Expanding Coverage with Long Run Sustainability

PFRDA Second Pension Conclave
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Good pension policy looks for broad and diversified sources of retirement income for a country.

Public Pensions

Private Pensions

Old age income security and retirement income
Different sources are needed to expand coverage and ensure sustainability – since no one ‘pillar’ can achieve everything.
Policy design needs to be routed in the nature of the labor and capital market – now and developing them for the future.
There is a chance for greater savings to help fund better infrastructure – but it does not happen organically – proactive, efficient and well-targeted policy and regulation are vital.

Old age income security and retirement income

Long Run Growth

Public Pensions
Private Pensions
Family
Insurance
Work
Housing

Capital Market
Labor Market

World Bank Group
India is often highlighted as a young country

But the share of the elderly is set to double by 2050 – creating only a short demographic ‘window’

Current contributions into pensions are very low – creating a significant challenge despite being a ‘young’ nation.

Source: International Patterns of Pension Provision II
Health costs that rise strongly with age add another dynamic to be proactive on tackling pension costs.

Public Health care expenditure by age groups in OECD countries
And the consequences of not balancing sustainability whilst expanding coverage can be painful.

Cumulative Percentage Reduction in Current-Law PAYGO Pension Benefits to the Elderly (Aged 60 & Over) Relative to “Current-Deal” Benefits,* from 2010 to 2040

- Netherlands: 5%
- Sweden: -19%
- US: -22%
- Australia: -24%
- UK: -26%
- France: -33%
- Canada: -33%
- Germany: -37%
- Japan: -39%
- Italy: -46%

Source: Jackson (2013)
The value chain from collection to payout is delivered in many ways across countries – with big differences in outcomes.

<table>
<thead>
<tr>
<th>Pension Membership Channels</th>
<th>Record Keeping &amp; Account Management</th>
<th>Investment Governance and Trustee</th>
<th>Investment Management</th>
<th>Payout Phase</th>
</tr>
</thead>
</table>

![Diagram showing the value chain from collection to payout]
The NPS model embodies some strong structural solutions.
India already has many pension channels that can be leveraged more effectively and coherently – building on new PFRDA Act

<table>
<thead>
<tr>
<th>Program</th>
<th>Type</th>
<th>Workers</th>
<th>Intermediaries</th>
</tr>
</thead>
<tbody>
<tr>
<td>NPS</td>
<td>DC</td>
<td>Organized</td>
<td>NPS system</td>
</tr>
<tr>
<td>NPS Lite</td>
<td>DC</td>
<td>Unorganized low-income</td>
<td>NPS system</td>
</tr>
<tr>
<td>APY</td>
<td>DB</td>
<td>Unorganized low-income</td>
<td>NPS system</td>
</tr>
<tr>
<td>EPFO</td>
<td>DC</td>
<td>Organized</td>
<td>EPFO system</td>
</tr>
<tr>
<td>Other Provident Funds</td>
<td>DC</td>
<td>Organized</td>
<td>Trusts; insurers, banks, investment managers, self-administered</td>
</tr>
<tr>
<td>Superannuation</td>
<td>DB,</td>
<td>Organized</td>
<td>Trusts; insurers, banks, investment managers, self-administered</td>
</tr>
<tr>
<td></td>
<td>DC</td>
<td></td>
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</tr>
<tr>
<td>Gratuities</td>
<td>DB</td>
<td>Organized</td>
<td>Trusts; insurers, banks, investment managers, self-administered, or unfunded</td>
</tr>
<tr>
<td>Individual</td>
<td>DC</td>
<td>Organized and unorganized</td>
<td>Insurers, banks, or investment managers</td>
</tr>
</tbody>
</table>
Coverage expansion needs to act at a number of levels

1. Product – including accumulation and payout
2. Processes
3. Distribution
4. Generic promotions/ publicity and Retirement Literacy
5. Organic coverage growth of NPS/ APY
6. Growth Opportunities from transfers and expansion

A segmented approach will be vital given the diversity in the labor market – ranging from work with formal sector employers, formal workers employing staff informally, and the unorganized sector – itself segmented following analysis
Many countries have generated large pension assets – but without generating the diversification and long run orientation they had hoped.

- Pensions / social security fund often largest pool of domestic capital – but lacking investment instruments.
- Investment Diversification – has disappointed with too much in government bonds in many countries / and investment has suffered.

Public Pension Assets % GDP

Source: Musalem and Souto (2010)
In theory pension assets provide a source for long term finance – including for infrastructure

<table>
<thead>
<tr>
<th>Institutional Investors</th>
<th>AUM USD $</th>
<th>Current Investment in EMDE Infrastructure</th>
<th>Potential Investment in EMDE Infrastructure</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>OECD Institutional Investors</td>
<td>79 trillion +</td>
<td>&lt;1% = total leading investors c10% most in domestic markets</td>
<td>1% assets = $750 billion</td>
<td>WEF (2011) breakdown of institutional investors AUM to truly long-term capital = $6.5 trillion Around 1% of this implies c$50 billion target</td>
</tr>
<tr>
<td>Emerging Market Institutional Investors</td>
<td>4.5 trillion</td>
<td>Even more limited than leading OECD investors Chilean pension funds 1.5%</td>
<td>1% assets = c$50 billion</td>
<td>This target could be much higher as many EM institutions can only invest in domestic markets</td>
</tr>
<tr>
<td>Sovereign Wealth Funds</td>
<td>4 trillion</td>
<td>0-5%¹³</td>
<td>c5% assets = c%250 billion</td>
<td>Many of new EM SWF being set up to specifically invest in domestic infrastructure</td>
</tr>
<tr>
<td>EM pension reserve and social security funds</td>
<td>1 trillion</td>
<td>Limited – ad hoc examples (up to 10%)</td>
<td>10% assets = c$100 billion</td>
<td>High target as these funds are often the largest single source of capital in a developing country</td>
</tr>
</tbody>
</table>

Source: Inderst and Stewart 2014
‘Infrastructure’ is a broad term and specific segments need to be well targeted and understood.

- **Economic Infrastructure** — e.g. transport, utilities, communication, renewable energy
- **Social Infrastructure** — e.g. schools, hospitals, defense buildings, prisons, stadiums

**Greenfield Investments**
- Construction
- Design, build, operating risk
- Typically higher risk

**Brownfield Investments**
- Typically medium risk — e.g. operating toll road with need for significant capital investment for improvement/expansion

**Secondary Stage Investments**
- Post construction
- Low risk, low return
- Similar to long term bond with coupon
- Well established cash flows — e.g. operating toll roads
There are a set of core questions to answer to establish successful institutional infrastructure investment:

- Are there institutional investors with investment funds? (Pension / social security funds, insurers, SWFs)
  - Yes (type, size)
  - No: Create or reform funded pension / social security system

- Are there substantial investment limits / constraints?
  - No
  - Yes: Review
  - Quantitative limits
  - Asset classes / investment vehicles
  - Liquidity
  - Investor regulation
  - Funding & solvency
  - Foreign investments

- Are there infrastructure assets to invest in?
  - Yes: private / privatized
  - Yes: public - private / PPP
  - No: Develop / review infrastructure policy

- Are there working capital markets? (equities / bonds / derivatives)
  - Yes
  - No: Develop / reform capital markets

- Is the bank intermediation working?
  - Yes
  - No: reform banks
  - No: development banks
  - No: multilateral development agencies

- Is there a favourable macro-environment (political, law, institutions)
  - Yes
  - No: reform / improve
  - Political stability
  - Rule of law
  - Regulatory certainty
  - Institutions
Improved coverage needs to be built on a strong supervisory foundation focused on improving long run outcomes

**Perimeter**
- Programs subject to PFRDA supervision
- Fill gaps where pension products are unregulated
- Avoid overlaps: work with other agencies and liaise through FDFC

**Outcomes**
- Identify desired outcomes re efficiency, sustainability, coverage, adequacy, security
- For programs within the perimeter – clarity on development role

**Risks**
- Identify risks to the achievement of outcomes be proactive
- At various levels: program, plan, intermediary
- Risk Based approach uses most sensible solution – can include detailed rules and is tailored to specifics of each country
A rigorous process of data collection, risk assessment and risk mitigation is central to improving outcomes

**Perimeter**
- Identify programs and gather data
- Consult with government, regulators, other stakeholders
- Take steps needed to close the gaps

**Outcomes**
- Outcomes-based assessment re international standards & best practice
- Focus on outcomes subject to control or influence by PFRDA
- Establish metrics and goals

**Risks**
- Develop risk map for the private pension system
- Identify potential adverse events that could affect outcomes
- Estimate the likelihood and impact of such events

**Strategy**
- Develop a regulatory strategy for dealing with the most significant risks
- Strategy include regulation, supervision, communication, other activities
- Establish a process for monitoring progress and updating the strategy