's put that goal to the test using the eight countries that have *KPA Advisory Service* subscribers: Australia, Canada, Finland, Japan, Netherlands, Singapore, the UK, and the USA. Table 2 sets out their Total, Adequacy, Sustainability, and Integrity scores. The countries are ranked in order of their total quality score.

What messages can we extract from Table 2? Consider the following:

- The considerable variance in the scores suggests considerable variance in the RIS quality in the eight countries.
- Maybe not surprisingly, there are positive correlations in Table 2 in the sense that the country index scores of the three RIS dimensions are relatively high or low together. At the extremes, for example, the scores of all three dimensions are high in the Netherlands and low in Japan. The outlier is the UK, with its Integrity score much higher than its Adequacy and Sustainability scores. Why is that?
- Calculating the average scores for the three dimensions, Integrity achieves an average score of 79, considerably higher than the average 62 score for Sustainability. While these average scores are not directly comparable, it does suggest that RIS sustainability may be a bigger challenge across the world than RIS Integrity.

Table 2 RIS Quality Scores for Eight Selected Countries

	Total	Adequacy	Sustainability	Integrity
Netherlands	83	82	79	89
Australia	74	67	75	86
Finland	73	71	61	94
Singapore	71	74	60	83
Canada	69	68	64	78
UK	65	59	58	84
USA	60	59	62	60
Japan	49	53	36	59

Source: *Mercer CFA Institute Global Pension Index 2020*

The *MCGPI 2020 Report* provides its own qualitative interpretations of its quantitative country findings. We turn to these next.

The Stories behind the Numbers

Here are summaries of the eight country commentaries:

- Netherlands: good benefits, high coverage, well-funded, but also undergoing major reforms. Index score could be further raised by raising household savings rates/lowering debt levels, and raising labour force participation rates for older workers.[iv]
- Australia: its high-ranking RIS could be further improved by raising household savings rates/ lowering debt levels, raising labour force participation rates for older workers, easing Pillar 1 means testing, introducing a mechanism to raise retirement age, and introducing a requirement to take part of accumulated retirement savings as a lifetime income stream.
- Finland: its high-ranking RIS could be further improved by raising household savings rates/ lowering debt levels, raising labour force participation rates for older workers, raising the mandatory pension plan contribution rates, and fair pension allocation rules in marriage breakdown.
- Singapore: all working residents are covered through the *Central Provident Fund* (*CPF*), which provides not only pensions, but also medical coverage and housing expenses. The system could be further improved by opening the *CPF* to non-residents (which compose a significant proportion of the workforce), raising the age at which some *CPF* retirement savings can be accessed, and reducing barriers to employers establishing their own pension plans.
- Canada: its RIS has a mix of Pillar 1, 2, and 3 components. The system could be improved by raising household savings rates/lowering debt levels, raising labour force participation rates for older workers, reducing public debt as a percentage of GDP, and dealing with the lack of cost-effective Pillar 2 pension coverage for private sector workers.
- United Kingdom: its RIS has a mix of Pillar 1, 2, and 3 components. The system could be improved by raising household savings rates/lowering debt levels, raising the minimum Pillar 1 pension, raising contribution rates in Pillar 2 plans, further increasing worker coverage in Pillar 2 plans, and restoring requirement to take part of accumulated retirement savings as a lifetime income stream.
- United States: its RIS has a mix of Pillar 1, 2, and 3 components. The system could be improved by raising low-income benefits and funding in its Pillar 1 social security system, raising benefits and funding in Pillar 2 occupational plans, dealing with the lack of Pillar 2 coverage for private sector workers, limiting access to retirement savings before retirement, and introducing requirement to take part of accumulated retirement savings as a lifetime income stream.

- Japan: its RIS has a Pillar 1 with two components: flat rate and earnings-related. It also has a voluntary Pillar 2 sector. System improvements include continuing to increase the state pension age, reducing government debt as a percent of GDP, and increasing Pillar 2 pension coverage, benefits, and contribution rates.

So what should we take away from all this? The *Letter* concludes with some thoughts on this question.

What Are the Take-Aways?

A striking finding in the *MCGPI* results is that despite the material RIS design and quality score differences in the eight countries, the underlying global reality of aging populations leads to broadly similar improvement recommendations. On the macro public policy level, that means exercising fiscal discipline in state finances and raising official retirement ages. On the more micro RIS policy level, that means extending Pillar 2 pension coverage where it is currently too low, raising retirement savings rates, and requiring at least part of accumulated retirement savings be converted into lifetime income streams.

Among these take-aways, the almost universal 'raise retirement savings rates' recommendation generated by the *MCGPI* results deserves further reflection. Raising retirement savings rates now will not automatically generate more retirement income in the future. That outcome also requires those additional retirement savings are productively invested to meet the growing demand for the goods and services future retirees will want as consumers. As we have noted in past *Letter*s, that desired outcome requires increasingly active participation by pension organizations in ensuring that retirement savings are indeed converted into sustainable high-productivity capital. That in turn means rethinking investment policy and regulation.[v]

These realities make the decision of the *CFA Institute* to support the *MCGPI* project a timely one. Through its support, the *Institute* will help foster greater understanding of the critical role its members play in moving the global savings-to-investment conversion process in the right direction.

Keith Ambachtsheer

Endnotes:

i. *For example, in his new book "When More Is Not Better", Roger Martin tells the story of Wells Fargo where management wanted to foster deep, 'sticky' relationships with its customers. As their benchmark for achieving this goal, they chose number of accounts per customer. Branch employees responded by opening millions of ghost banking, credit card, mortgage, and auto loan accounts. Customers never knew these accounts existed.*

ii. *It so happened that the International Centre for Pension Management (ICPM) had chosen Melbourne as the location for its 2009 Discussion Forum. That created a great opportunity for ICPM and MCGPI to collaborate. I was ICPM's Executive Director at that time.*

iii. *From the **MCGPI Report 2020**, page 2.*

iv. *See the **August 2020 Letter** for more on these pension reform developments in the Netherlands.*

v. *See the **September 2020 Letter** for more on these investment policy and regulation implications.*

Published by KPA Advisory Services Ltd., 1 Bedford Road, Suite 2802, Toronto ON Canada M5R 2B5
416.925.7525. www.kpa-advisory.com